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Los Angeles County Metropolitan Transportation Authority:

*It Could Use Certain Recommended
Management Tools to Improve Its
Oversight of Legal Contracts, and Its
Efforts Resulted in the Award of a Large
Construction Contract Within Budget*



July 2004
2003-119

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CALIFORNIA STATE AUDITOR

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July 14, 2004

2003-119

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 Los Angeles County Metropolitan Transportation Authority's (MTA) legal and procurement practices. This report concludes that while its legal costs declined in fiscal year 2002–03, the MTA could improve the oversight of these costs by requiring the county of Los Angeles, Office of the County Counsel (County Counsel), to fully implement recommended management tools in its agreements with outside counsel. County Counsel acts as the MTA's general counsel, representing the MTA in transactional matters and monitoring outside counsel. Specifically, the MTA could benefit from the use of case plans and budgets, which provide a blueprint for the conduct of cases and allow an evaluation of the reasonableness of billed legal costs by providing cost estimates with which they may be compared.

The MTA and County Counsel appeared to thoroughly review the expense portion of legal invoices and to enforce most billing rates. Errors related to billing rates or to a lack of required documentary support amounted to only 1 percent of the legal costs we tested. Nevertheless, the MTA and County Counsel often could not show that outside counsel received prior approval for the cost and use of consultants and expert witnesses. In addition, a task-based billing format for invoices—which uses standardized billing codes for legal tasks—would aid in the analysis of legal fees by allowing for a quick determination of how much outside counsel spent on particular legal tasks.

Finally, through a process that spanned 18 months, the MTA procured a construction contract within budget for its Metro Gold Line Eastside Extension Project. After receiving bids for its initial invitation for bid that were significantly above estimate, the MTA revised the scope and other requirements of the project. After a second invitation for bid, the MTA made further changes to the project's scope of work and reduced other costs, allowing it to award a \$600.4 million contract.

Respectfully submitted,

ELAINE M. HOWLE
State Auditor

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SUMMARY

Audit Highlights . . .

Our review of the Los Angeles County Metropolitan Transportation Authority's (MTA) oversight of outside counsel found that:

- Its contracts generally include recommended management tools, such as case plans and budgets; however, case files often did not contain evidence of them.*
- Errors related to lack of required documentary support or to billing rates amounted to only 1 percent of tested costs.*
- A task-based billing format would, however, aid in the review of invoices by allowing for a quick determination of how much outside counsel spent on particular efforts.*
- Finally, there was often a lack of written prior approvals for the use and cost of consultants and expert witnesses.*

The MTA took actions to award a construction contract for its Metro Gold Line Eastside Extension Project within budget by revising the project scope and reducing other project costs.

RESULTS IN BRIEF

The Los Angeles County Metropolitan Transportation Authority (MTA) serves as the planner, coordinator, and operator of the public transportation system for Los Angeles County. This report focuses on its oversight of legal costs and its procurement of a contract for a major construction project.

The MTA could improve the oversight of its legal costs by requiring the county of Los Angeles, Office of the County Counsel (County Counsel), to fully implement recommended management tools included in its contracts with outside counsel. County Counsel represents the MTA in transactional matters such as drafting and reviewing contracts, and provides advice on all legal issues and developments in outstanding legal cases. It also monitors outside counsel—contract lawyers who represent the MTA in a variety of litigation and transactional matters.

Three units account for the vast majority of the MTA's legal costs: County Counsel, Public Liability/Property Damage, and Workers' Compensation. County Counsel legal costs represented 65 percent of all MTA legal costs between July 1995 and December 2003. These costs include those for legal matters other than public liability/property damage and workers' compensation (other legal matters), such as construction litigation. After increasing from \$9.9 million in fiscal year 1995–96 to a high of \$31 million in fiscal year 2001–02, County Counsel legal costs declined to \$14.6 million in fiscal year 2002–03 as several major cases related to subway construction either closed or completed their trial phases. Seven major cases accounted for the majority of County Counsel's recent legal costs. The MTA expects legal costs to continue at a lower level in the near term and has budgeted \$12 million for County Counsel legal costs in fiscal year 2004–05.

The MTA could benefit from the use of case plans and budgets, which provide a blueprint for the conduct of cases and allow an evaluation of the reasonableness of billed legal costs by providing cost estimates with which they may be compared. However, most case files related to other legal matters that we tested held no evidence of case plans or budgets covering each

phase of the case, and most public liability/property damage cases we tested contained no budget revisions as is required for cases that exceed their budget. Further, outside counsel for workers' compensation cases are not required to submit budgets. County Counsel believes that case plans and budgets are not effective tools for managing complex and unpredictable cases. However, plans and budgets should be evolving documents subject to change and are useful for both simple and complex cases.

Although legal costs are detailed for legal services and related to the appropriate cases, a task-based billing format for invoices—which uses standardized billing codes for legal tasks—would aid in the analysis of legal fees. This would allow for a quick determination of how much outside counsel spent on particular tasks such as briefs or depositions. A task-based format can provide for a more meaningful review of legal fees and can also lead to better-informed discussions with outside counsel, potentially allowing improved quality of services. Although we saw no evidence of such a task analysis, both the MTA and County Counsel appeared to thoroughly review the expense portion of invoices and to enforce most billing rates. Errors related to billing rates or to a lack of documentary support amounted to only 1 percent of the legal fees and expenses we tested. The MTA and County Counsel, however, often could not show that outside counsel received prior approval for the cost and use of consultants and expert witnesses, as required in contracts with outside counsel.

Through a process that spanned 18 months, the MTA procured a construction contract within budget for its Metro Gold Line Eastside Extension Project (project), a six-mile light-rail line. The MTA received two bids in response to its initial invitation for bid, and the low bid, under the type of insurance program that the MTA ultimately used, was \$54.9 million above the estimate. A large portion of the difference was attributable to the general requirements and mobilization components of the project. The project's size appears to be one reason why the MTA did not receive more bids. Certain contractors that were interested in the project and had the capability to bid on it did not do so, citing difficulties in forming joint ventures with other firms to handle the size of the project. Some contractors also had the perception that they would have difficulty working for the MTA.

After the MTA rejected the initial bids, it significantly revised and revamped the scope and other requirements of the project. It provided an opportunity for bidders to compete for three

separate contracts, adopted a simpler procurement process, and revised other technical aspects of the project. This time it received five bids, but the low bid was still higher than expected—15 percent above the estimate. Based on discussions with the low bidder, the MTA further modified elements of the project's scope of work, and reassessed and reduced other costs. Based on the modified scope, the low bidder made a final offer of \$610 million,¹ \$59.8 million lower than its previous offer. The federal government recently approved a grant agreement with the MTA for \$490.7 million that will help pay for the project, and the MTA sent a notice of contract award to the low bidder. As of early June 2004, the MTA expected to authorize the contractor to begin work by the end of the month.

RECOMMENDATIONS

To more effectively monitor outside counsel, the MTA, in conjunction with County Counsel, should take the following actions:

- Require outside counsel to prepare flexible case plans and budgets detailed by phase, as well as budget revisions where outside counsel expect costs to exceed budgets.
- Consider requiring outside law firms to submit invoices using a task-based billing format if they have the ability to do so.

The MTA, in conjunction with County Counsel, should ensure outside counsel adhere to all billing requirements detailed in contract provisions and billing guidelines, including requiring that outside counsel receive written prior approval to use consultants and expert witnesses within an established budget.

AGENCY COMMENTS

The MTA believes that its internal control practices sufficiently safeguard taxpayer resources. It does not indicate whether it will implement any of the report's recommendations. In addition, the MTA contends that the report does not conform to generally accepted government auditing standards. We disagree. Our comments follow the MTA's response. ■

¹ The \$610 million offer included \$9.6 million for overhead compensation should delays occur and for construction options that may be exercised at a later date. The remaining \$600.4 million is the amount of the contract award.

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INTRODUCTION

BACKGROUND

The Los Angeles County Metropolitan Transportation Authority (MTA) was established in 1993 by state law as the result of the merger of the Los Angeles County Transportation Commission and the Southern California Rapid Transit District. The MTA serves as the planner, coordinator, and operator of the public transportation system for Los Angeles County. It uses a variety of means—bus, light rail, and heavy rail—to meet the transit needs of county residents. The MTA's primary activities in providing transit services include the following:

- Operation of the second-largest bus system in the United States, comprising a fleet of more than 2,300 buses that provide more than 88 million vehicle service miles annually to an average of 1.1 million passengers per day.
- Operation of three light-rail lines and one heavy-rail line carrying more than 200,000 passengers per day.
- Development and construction of Metro Rapid² bus lines and fixed lanes for the exclusive use of buses and multipassenger vehicles.
- Rail construction.
- Promotion of the use of public transit services and ride-share programs.

The MTA board consists of the following:

- Five members of the Los Angeles County board of supervisors.
- The mayor of the city of Los Angeles and three appointees (two public members and one member of the Los Angeles city council).
- Four members appointed by the Los Angeles County City Selection Committee.
- One nonvoting member appointed by the governor.

- Administration of funds for all Los Angeles County transit providers.

The MTA is governed by a board of directors (MTA board), whose 14 members are appointed by various groups as noted in the text box. The MTA board establishes policies and authorizes appropriations. The MTA's chief executive officer reports directly to the MTA board and manages operations. Among other tasks, the chief executive officer directs and oversees system operations, regional transportation planning, and programming functions.

² Metro Rapid is the MTA's express bus service, which uses low-floor buses, signal priority at intersections, streamlined on-street boarding and unloading of passengers, and improved bus stop spacing at planned stations.

OFFICE OF THE COUNTY COUNSEL ACTS AS THE MTA'S GENERAL COUNSEL

The MTA is a public agency separate and distinct from the county of Los Angeles. However, in 1994 the MTA board appointed the county of Los Angeles, Office of the County Counsel (County Counsel), to serve as the MTA's general counsel. County Counsel, through its Transportation Division, provides services to the MTA. The Transportation Division employs 15 attorneys and various support staff who are located in the MTA headquarters building. County Counsel directly represents the MTA in transactional matters and performs such tasks as drafting and reviewing contracts, providing advice on almost all legal issues, and sitting with the MTA board and its committees to provide advice during their meetings. County Counsel also monitors outside counsel—contract lawyers who represent the MTA in a variety of legal matters.

MTA staff review County Counsel invoices for adherence to established guidelines. The MTA is also responsible for determining through its budget process the amount of services County Counsel is to provide each year. In addition, MTA staff and the MTA board must approve large legal settlements. There is no written contract between the MTA and County Counsel; however, there is an understanding that County Counsel will bill the MTA at an hourly rate sufficient to cover the costs it incurs in representing the MTA.

THREE UNITS ACCOUNT FOR MOST MTA LEGAL COSTS

Although County Counsel accounts for the majority of its legal costs, the MTA also pays legal costs through two units within its Risk Management Division: the Public Liability/Property Damage Unit (PL/PD Unit) and the Workers' Compensation Unit. The PL/PD Unit is responsible for the administration and settlement of claims for personal injury and property damage related to bus and rail accidents. The Workers' Compensation Unit oversees the administration and settlement of workers' compensation claims relating to periods after August 2001. Although County Counsel is involved with public liability/property damage and workers' compensation litigation, the PL/PD Unit uses outside counsel to represent the MTA in the majority of its cases, and the Workers' Compensation Unit uses outside counsel for all of its cases. Both units are responsible for monitoring outside counsel.

In fiscal year 2002–03, County Counsel legal costs for staff and outside counsel amounted to \$14.6 million, while legal costs for public liability/property damage totaled \$8.7 million and workers' compensation totaled \$3.1 million. Although County Counsel accounts for the majority of the MTA's legal costs, the PL/PD and Workers' Compensation units oversee many more, but smaller, legal matters. In fiscal year 2002–03, the PL/PD Unit paid outside counsel costs for 1,000 cases and the Workers' Compensation Unit did so for 1,400 cases; County Counsel made payments to outside counsel relating to about 60 legal matters. Table 1 provides a brief overview of the entities that provide and manage legal services for the MTA. Other MTA units also had costs for legal services, but in recent years these costs have been insignificant. For example, in fiscal year 2002–03, all other units only paid about \$92,000 for legal services.

TABLE 1

Roles of Various Entities in Providing and Managing Legal Services for the Metropolitan Transportation Authority

Entity	Public Liability/ Property Damage	Workers' Compensation	Other Legal Matters*
County Counsel	<ul style="list-style-type: none"> • Along with the MTA, approves outside counsel firms used to litigate cases. • Discusses cases litigated by outside counsel with the Public Liability/Property Damage Unit prior to trial. • Litigates some cases. 	<ul style="list-style-type: none"> • Along with the MTA, approves outside counsel firms used to litigate cases. • Provides advice to the Workers' Compensation and other MTA units. • Discusses case-related issues with outside counsel and MTA staff. • Oversees special fraud investigation unit. • Oversees third-party administrator and outside counsel related to claims from injuries that occurred before September 1998. 	<ul style="list-style-type: none"> • Litigates some cases. • Oversees outside counsel. • Represents the MTA in transactional matters.
Risk Management's Public Liability/ Property Damage Unit	<ul style="list-style-type: none"> • Oversees third-party administrator who manages outside counsel on claims of \$50,000 or less. • Oversees outside counsel on claims over \$50,000. 	None	None
Risk Management's Workers' Compensation Unit	None	Oversees outside counsel related to claims for injuries that occurred after August 2001.	None
Outside Counsel	<ul style="list-style-type: none"> • Litigate the majority of cases. • Worked about 1,000 cases in fiscal year 2002–03. 	<ul style="list-style-type: none"> • Litigate all cases. • Worked about 1,400 cases in fiscal year 2002–03. 	<ul style="list-style-type: none"> • Litigate major cases. • Provide advice on transactional matters. • Worked about 60 legal matters in fiscal year 2002–03.

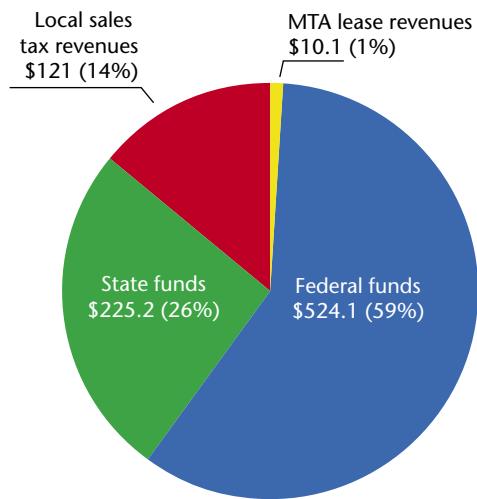
* Includes litigation cases relating to such things as breach of contract and employment disputes, as well as transactional matters, such as the drafting of contracts.

STATE FUNDS AND OTHER SOURCES PAY FOR CLAIMS AND JUDGMENTS RELATED TO CONSTRUCTION AND OPERATIONS

The MTA receives funds from a variety of sources, the largest of which include local sales tax revenues, fare revenues, and federal and state funds. These funds are pooled and are generally to be used for specified purposes. For example, a governmental grant for a specific construction project is not to be used for other purposes. Similarly, the MTA is to use revenues from bus and rail passenger fares only for operations. Money used to satisfy claims and judgments related to construction litigation comes from project-specific funding sources. For example, as Chapter 2 details, the MTA recently awarded its largest-ever construction contract for erecting the Metro Gold Line Eastside Extension Project, a six-mile light-rail line. As shown in Figure 1, the total budget for this project is \$880.4 million, with \$524.1 million, or 59 percent, funded by the federal government and \$225.2 million, or 26 percent, funded by the State.³

FIGURE 1

Funding Sources of the Metropolitan Transportation Authority's Metro Gold Line Eastside Extension Project (in Millions)



Source: Metro Gold Line Eastside Extension Project's February 2004 monthly status report.

³ The MTA has already received \$50 million of these funds. However, as a result of the State's recent budget problems, the MTA has agreed to advance the remaining \$175 million. The State is scheduled to begin reimbursing the MTA for these advances in 2006.

Local Sales Tax Revenues

Proposition A—This sales tax initiative was approved by Los Angeles County voters in 1980. The proposition established a one-half cent sales tax to be used for public transit.

Proposition C—This sales tax initiative was approved by Los Angeles County voters in 1990. The proposition established a one-half cent sales tax to be used for public transportation purposes.

State Sales Tax Revenues

Transportation Development Act—created by state law in 1972, this act authorizes the use of one-fourth of 1 percent of the state sales tax for transportation purposes.

State Transit Assistance Program—created under Chapter 161, Statutes of 1979, this program provides funds derived from the sales tax on gasoline to be used for transit purposes as specified by the Legislature.

Claims and judgments against the MTA for public liability/property damage and workers' compensation cases related to operations are covered by fare revenues as well as allowable federal, state, and local sources. For example, money budgeted to fund MTA operations in fiscal year 2003–04 comes from the following sources:

- Local sales tax revenues—\$346 million, or 37 percent. Refer to the text box for sources of local sales tax revenues.
- Fare revenues—\$273.1 million, or 29 percent.
- State sales tax revenue—\$185.4 million, or 20 percent. Refer to the text box for sources of state sales tax revenues.
- Federal operating grants—\$110 million, or 11 percent.
- Miscellaneous operating and nonoperating revenue—\$28.1 million, or 3 percent.

SCOPE AND METHODOLOGY

The Joint Legislative Audit Committee (audit committee) directed the Bureau of State Audits to review the MTA's legal and procurement practices. Specifically, the audit committee asked us to compile and note trends in MTA legal costs from 1995 through 2003, including costs associated with outside consultants and experts. The audit committee also asked us to determine the sufficiency of the MTA's oversight of its outside legal counsel and associated costs, as well as to review the reasonableness of a sample of legal and claims expense billings. We were also directed to identify the role of the MTA's outside counsel in the processing and settlement of claims, including construction litigation, and in the negotiating of primary and excess insurance policies. Further, the audit committee asked us to determine the steps the MTA has taken to identify and address conflicts of interest, if any, on the part of outside counsel. We were also asked to review the MTA's financial audit report to determine if it properly disclosed legal and insurance contingencies and pending litigation, and to determine the allowable sources of funding to satisfy judgments against the MTA and any impact such judgments have on state funding.

Finally, the audit committee directed us to survey a sample of those vendors that expressed an interest in but did not submit bids for the MTA's Metro Gold Line Eastside Extension Project to determine whether a pattern exists in their reasons for not bidding, as well as to determine those components of the winning bid that contributed to significant differences between the bid and the engineer's estimate.

To compile and note trends in legal costs, including costs associated with outside consultants and experts, we obtained accounting records from the MTA and County Counsel that detailed these costs on an invoice-by-invoice basis. We summarized this information in a variety of ways, including by case, to better determine the reasons behind changes in annual legal costs.

To understand the MTA's procedures for oversight of its outside counsel, we interviewed County Counsel attorneys and managers in the PL/PD and Workers' Compensation units, and reviewed the contracts and guidelines governing the MTA's outside counsel. To determine the sufficiency of the MTA's provisions for overseeing its outside counsel and associated costs, we conducted a literature search to identify recommended practices for managing outside counsel and then compared the recommended practices to those of the MTA. We reviewed 10 invoices from PL/PD Unit cases, 15 invoices from Worker's Compensation Unit cases, and 37 invoices related to all other legal matters, which were primarily cases. We attempted to review 40 invoices related to these other legal matters, but the MTA was not able to provide three of them. We generally selected those invoices that contained large costs. We reviewed the invoices and related case files to determine whether outside counsel adhered to the requirements listed in their contracts and to billing guidelines. We reviewed closed files to examine oversight of other legal matters. These files supported County Counsel's statement that it does not generally require outside counsel to submit case plans or detailed budgets but instead relies on frequent contacts to monitor outside counsels' work, as discussed further in Chapter 1. County Counsel acknowledged that it has used the same oversight methods for all of its cases, whether closed or open.

We obtained an understanding of the services that outside counsel provide to the MTA. To identify the role of outside counsel in settling claims and negotiating insurance policies, we reviewed 16 public liability/property damage, workers' compensation, and other legal cases settled since July 2001 to

determine whether outside counsel adhered to MTA guidelines requiring the approval of MTA staff, the MTA's Claims Committee, or the MTA board. The MTA could not provide us with a listing of settlements for workers' compensation cases related to injuries occurring before September 1, 1998. According to the third-party administrator managing these cases, it has not maintained this data in a readily accessible form. We therefore reviewed cases selected for our oversight testing to determine if they were settled and if so, whether outside counsel adhered to MTA guidelines. We also reviewed board committee reports indicating who advised the MTA board on the selection and negotiation of insurance policies over the same time period. We found that outside counsel have not played a role in this effort. Rather, our review of MTA board committee reports indicate that MTA staff, in conjunction with MTA's insurance broker, have provided the MTA board with input and analysis related to public liability/property damage, workers' compensation, and construction insurance.

To determine what steps the MTA has taken to identify and address conflicts of interest, we reviewed its contracts with outside counsel to determine if they contained provisions requiring outside counsel to notify the MTA if and when a conflict of interest arises. We also followed up on the waiver requests of outside counsel, identified during our review of case files, to determine if the MTA documented its conflict waivers.

To determine if the MTA properly disclosed reserves and litigation in accordance with generally accepted accounting principles, we reviewed the work papers of the MTA's external auditors, including actuarial letters, attorney confirmation letters, and the MTA's management representation letters for the last two fiscal years. Refer to the Appendix for further information.

To determine the allowable sources of funding to satisfy judgments against the MTA, we reviewed budgets and had discussions with accounting staff regarding sources of funding and the flow of these funds. According to MTA staff, the same funding sources pay for judgments and settlements, which are alternative methods for resolving disputes. We therefore extended our testing of settlements to determine if the MTA paid them from allowable funding sources.

To determine why the MTA did not receive more bids for its Metro Gold Line Eastside Extension Project, we identified seven contractors that had the capability of bidding on projects of a similar size and nature and that had expressed an interest in the

project but opted not to bid. We attempted to survey the seven contractors to determine the factors that contributed to their not placing a bid. Six of them participated in the survey. We also reviewed documentation related to the MTA's discussions and meetings with bidders and industry experts. Further, we reviewed the MTA's invitation for bid documents to gain an understanding of the various components of the solicitation package and what changes the MTA made to it over time. To determine why the bids the MTA did receive were higher than expected, we interviewed MTA managers. We also analyzed the schedule of quantities and prices to determine what components of the contractor bids were higher than the engineer's estimate. ■

CHAPTER 1

The Metropolitan Transportation Authority Does Not Use Certain Recommended Management Tools in Its Oversight of Legal Contracts

CHAPTER SUMMARY

The legal costs of the Los Angeles County Metropolitan Transportation Authority (MTA) increased substantially from fiscal years 1995–96 through 2001–02 before declining significantly in fiscal year 2002–03. The MTA expects legal costs to continue at this lower level in the near term. The MTA could improve the oversight of its legal costs by requiring the county of Los Angeles, Office of the County Counsel (County Counsel), through its Transportation Division, to fully implement recommended management tools that are included in its agreements with outside counsel. In particular, the MTA could benefit from the use of case plans and budgets, which provide a blueprint for the conduct of a case and allow an evaluation of the reasonableness of billed legal costs by providing cost estimates with which they may be compared. For most legal matters other than public liability/property damage and workers' compensation cases (other legal matters) we tested, case files did not provide evidence of case plans or budgets covering each phase of the case, although County Counsel contracts require both. These other legal matters include cases related to construction litigation.

In addition, for most public liability/property damage cases we tested, there were no budget revisions as required for cases that exceed their budgets. County Counsel believes that case plans and budgets are not effective tools for managing complex and unpredictable cases. However, plans and budgets should be evolving documents subject to change and are useful for both simple and complex cases.

The MTA's legal costs consist of both legal fees (costs related to attorneys and paralegals working on a case) and expenses (other goods and services incurred by law firms, such as the costs of expert witnesses and consultants). The MTA and County Counsel appeared to thoroughly review the expense portion of invoices and to enforce most billing rates for fees

and expenses. Errors in tested invoices related to billing rates or to a lack of documentary support amounted to only 1 percent of tested costs. The current line-item billing format, however, details individual attorneys' activities in segments as small as one-tenth of an hour. Consequently, monthly invoices can be very lengthy and do not easily lend themselves to an analysis of tasks performed. We saw no evidence that the MTA had performed such an analysis. A task-based billing format, where legal fees are categorized according to the nature of the service performed, would alternatively allow the MTA to quickly develop information on legal costs by task. In turn, this information could spark discussions with outside counsel regarding how they are conducting the cases and potentially improve their efficiency.

MTA LEGAL COSTS HAVE FALLEN AS MAJOR CONSTRUCTION-RELATED CASES HAVE CLOSED OR WOUND DOWN

After increasing from fiscal years 1995–96 through 2001–02, legal costs for County Counsel, which cover other legal matters, declined substantially in fiscal year 2002–03 as several major cases related to subway construction either closed or completed their trial phases. Those and other legal matters, which account for 65 percent of the MTA's legal costs presented in Table 2, were significantly higher from fiscal years 1998–99 through 2001–02. Higher costs can be attributed in large part to litigation related to the construction of the MTA's Metro Red Line subway, a \$4.5 billion construction project that experienced several significant problems, including the subsidence of a portion of Hollywood Boulevard caused by subway tunneling. In fiscal year 2001–02, the court rendered a judgment in the MTA's favor on its second most expensive case, currently on appeal. In early fiscal year 2002–03, the MTA settled two of its most expensive cases. Consequently, County Counsel's legal costs declined in fiscal year 2002–03. The MTA expects legal costs to continue at a lower level in the near term and has budgeted \$12 million for County Counsel legal costs for fiscal year 2004–05. Total legal costs for public liability/property damage and workers' compensation cases, in contrast, have remained steadier throughout this period.

MTA legal costs have dropped since peaking in fiscal years 1998–99 through 2001–02.

TABLE 2

**Metropolitan Transportation Authority (MTA) Legal Costs From
Fiscal Year 1995–96 Through December 2003**

Fiscal Year	County Counsel*	Public Liability/ Property Damage	Workers' Compensation†	Miscellaneous‡
1995–96	\$ 9,882,767	\$9,734,101	\$2,416,699	\$ 527,082
1996–97	12,459,780	7,932,159	2,211,003	5,384,934
1997–98	16,346,970	7,824,567	2,207,628	582,619
1998–99	26,684,266	7,710,350	NA	1,391,253
1999–2000	23,263,326	5,249,911	NA	185,975
2000–01	27,096,436	6,814,600	NA	112,821
2001–02	30,985,821	7,460,136	1,967,325	375,314
2002–03	14,578,789	8,746,202	3,143,629	91,755
First half of 2003–04	6,436,073	4,366,055	2,382,889	9,301

Sources: County Counsel legal cost data, public liability/property damage legal cost data provided by the MTA's third-party administrator, workers' compensation legal cost data provided by the MTA and its third-party administrator, and the MTA's financial and information accounting system for all miscellaneous legal costs.

NA = Not applicable.

* County Counsel amounts include some costs associated with public liability/property damage and workers' compensation cases.

† Annual costs for workers' compensation include costs for injuries that occurred in previous years. For fiscal years 1998–99 through 2000–01, the MTA said it could not provide legal costs related to injuries that occurred before September 1, 1998, because the third-party administrator does not maintain detailed cost records for more than two years. The MTA's workers' compensation program was fully insured by a third-party administrator for injuries that occurred between September 1, 1998, and August 31, 2001. This policy covered claims payments as well as any associated legal costs. Costs related to injuries occurring since the MTA began self-administering workers' compensation claims on September 1, 2001, were \$121,969 for fiscal year 2001–02, \$1,390,803 for fiscal year 2002–03, and \$1,245,082 for the first half of fiscal year 2003–04.

‡ Miscellaneous costs do not include bond counsel costs, which are paid from the proceeds of bond sales. Between July 1, 2000, and June 30, 2003, these costs averaged \$114,000 per year.

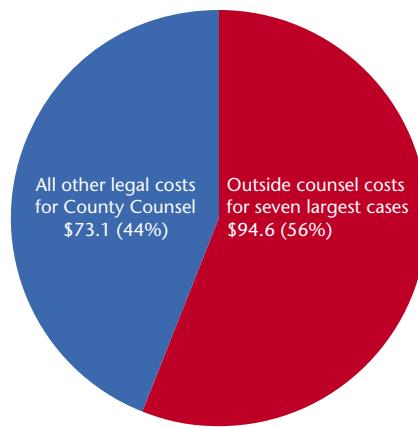
Various organizations have been responsible for the MTA's workers' compensation legal costs. Until September 1998, Presidium, Inc. was the third-party administrator that oversaw all workers' compensation claims. The MTA was self-insured during this period. From September 1998 through August 2001, Travelers Property and Casualty both administered and fully insured all workers' compensation claims, including associated legal costs. The MTA has self-administered and self-insured its workers' compensation program for injuries occurring after August 2001. Travelers Property and Casualty, however, remains responsible for handling any claims related to prior coverage periods.

A small number of cases have had a large impact on MTA legal costs. Figure 2 on the following page shows that from July 1995 through December 2003, seven major cases accounted for

56 percent of the MTA's County Counsel legal costs. Six of these seven cases related to the construction of the MTA's Metro Red Line subway. The MTA initiated two of the seven cases.

FIGURE 2

**Portion of County Counsel Legal Costs Spent on Outside Counsel for the Metropolitan Transportation Authority's Seven Largest Cases From July 1995 Through December 2003
(in Millions)**



Source: County Counsel cost reports.

THE MTA RELIES ON COUNTY COUNSEL TO PROVIDE IT WITH LEGAL SERVICES

Since 1994, the MTA has relied on County Counsel to provide it with basic legal services. County Counsel, through its Transportation Division located at MTA headquarters, acts as general counsel for the MTA. As discussed in the Introduction, the Transportation Division employs 15 staff attorneys who provide advice on almost all legal issues, represent the MTA in both transactional matters and in a variety of litigation matters, and monitor outside counsel. The MTA expended 83 percent of the legal costs noted previously in Table 2 on outside counsel, contract law firms that advise and represent the agency. Costs for County Counsel attorneys remained relatively steady from fiscal years 1995–96 through 2002–03, ranging from \$3.2 million to \$3.8 million annually.

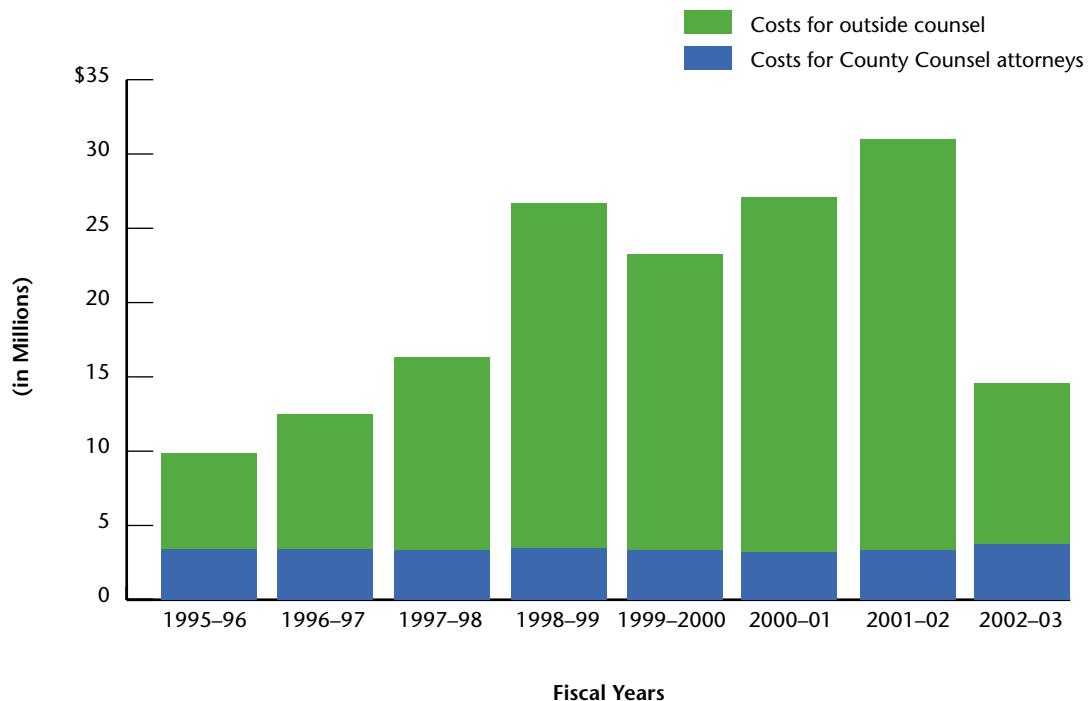
Outside Counsel Perform Most of the MTA's Legal Work

The MTA, through County Counsel, contracts with outside counsel to provide services for public liability/property damage and workers' compensation cases, and for litigation that it anticipates will be too time-consuming to handle internally, such as major construction litigation. Outside counsel are generally responsible for all phases of litigation, including pleadings, discovery, trial, settlement discussions, and appeals. In addition to major litigation cases, outside counsel are involved in some transactional work, such as reviewing contracts.

As part of their litigation duties, outside counsel provide advice on the settlement of litigated cases but do not have authority to approve settlements. Settlements are subject to approval by the appropriate MTA staff, the MTA's Claims Committee, or the MTA board of directors (MTA board), depending on the type of case and settlement amount. For example, public liability/property damage settlements over \$10,000 require approval by both MTA and County Counsel staff, while settlements above \$50,000 require approval by the Claims Committee. Settlements up to \$50,000 for workers' compensation cases require approval by the claims manager, while settlements above \$50,000 require approval by a member of County Counsel. For other cases, settlements up to \$50,000 require approval by the County Counsel with concurrence from the head of the unit whose budget is affected, while the Claims Committee generally approves those above \$50,000. For all types of cases, settlements above \$200,000 require MTA board approval. We reviewed 16 settlements the MTA has paid since July 2001 for public liability/property damage, workers' compensation, and other legal matters, and determined that outside counsel provided advice on settlements but that the appropriate parties gave final approval for the deals.

Outside counsel advised the MTA on the settlement of cases, but the appropriate parties within the MTA and County Counsel approved the deals.

Payments to outside counsel account for a significant proportion of the MTA's legal costs. Although County Counsel is involved with workers' compensation and public liability/property damage litigation, outside counsel litigate all workers' compensation cases and the majority of public liability/property damage cases. Consequently, payments to outside counsel account for most of the MTA's legal costs related to these areas. Moreover, as shown in Figure 3 on the following page, MTA payments to outside counsel make up a majority of legal costs for County Counsel.

FIGURE 3**Outside Counsel Costs as a Proportion of County Counsel Legal Costs for Fiscal Years 1995–96 Through 2002–03**

Source: County Counsel cost reports.

Note: From July 1, 2003, through December 31, 2003, costs associated with County Counsel attorneys totaled \$1.7 million, while costs associated with outside counsel totaled \$4.7 million.

County Counsel Takes Appropriate Action to Ensure Outside Counsel Do Not Have Conflicts of Interest

Generally, County Counsel, on behalf of the MTA, enters into contracts with outside counsel. Contracts for workers' compensation and other legal matters contain standard provisions that allow for cancellation if conflicts of interest should arise. Contracts for public liability/property damage cases require outside counsel to immediately notify County Counsel of any potential conflict of interest. In addition, outside counsel are required by the California Rules of Professional Conduct, which regulate the conduct of members of the State Bar, to notify County Counsel of any potential conflict of interest. County Counsel has a practice of reviewing potential conflicts of interest presented by outside counsel and either issuing a written waiver of the conflict if it determines there is no real potential for the MTA's work to be compromised or dismissing outside counsel from the case. This practice is consistent with the rules regulating the conduct of

attorneys. A review of both case files and conflict-of-interest waivers indicate that County Counsel appropriately followed its internal practice in addressing conflict-of-interest issues.

COUNTY COUNSEL DOES NOT USE CERTAIN RECOMMENDED CASE MANAGEMENT TOOLS

County Counsel's policies for overseeing outside counsel generally comprise several of the recommended tools for managing legal contracts, including executing written agreements and requiring outside counsel to submit case plans and budgets. In addition, County Counsel provides outside counsel with detailed billing guidelines for both legal fees and expenses. Although its contracts include recommended oversight tools, County Counsel does not use several of them.

Contracts With Outside Counsel Include Recommended Tools for Managing Legal Contracts

County Counsel contracts with outside counsel include key provisions recommended for managing legal contracts. In particular, these contracts generally require outside counsel to submit case plans and budgets, and include detailed billing guidelines. Moreover, they usually require outside counsel to project a budget covering all phases of a case and to obtain approval for any deviations from the budget. Table 3 on the following page lists recommended practices for managing outside counsel and notes which ones the various types of County Counsel contracts contain.

County Counsel contracts with outside counsel generally require case plans and budgets covering all phases of a case.

The management tools listed in Table 3 are recommended in *Successful Partnering Between Inside and Outside Counsel (Successful Partnering)* and in the California Public Contract Code. *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 drew 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 Section 10353.5 of the California Public Contract Code, state agencies are to include certain provisions in their contracts for legal services. Although the MTA is not a state agency, the Public Contract Code section nevertheless provides a model for contracting policies. Both sources recommend using the following tools for effective management of outside counsel:

case plans, budgets, and billing guidelines. In addition, *Successful Partnering* recommends, and the Public Contract Code assumes, the creation of a written agreement between a client and its outside counsel.

TABLE 3

County Counsel Provisions for Managing Outside Counsel

Recommended Management Tool	Public Liability/Property Damage*	Workers' Compensation	Other Legal Matters
Written agreement	Yes	Yes	Yes
Case plans	Yes	Yes [†]	Yes
Budgets	Yes	No	Yes
Detailed billing requirements for legal fees and expenses	Yes	Yes	Yes

* For public liability/property damage cases with claims under \$25,000, the Metropolitan Transportation Authority (MTA) uses a flat-fee system in which it pays outside counsel a set fee of \$4,400 for all legal services associated with the case. Case plans and budgets are not required for these cases. The MTA estimates that 50 percent of its public liability/property damage cases fall into this category.

[†] Contracts for workers' compensation cases require an opening letter that includes an analysis of the case, recommended steps for producing evidence, and an indication of legal actions the attorney will take.

Written Agreements

Written agreements are used to clarify the expectations of clients and counsel with respect to such issues as the scope of services, the responsibilities of the attorney and client, and the basis for compensation. Such clarifications help to define standards that might otherwise become the subject of dispute. Although written agreements are not compulsory in all states, the California Business and Professions Code generally requires attorneys with cases in which expenses to a client, including attorney fees, are expected to exceed \$1,000 to have written agreements with their clients. Except for one instance, the MTA or County Counsel had a contract with each outside counsel that we tested. The one instance involved a law firm that provides legal advice to the MTA on issues related to federal transportation law. Although the MTA had a task order detailing the work associated with a particular issue, the task order referred to a contract that had expired.

Case plans help focus outside counsel on key issues to establish priorities and function more effectively.

Case Plans

Case plans function as a blueprint for the conduct of a case and help focus outside counsel on key issues to establish priorities and function more effectively. A case plan, which can be developed for either litigation or transactional work, is a detailed statement of anticipated activities and resources—including staffing—required for a legal matter. Both outside counsel and inside counsel should view the case plan as a living document that may change as new facts are learned through investigation and discovery or if opposing counsel takes unanticipated action.

Case plans are generally organized by the phasing of case activities. For example, as litigation progresses, a plan may include all or part of the following: case assessment and development, pretrial pleadings and motions, discovery, trial preparation and trial, and appeal. In addition, a case plan generally includes alternatives to litigation, such as settlement or mediation. Case plans for transactional work may be simpler than those for litigation, listing a schedule of the different phases with an indication of who will be responsible for completing each phase and a preliminary budget. For the MTA's public liability/property damage cases with claims over \$25,000 and for other legal matters, contracts require outside counsel to submit case plans that include a statement of the facts, an analysis of liability exposure, and strategy recommendations. For workers' compensation cases, contracts require an opening letter that includes an analysis of the case, specific steps recommended to produce needed evidence, and an indication of what legal actions are to be implemented by the attorney.

Budgets

Requiring outside counsel to submit and adhere to a budget is one of the most common prescriptions for containing outside counsel costs. A budget generally includes an estimate of legal fees and other anticipated expenses to be incurred during the engagement. Budgets are closely related to case plans and typically grow out of them. Although outside counsel and inside counsel should view the budget as an evolving document that will change as the case progresses, inside counsel should require outside counsel to obtain approval for any work that may exceed the budget. Although case budgets are often subject to change, they have a number of benefits, including imparting outside counsel with a framework to provide regular progress

County Counsel contracts generally require outside counsel to project a budget and to obtain approval for deviations from the budget, but they do not require task-based budgeting.

reports and to evaluate potential strategies with inside counsel, furnishing information necessary to make critical decisions such as whether to pursue or settle a matter, sparking discussions with outside counsel regarding how they are conducting the case and encouraging cost consciousness.

Task-based budgeting, where each step of the case plan is broken down into the steps necessary to accomplish each phase, allows inside and outside counsel to gain a better understanding of the direction the matter will likely take. Task-based budgeting also forces all parties involved to think the matter through and to plan for foreseeable pitfalls. County Counsel contracts generally require outside counsel to project a budget for each phase of a case and to obtain approval for any deviations from the budget, but they do not require task-based budgeting. County Counsel contracts do not require any budget for public liability/property damage claims under \$25,000 or for workers' compensation cases. The policy regarding workers' compensation cases is discussed in greater detail later in this chapter.

Billing Requirements

Detailed billing requirements allow inside counsel to control costs by specifying limits on specific types of expenses and establishing billing rates. Legal invoices generally contain two main areas of costs: legal fees and expenses. Legal fees consist of attorney and paralegal fees, and expenses include other costs such as those for consultants, deposition transcripts, photocopies, and messenger services. *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 work performed and names of attorneys performing the work. Identifying the attorneys assigned to a case helps prevent the rotation of attorneys working on the case, a practice that can be expensive because new attorneys must spend time becoming familiar with the case before doing substantive work. This source also suggests that billing requirements clearly state which expenses an organization will pay and which it will not. For example, many corporations state in their policies that they will not pay for any overhead premium beyond the actual cost of computerized research.

In addition to detailed billing requirements, *Successful Partnering* recommends that organizations require detailed bills from outside counsel. Detailed bills allow inside counsel to determine

if outside counsel is 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 most common type of legal invoice presents detailed line-item descriptions of the time spent by each attorney on a case each day. However, such hourly billing systems can be confusing and do not provide data in a way that helps plan and manage legal fees. Furthermore, inside counsel cannot readily determine how much outside counsel have spent on particular tasks or phases of a case.

Task-based billing allows organizations to more readily analyze the overall time outside counsel have spent on particular categories of tasks.

An alternative to hourly billing is task-based billing. According to *Successful Partnering*, task-based billing, where the invoice is formatted to categorize time and dollars charged according to the nature of the services performed, is a useful way to facilitate the meaningful review of legal fees. With task-based billing an organization can more readily analyze the overall time outside counsel have spent on particular task categories without having to piece together the time records of individual attorneys. Task-based billing enables inside counsel to readily compare the actual amount spent on a task, such as preparing a brief or taking depositions, with the expected amount listed on the task-based budget, as described previously. Such a comparison allows for a meaningful discussion between inside and outside counsel regarding the reasons for differences between actual and expected costs.

In 1995, a consortium of law firms, in cooperation with the American Corporate Counsel Association and the American Bar Association, created the Uniform Task-Based Management System, which formulated a standardized set of billing codes for various legal tasks. The *2002 PricewaterhouseCoopers Law Department Spending Survey* found that 15 percent of respondents, which included 207 corporate law departments from 16 industries, had implemented the system and 17 percent planned to do so in the future. Although task-based billing is not yet widely used, it can provide significant benefits. System proponents believe use of uniform billing codes facilitates an organization's ability to understand both the legal services provided by outside counsel and the reasons for cost increases. Other reported benefits include time saved in reviewing bills, better communication with outside counsel, and potentially both legal cost savings and improved quality of services. For the most part, companies have focused implementation of a task-based billing format with their top billing law firms. Focusing on the top billing law firms allows for the achievement of the greatest efficiency gains for the least effort.

The MTA does not use task-based billing. However, its outside counsel must adhere to detailed billing requirements for both legal fees and expenses. These requirements are spelled out in County Counsel billing guidelines. Although the guidelines cover many types of legal expenses, they do not include air travel or some new technologies such as imaging and video services, which were included in the invoices we tested. The lack of guidelines for these services may make it more difficult for staff approving invoices to determine whether an expense is excessive.

County Counsel Generally Uses Neither Case Plans Nor Budgets Detailed by Phase

Although County Counsel's contracts require outside counsel to submit case plans and budgets covering each phase of a case, our review of case files for other legal matters rarely found evidence of either. Other legal matters, which include all cases except public liability/property damage and workers' compensation cases, accounted for 65 percent of the MTA's legal costs from July 1995 through December 2003. Only three of the nine case files we reviewed contained documents pertaining to a budget: two contained a detailed budget broken out by task, and another contained documents that referred to a budget for the remainder of the case but was devoid of budget information by phase. Furthermore, none of the nine case files had a comprehensive case plan. Although three of the nine case files contained documents that relate to strategy, the documents generally included recommendations by outside counsel on a particular aspect of the case, not a detailed description of the anticipated activities and resources needed to complete the case.

The assistant county counsel, Transportation Division (assistant counsel), who heads County Counsel operations at the MTA, says that County Counsel does not require case plans and budgets as detailed in the contracts because it believes its cases are complex and do not lend themselves to such case management methods. Instead, County Counsel assigns a staff attorney for each case and relies on frequent contact to oversee outside counsel's work. Our review of nine case files and 17 related invoices indicated that the assigned County Counsel attorney was engaged in such oversight. For example, case files show that outside counsel often copied County Counsel on its correspondence with its consultants, opposing counsel, and the court. Furthermore, County Counsel and outside counsel periodically exchanged written memoranda and often communicated with one another via e-mail and telephone.

County Counsel does not require case plans and budgets as detailed in the contracts because it believes its cases are complex and do not lend themselves to such case management methods.

Without a budget covering each phase, it is difficult to determine the reasonableness of actual legal costs because there are no benchmarks with which to compare them.

County Counsel's use of such communication is beneficial; however, its belief that its cases do not lend themselves to case plans and budgets is contradicted not only by its own contracts, which require both, but also by professional literature, which states that in any type of litigation, whether simple or complex, the development of a comprehensive plan and budget by inside and outside counsel at the beginning of the case can be critical to cost-effective management of the litigation. Without a budget covering each phase of the case, it is difficult to determine the reasonableness of actual legal costs because there are no benchmarks with which to compare them. The literature also states that the investment of time for thoughtful planning at the start of a case can yield enormous savings later on. This point of view was echoed by the outside counsel firm that represented the MTA in its most expensive case during the period between fiscal years 1995–96 and 2002–03. In responding to the request for proposals for this case, outside counsel said that to effectively and efficiently represent the MTA, it would develop a case plan, a critical component of which would be the preparation of a thorough and well-reasoned budget. The outside counsel firm noted that because construction litigation can be an expensive proposition if pursued through trial, it would develop a comprehensive budget early in the case to enable the MTA to make informed litigation and business decisions as the case progressed. The assistant counsel believes this budget was of little value because it did not accurately predict the course of the litigation. This view, however, does not recognize that the budgeting process is valuable in and of itself. As *Successful Partnering* states, the process and discipline of preparing a plan and budget can sometimes be even more beneficial than the final plan and budget are.

The MTA Did Not Always Require Budgets and Budget Updates in Outside Counsel Cases

Unlike oversight for other legal matters, the MTA generally requires that outside counsel for public liability/property damage and workers' compensation cases submit plans at the outset of the case and regular written status reports throughout the case. The MTA also requires budgets for public liability/property damage cases but does not require budgets for workers' compensation cases. According to the lead County Counsel attorney who oversees workers' compensation cases, the contracts do not require a budget because workers' compensation claims are highly unpredictable and it is extremely hard to set an estimate of legal costs. However, as noted previously, budgets

should be viewed as evolving documents subject to change. The fact that legal cases may be unpredictable does not negate the value of establishing cost expectations.

All 10 of the public liability/property damage cases we tested included a case plan, and 12 of the 15 workers' compensation cases contained such plans. Although they were not in the exact form established in the contracts, all 10 public liability/property damage cases and 13 of 15 worker's compensation cases tested also contained regular written status updates.

***Tested public liability/
property damage cases
frequently did not have
required budget revisions.***

The public liability/property damage cases we tested contained a starting budget, but only three contained revisions as required by contract for cases that exceed their budgets. All 10 should have had such documents because they all exceeded their initial budgets. Furthermore, the three cases with revised budgets exceeded their new budgets and should have contained further revisions. The MTA believes the increased spending on the cases was acceptable because, according to its risk financing manager, claims examiners approved additional work and increases in funds set aside for legal costs. Although increases in reserved funds indicate the claims examiners agreed to higher costs, it is important that revised budgets be memorialized so outside counsel and the MTA clearly understand why costs increased and agree to expected future costs.

ALTHOUGH OUTSIDE COUNSEL GENERALLY ADHERED TO BILLING GUIDELINES, THE MTA AND COUNTY COUNSEL COULD IMPROVE THEIR OVERSIGHT IN CERTAIN AREAS

County Counsel and the MTA appeared to have thoroughly reviewed the expense portion of invoices, and legal fees were generally well-detailed and related to the appropriate case. Instances where the MTA paid outside counsel for costs that did not comply with contract provisions or guidelines related to billing rates or required documentary support only amounted to 1 percent of costs we tested. Nevertheless, the MTA and County Counsel could improve processes for reviewing legal fees and overseeing certain other costs. Because invoices that present detailed descriptions of work performed by legal staff each day do not facilitate the analysis of costs, implementation of a task-based billing system could simplify the review process and allow County Counsel to better determine the reasonableness of costs. In addition, County Counsel and the MTA often did not require

written preapproval for the cost and use of expert witnesses and consultants (experts). Further, the Workers' Compensation Unit paid several invoices that claims examiners did not approve.

Outside Counsel Generally Furnished Well-Detailed Invoices for Legal Services Related to the Appropriate Case

For the invoices we reviewed, the activities for which outside counsel billed were generally well-detailed and were for legal services related to the appropriate case. Outside counsel generally followed billing requirements by submitting invoices that recorded each attorney's activities in segments as small as one-tenth of an hour, and by providing detailed invoices for expenses. In addition, the MTA appeared to have thoroughly reviewed the expense portion of invoices. For example, it disallowed expenses on 17 of 37 invoices related to other legal matters. In several instances the MTA reimbursed outside counsel for costs that were in excess of its contract provisions and guidelines; however, the dollar value of related errors was relatively small. We tested invoices totaling \$457,000 for public liability/property damage and workers' compensation cases and \$8.9 million for other legal matters. Only \$116,000, or 1 percent, of the tested legal fees and expenses did not comply with contract provisions or billing guidelines related to billing rates or required documentary support. We noted the following problems:

- The MTA made a few payments to outside counsel at rates higher than those specified on contracts or case plans. In total, the MTA paid outside counsel \$63,000 more than agreed to.
- The MTA occasionally reimbursed outside counsel for costs in excess of the guidelines, unrelated to the case, or for which outside counsel did not provide required documentation. These costs amounted to \$53,000.

In addition, the MTA paid for attorneys and paralegals who were not listed on contracts or case plans in 23 of the 62 tested invoices for public liability/property damage cases, workers' compensation cases, and other legal matters. On four of 15 workers' compensation invoices, it also paid fees for attorneys who were not identified on the invoices. As noted previously, identifying the attorneys assigned to a case helps prevent the rotation of attorneys, a practice that can be expensive because new attorneys must spend some time becoming familiar with the

Only 1 percent of tested legal costs lacked required documentary support or did not comply with billing rates.

case before doing substantive work. Although the MTA did not disallow the costs associated with those attorneys and paralegals not on the contracts, the billing rates were in accordance with other outside counsel staff working at the same level.

A Task-Based Billing Format Would Aid County Counsel and the MTA in Reviewing Legal Costs

Successful Partnering indicates that it is difficult to review legal fees using the traditional legal invoice that presents detailed line-item descriptions of the time spent by each attorney on a case each day. Without time-consuming analysis, inside counsel is limited in achieving a comprehensive view of how legal dollars were spent. Line-item descriptions of legal work in the invoices we reviewed sometimes exceeded 80 pages. Further, we saw no evidence that the MTA and County Counsel analyzed legal fees to determine the amount spent on specific phases or tasks, and without this step, they cannot effectively gauge the reasonableness of costs for particular efforts. A task-based billing format could simplify the review process. We contacted three outside counsel firms providing services to the MTA that received more than \$15 million in payments during the period from July 1, 1995, through December 31, 2003. Two said they currently have the ability to submit invoices in a task-based format.

The assistant counsel believes that task-based billing would not be beneficial, stating that the most effective way to monitor outside counsel is to work closely with them, reviewing significant court papers before they are filed and attending court hearings to see how well the MTA's position is being presented. Because County Counsel is in frequent contact with outside counsel, it believes that it already knows when a case involves a lot of work in particular areas and that task-based billing would not provide any additional useful information. As we stated earlier, County Counsel's process of monitoring outside counsel through frequent contact is beneficial. However, although County Counsel may have an idea of which tasks are most time-consuming, it does not currently have a system showing how much total time outside counsel have actually spent on particular tasks or phases. Moving to a task-based billing format would provide County Counsel with this information and allow it to compare actual costs to expectations. In addition, it could possibly reduce the administrative time it takes to review invoices. Consequently, a task-based billing format would augment and strengthen County Counsel's current oversight processes.

We saw no evidence that the MTA and County Counsel analyzed legal fees to determine the amount spent on specific phases or tasks.

County Counsel and the MTA Often Did Not Require Written Preapproval for the Use and Cost of Experts

The MTA and County Counsel often could not provide documentation for the prior approval of the use and cost of consultants and expert witnesses.

For both public liability/property damage cases and other legal matters, contracts mandate that outside counsel obtain prior approval for the use and cost of experts. The MTA and County Counsel, however, were unable to provide documentation showing the prior approval of the use or cost of a number of experts for cases we tested. For example, 16 of 17 invoices that included charges for experts used in other legal matters had no documentation of prior approval. Experts can make up a significant portion of legal costs; the 16 invoices contained payments for 33 experts that totaled nearly \$840,000. This accounted for roughly 9 percent of all County Counsel costs tested. For public liability/property damage cases, the MTA was unable to provide documentation showing its preapproval of the use and proposed budget of one expert and the proposed budgets of six other experts. Payments related to these experts accounted for 6 percent, or about \$24,000, of the public liability/property damage costs tested.

With regard to the oversight of other legal matters, the assistant counsel explained that County Counsel often orally approves the use and cost of experts and therefore maintains no written documentation. For the public liability/property damage cases, the MTA's risk financing manager explained that experts work from fee schedules and not budgets and that the MTA agrees to retain them for their fees. The MTA provided fee schedules for the experts noted above. Written approval and budgets nevertheless increase the likelihood that all parties clearly understand what work is to be performed and at what cost.

Workers' Compensation Unit Oversight Staff Did Not Approve Some Invoices

The MTA's Workers' Compensation Unit needs to ensure that appropriate staff approve invoices. Before the MTA reimburses outside counsel for each invoice, personnel responsible for oversight of outside counsel generally must review and sign off on the invoice. For both public liability/property damage cases and other legal matters, testing showed that designated staff routinely did this.

The Worker's Compensation Unit had a policy, however, of allowing clerks to authorize payment of invoices up to \$10,000 without a claims examiner reviewing the invoice. Claims examiners were to later review and approve the claims. In

fiscal year 2002–03, no individual invoice exceeded this limit. However, two of the 15 workers' compensation invoices selected for testing were paid between four and 12 months before our testing and were never approved by claims examiners or their supervisors. For another three of the 15 selections, the MTA could not provide us with the processed invoices, so we could not determine if designated staff had approved them. In May 2004, one of the County Counsel attorneys assigned to workers' compensation cases, in response to our questions about these exceptions, informed us the MTA has changed its policy and now requires the approval of claims examiners before making payments of any size to outside counsel.

RECOMMENDATIONS

To better monitor outside counsel, the MTA, in conjunction with County Counsel, should take the following actions:

- Require outside counsel to prepare flexible case plans and budgets detailed by phase, as well as budget revisions where outside counsel expect costs to exceed budgets.
- Consider requiring outside law firms to submit invoices using a task-based billing format if they have the ability to do so.

The MTA, in conjunction with County Counsel, should ensure that outside counsel adhere to all billing requirements detailed in contract provisions and County Counsel billing guidelines, including that payments are only made at agreed billing rates. Further, the MTA should ensure that outside counsel receive written prior approval to use consultants and expert witnesses within an established budget.

The Workers' Compensation Unit should ensure it follows its new procedure to pay invoices only after approval by oversight staff.

The MTA should request that County Counsel update its billing guidelines to address allowable expenses related to new technologies and air travel. ■

CHAPTER 2

The Metropolitan Transportation Authority's Efforts Resulted in the Award of a Large Construction Contract Within Budget

CHAPTER SUMMARY

Through a process that spanned 18 months, the Los Angeles County Metropolitan Transportation Authority (MTA) procured a construction contract for a six-mile light-rail line within the project's \$880.4 million budget. The MTA received two bids in its initial invitation for bid (IFB) for its Metro Gold Line Eastside Extension Project (project), and the low bid, under the type of insurance program that the MTA ultimately used, was \$54.9 million above the estimate. A large portion of the difference was attributable to the general requirements and mobilization components of the project. The project's size appears to be one reason why the MTA did not receive more bids. Certain contractors that were interested in the project and had the capability to bid on it did not do so, stating that the size of the project would necessitate the formation of joint ventures with other firms. Some of these contractors were not able to do so. In addition, some of these contractors had the perception that it is difficult to work for the MTA.

After the MTA rejected the initial bids, it significantly revamped the scope and other requirements of the project, allowing bidders to compete for three separate contracts, adopting a simpler procurement process, reducing insurance limits and disadvantaged business enterprise goals, and revising other technical aspects of the project. The MTA received five bids for its revised IFB; however, the lowest bid was still higher than expected—15 percent above the estimate—and the MTA again accepted none of the new bids. As with the first IFB, bids were consistently higher than estimates in two primary areas: general requirements—a single component including such items as project management and traffic control, and mobilization—the preparation and movement of personnel, equipment, and supplies. After discussing and negotiating with the low bidder, the MTA again modified certain elements of the project's scope of work to reduce costs, and the low bidder made a final offer

of \$610 million,⁴ \$59.8 million lower than its previous offer. On June 1, 2004, the federal government approved a grant agreement with the MTA for \$490.7 million that will help pay for the project. As of early June 2004, the MTA expected to authorize the contractor to begin work by the end of the month.

THE MTA DID NOT RECEIVE ACCEPTABLE BIDS IN ITS INITIAL ATTEMPT

The MTA received two bids in its initial attempt to procure a construction contract for the project. The MTA found the bids unacceptable, leading it to make significant changes to its solicitation package. The project is budgeted at \$880.4 million, making it the largest construction project the MTA has undertaken since construction of its Metro Red Line subway system in the 1990s. Of this budget, \$600.4 million, or 68 percent, will be spent on one construction contract, the largest single contract the MTA has ever procured and administered.

The \$600.4 million construction contract for the project is the largest single contract the MTA has ever procured and administered.

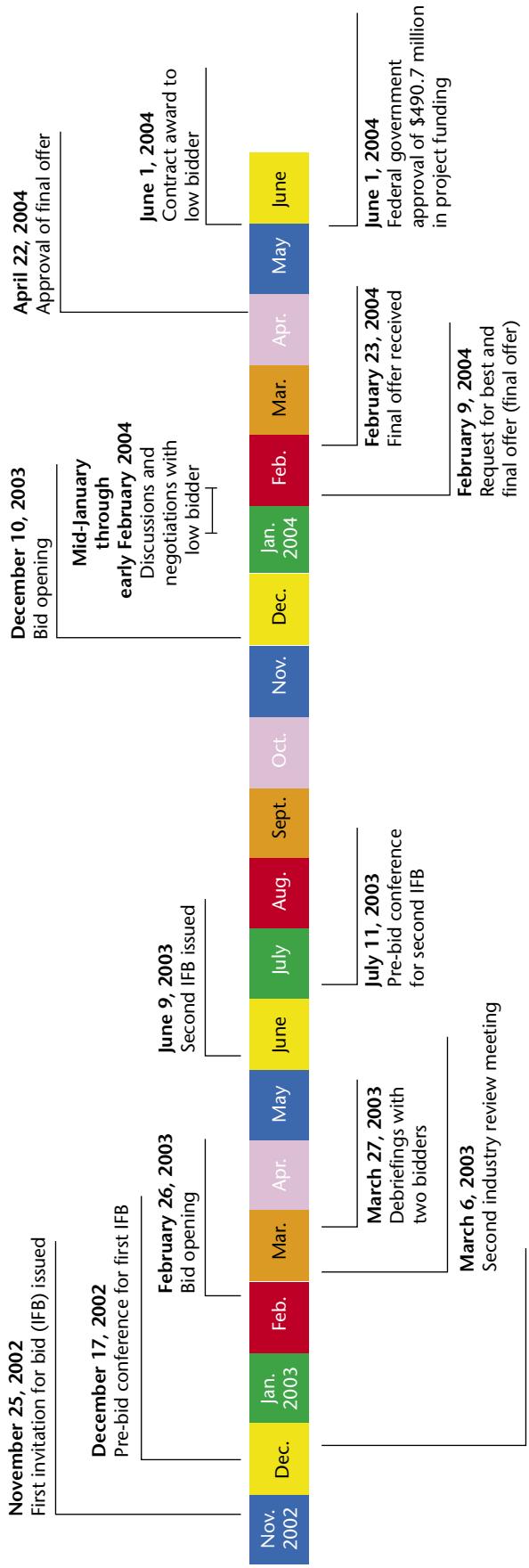
The project, six miles in length, is a dual-track light-rail system that will connect East Los Angeles with downtown Los Angeles. Originating at Union Station, the light-rail line will operate at street level for over four miles and through tunnels for nearly two miles; it will have eight stations, two of which will be underground. With a forecast opening date of 2009, the MTA is estimating a capacity for 22,000 daily boardings. As of early June 2004, the construction phase of the project had yet to begin; however, preconstruction activity has been ongoing, including utility relocations, real estate acquisitions, and agreements with third parties.

Figure 4 shows that 18 months elapsed between the time the MTA first invited contractors to bid on the construction of the project and the time it awarded a contract. During this period, the MTA determined that it would need to revise the project and invite contractors to bid a second time. The rest of the chapter discusses the events that transpired during the 18-month period.

⁴ The \$610 million offer included \$9.6 million for overhead compensation should delays occur and for construction options that may be exercised at a later date. The remaining \$600.4 million is the amount of the contract award.

FIGURE 4

Time Line of the Efforts of the Metropolitan Transportation Authority to Obtain a Construction Contract for Its Metro Gold Line Eastside Extension Project



Source: Various Metro Gold Line Eastside Extension Project bid solicitation documents.

In November 2002, the MTA issued its first IFB for the project. This IFB established a contracting opportunity for construction of the project's underground tunnel segment, consisting primarily of tunnel and station excavation, as well as construction of the east and west entrances to the tunnel. At that time, the MTA intended to issue a subsequent contract for the remainder of the project—including construction of the stations, track installation, and systems integration and testing.

According to the MTA's records, 90 firms—including prime contractors⁵ and subcontractors, engineers, consultants, and suppliers—obtained the first IFB. In December 2002, the MTA held a pre-bid conference, attended by 27 firms, where it answered questions and provided additional information related to the contract. Two days later, the MTA conducted an industry review meeting in which it invited members of the construction industry to provide comments on the solicitation package, technical specifications, and the commercial terms and conditions of the contract. The MTA invited 100 top design-build firms to this meeting; 15 attended. Design-build firms are responsible for both the design and construction of a project. Following this meeting, the MTA attempted to resolve issues raised by participants.

Bid Prices for the Tunneling Contract Exceeded Expectations

The MTA received two bids for the tunneling portion of the project, and both were higher than expected. Competitive bidding is a process by which a contract to provide public-sector services is awarded to the lowest bidder after offers are solicited and evaluated. Competitive bidding is intended to deliver more cost-effective services than other methods. Consequently, public agencies typically rely on competitive bidding to deliver the lowest cost among qualified bidders. However, when bids for the IFB were received and opened by MTA officials in February 2003, bids were at least 33 percent higher than estimates.

Two joint ventures—partnerships of more than one contractor—submitted bids for the contract. Bid prices were well above the engineer's estimates, as shown in Figure 5. These estimates, opened at the same time as the bids, were generated by the MTA's engineering consultant who also produced the final design of the tunnel contract. The MTA had instructed bidders to submit bids in two parts, taking into account two types of

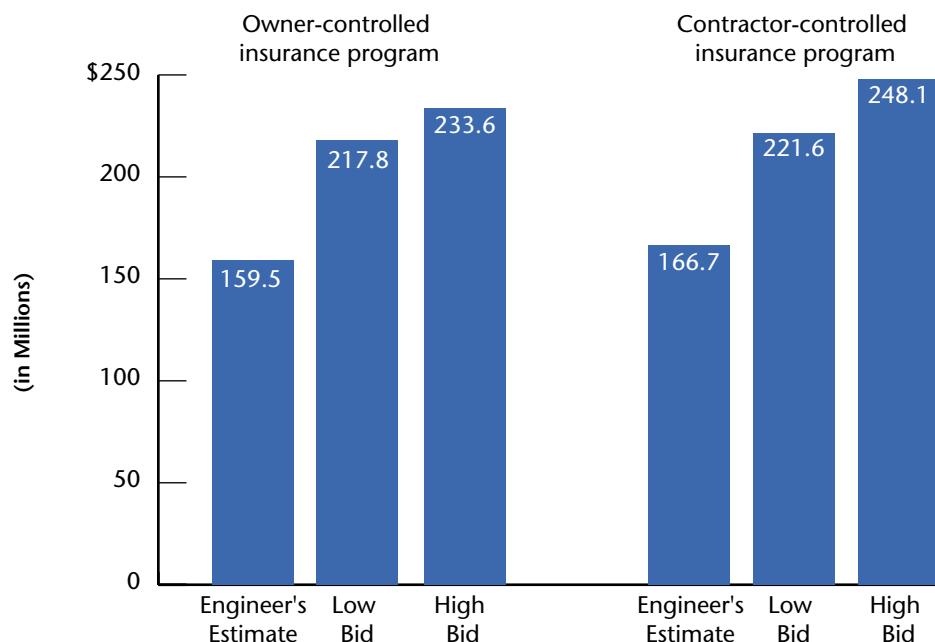
Bids for the tunneling portion of the project exceeded estimates by at least 33 percent.

⁵ The prime contractor has overall responsibility for coordinating and integrating the activities of subcontractors.

construction insurance. Construction projects such as these may be insured through either an owner-controlled or contractor-controlled insurance program. Under the owner-controlled option, in which the MTA would have been responsible for acquiring and administering construction insurance and claims, the low bid was \$217.8 million, or \$58.3 million (37 percent) higher than the engineer's estimate. The low bid for the contractor-controlled insurance option, furnished by the same joint venture, came in at \$221.6 million, or \$54.9 million (33 percent) above the engineer's estimate. Of this difference, \$33.7 million (61 percent) related to general requirements and mobilization components. The makeup of the components is discussed in more detail later in the chapter. The MTA rejected the bids because they did not meet disadvantaged business enterprise goals and were higher than the engineer's estimates.

FIGURE 5

Comparison of Engineer's Estimates and Price of Bids in Response to First Invitation for Bid



Source: Schedule of quantities and prices for the first invitation for bid issued by the Metropolitan Transportation Authority for the tunneling portion of its Metro Gold Line Eastside Extension Project.

The Size of the Project Appears to Have Limited the Number of Bidders

The size of the project appears to be one reason why the MTA did not receive more bids on the tunneling contract. We attempted to survey seven contractors that were interested in and had the capability to bid but did not do so; six of them participated in the survey. Three contractors specifically mentioned that they would have needed to form joint ventures with other firms. One contractor said that it tried to form a joint venture but could not find any willing and qualified partners. Another contractor stated that it would have had to form a joint venture to make a successful bid attempt but eventually decided against proceeding.

The formation of a joint venture with one or more other companies can help facilitate access to large contracts by providing additional resources and helping to reduce risk. The two bids the MTA received for its tunneling IFB, as well as the bids for the subsequent IFB, were all made by joint ventures. The low bidder for the MTA's first IFB was a joint venture of two different firms, while the high bidder was a joint venture of three firms.

Survey Results Indicate Several Other Reasons Why Contractors Did Not Bid

According to survey results, the perception of some firms in the construction community is that it is difficult to work for the MTA.

According to survey results, the perception of some firms in the construction community is that it is difficult to work for the MTA. Of the six contractors that participated in the survey, four indicated the MTA's reputation or their perception of how the MTA does business was a primary factor in their decision not to bid on the project. When asked what factors usually contribute to whether or not they decide to place a bid on a project of a similar size or nature, nearly all indicated that the project's owner is important. Complaints about the MTA as an owner included that it is overly aggressive, tends to be unreasonable, and is excessively bureaucratic. This sentiment was echoed by comments from one of the bidding contractors that told the MTA that after its subcontractors saw all of the forms and documents required for the first IFB, they concluded the MTA had not reduced administrative burdens. In addition, three contractors indicated the MTA is viewed as litigious; two of these contractors commented that they negatively viewed the MTA's history of litigation with designers, contractors, construction managers, and insurance companies. We note however, that

only one of the surveyed contractors had ever worked for the MTA in the past; the rest based their opinions on discussions with other companies in the construction industry.

According to the MTA, negative perceptions associated with working for it may be based on misconceptions, lack of experience with the MTA, or a lack of understanding of its responsibilities to safeguard taxpayer dollars. The MTA commented that it seeks continuous improvement to streamline bureaucratic processes and administration. Specifically, the MTA stated that it has tremendously improved its commitment to make payments in a timely manner. The MTA also said it consistently seeks the most cost-effective and efficient methods for resolving disputes, seeking to avoid litigation. In response to claims that it is litigious, the MTA expressed that as a practice, it does not initiate litigation and only pursues it as a last resort. Further, it stated the litigation that has occurred has almost always been directed at the MTA by its contractors and subcontractors, resulting from its refusal to accept excessive demands for payments above and beyond contract terms. As noted in Chapter 1, of the seven major cases accounting for the majority of the MTA's County Counsel legal costs, the MTA initiated two.

The remaining two contractors that participated in the survey had other reasons for not bidding. One contractor stated that the location of the work was too far away from its base of operations. Another said that the size and length of the project made it too difficult to accurately estimate and forecast future escalation for material and labor costs, contributing to its decision not to bid.

Two of six contractors we surveyed stated that the project's disadvantaged business enterprise goals served as a deterrent to bidding.

Two of the six contractors stated that the goals for disadvantaged business enterprises were excessively high or unrealistic and also served as a deterrent to bidding. This concern was also voiced by certain participants in the industry review meeting as well as by the joint ventures that bid on the tunneling contract. These parties expressed to the MTA that the goals for disadvantaged business enterprises were too high for the scope of the work, and some commented that they were unachievable. As a result of these comments, the MTA made changes to these goals in its second IFB, as described later.

BY MAKING REVISIONS TO THE PROJECT SCOPE AND OTHER REQUIREMENTS, THE MTA WAS ABLE TO SOLICIT MORE BIDS

After the MTA rejected the bids it received in February 2003, it significantly revised and revamped the scope and other requirements of the project. This enabled it to solicit additional bids on its second attempt. In March 2003, the MTA held a second industry review meeting in which it discussed comments and suggestions that came out of its first such meeting. In addition, the MTA debriefed the two joint ventures that previously had placed bids on the tunneling contract. During these debriefings, the MTA discussed problem areas in the previous bids to help the contractors improve in future bidding attempts with the MTA. In addition, the MTA listened to the contractors' ideas for improving its solicitation package.

Industry review meetings and debriefings with the two joint ventures that previously had placed bids on the tunneling contract helped the MTA to improve its solicitation package.

Based in part on the industry review meetings and the debriefings, the MTA made numerous changes to the project scope and other requirements. For example, one bidder suggested the MTA could expect savings on a package combining both portions of the project—tunneling work and surface work. As a result, in its second IFB, the MTA provided the opportunity for bidders to compete for three separate contracts:

- A contract for performing only the project's underground tunnel segment, as in the first IFB.
- A contract for performing only the design and construction of the stations, track work, and systems.
- A combined contract, covering both tunneling and surface work.

Also, both bidders for the original IFB indicated in their debriefings that the MTA required too many prequalification and technical forms to be submitted with the bid price, making it logically difficult to meet all administrative requirements. As a result, the MTA adopted a two-step procurement process. It instructed bidders to first submit documents related to their technical qualifications. The MTA then reviewed the qualifications of each bidder and, based on its evaluation, established a short list of firms it determined to be capable, responsible, and technically acceptable. The MTA then invited these bidders to submit price bids. The MTA reserved the right to award either separate contracts or the combined contract, whichever, in its opinion, was the most advantageous to it.

The MTA also revised the insurance limits required of contractors in its second IFB. It limited bidders to a contractor-controlled insurance policy but also decreased insurance requirements to \$2 million per occurrence from \$25 million in the first IFB. In addition, the MTA revised the requirements to allow for a staged or sequential performance bond in the amount of the anticipated cost of the work to be done in each calendar year period as an alternative to obtaining a bond for the entire contract price.

The MTA set a goal of 25 percent of the total contract price for disadvantaged business enterprise participation in the first IFB. After the industry review meetings and debriefings with bidders, it reduced the goal for the tunneling portion of the work to 13 percent of the construction costs. For the rest of the project, the MTA established goals of 20 percent of design costs and between 20 percent and 30 percent of construction costs.

The MTA revised some technical aspects of the project as well. One original bidder in a debriefing questioned the requirement that contractors use new tunnel-boring machines. As a result, the MTA allowed reconditioned or rebuilt machines in the second IFB. The MTA also recognized that bidders perceived a high level of risk with respect to certain utility rearrangement work because of uncertainty associated with utility owners' design expectations, utility owners' own expenses, and the construction costs of such facilities. To more equitably share this risk, the MTA established a shared utilities program in which it agreed to pay the first \$12 million for certain utility work and to reimburse 50 percent of contractor costs for such work exceeding \$12 million.

For its second solicitation package, the MTA received five bids—three more than it did the first time.

The MTA issued its second IFB in June 2003. According to its records, 230 firms—including prime contractors and subcontractors, engineers, consultants, and suppliers—obtained this IFB, more than double the number that obtained the first one. About a month later, the MTA held a pre-bid conference attended by 110 firms, about four times as many as had attended the first pre-bid conference. In the subsequent months, as a result of bidders' questions and continued review by staff, the MTA modified its IFB eight times. The MTA received and opened bids in December 2003. This time around, it received three bids more than it did the first time. These bids came from four joint ventures made up of 10 contractors, eight of which did not participate in the first IFB. One bid addressed the tunneling

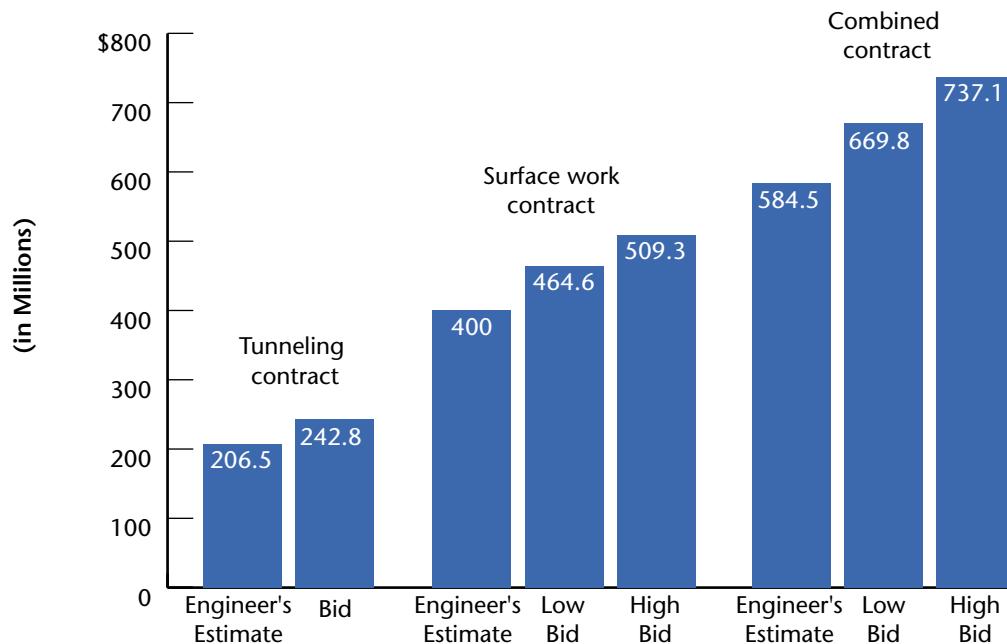
scope of work; two bids included the stations, track work, and systems scope of work; and the other two bids included all construction work.

TO FALL WITHIN THE PROJECT BUDGET, THE MTA REDUCED SOME COSTS

Bid prices in response to the second IFB still exceeded expectations, as shown in Figure 6. The low bid for the combined contract offered the MTA the best value because it was less than the combined low bids for the tunnel and above-ground contracts. Nevertheless, this bid, at \$669.8 million, exceeded the engineer's estimate by \$85.3 million (15 percent).

FIGURE 6

Comparison of Engineer's Estimates and Price of Bids in Response to Second Invitation for Bid



Source: Schedule of quantities and prices for the second invitation for bid issued by the Metropolitan Transportation Authority for the construction of its Metro Gold Line Eastside Extension Project.

Again, bids were consistently higher than estimates in two primary areas: general requirements and mobilization. Both are detailed in specific line items in the bidders' price listing, called the schedule of quantities and prices (price schedule). For example, as shown in Figure 6, the low bid for the combined

contract exceeded the engineer's estimates by \$85.3 million. The details of this bid show that the bidder's price for mobilization components was \$100 million while the engineer's estimate was \$36.6 million, a \$63.4 million variance. Additionally, the bidder's price for general requirements was \$60 million, \$36 million above the engineer's estimate. The \$99.4 million difference in these areas alone exceeded the total \$85.3 million difference between the bid and the engineer's estimate. Thus, for all other components, the low bidder came in \$14.1 million below the engineer's estimate.

In our review of the price schedules for the low bids of both IFBs, general requirements and mobilization were consistently priced much higher by the bidder than by the MTA's engineer. General requirements include such work as project management, environmental protection, security, clean-up, and traffic control. Mobilization consists of all work related to the preparation and movement of personnel, equipment, and supplies, and the establishment of offices, buildings, and other facilities at construction locations.

Again, as a result of higher-than-anticipated bid prices compared with its construction budget, the MTA did not accept these bids. Rather, it developed an action plan to stay within its project budget.

To Reduce Construction Costs, the MTA Modified Several Project Components

As a result of discussions and negotiations with the low bidder, the MTA modified certain elements of the scope of work to reduce costs without compromising project objectives.

In order to cut construction costs, the MTA assessed the bid results with the lowest bidder through direct discussions and negotiations that took place from mid-January to early February 2004, as shown previously in Figure 4. During this process, the MTA identified elements of the work where unreasonable risk perceptions may have led to high bid contingencies. According to the MTA, it was also able to ascertain the bidder's understanding of the scope of work, allowing it the opportunity to clarify misconceptions that may have led to the higher-than-anticipated bid prices. As a result of these discussions, the MTA modified certain elements of the scope of work to reduce costs without compromising project objectives.

Most significantly, the MTA eliminated the design and construction of a maintenance facility estimated to cost \$45 million. After the second IFB was issued, the MTA determined that it could accommodate the project's maintenance needs by modifying existing facilities.

In addition, the MTA modified a requirement to build a 200-space parking structure near one of its stations. Instead, the MTA has substituted a surface parking lot with 127 spaces. As a result of this adjustment, the bidder was able to cut \$2.2 million from its price bid.

The MTA also determined it could defer installation of two traction power substations. The second IFB provided for the procurement and installation of six traction power substations, designed to support a service level of three-car trains by the year 2020. The MTA decided it would add them when ridership dictates they are needed. In addition, the MTA redefined the scope of work to include fewer urban design enhancements. As a result of these adjustments, the bidder was able to cut \$7.6 million from its price bid.

After making adjustments to the project scope, the MTA received a final offer from the low bidder, which was \$59.8 million lower than the bidder's previous offer.

After making these and other adjustments, the MTA exercised its option to request a best and final offer (final offer) from the low bidder. In late February 2004, it received a final offer of \$610 million from this bidder, \$59.8 million (9 percent) lower than the bidder's previous offer. The \$610 million bid is made up of four components: (1) \$586.7 million for the base construction work; (2) \$5.9 million for overhead compensation should delays occur; (3) \$3.7 million for construction options that may be exercised at a later date; and (4) \$13.7 million for provisional sums to cover additional work that may be necessary, such as additional ground treatment and requests from third parties. Although the MTA evaluated all four bid components in determining the lowest responsible bidder, only the base construction work and provisional sums are part of its contract award. It plans on paying for the base work out of its construction budget and provisional sums out of its contingency budget, if needed.

To Stay Within Its Budget, the MTA Modified Other Expected Project Costs

By revising other expected project costs,⁶ the MTA was able to increase its construction budget without increasing the total cost of the project, as shown in Table 4. Because it made progress on certain aspects of the project—such as utility relocations and real estate acquisitions—since preparing the original budget almost a year earlier and because uncertainty was reduced by

⁶ Other project costs are supplementary costs to the actual construction work. These costs include project contingencies, acquisition of real estate and vehicles, professional services (design, legal, and consulting), and the MTA's administrative costs.

receipt of the final offer, the MTA determined it could adjust nonconstruction line items where appropriate to reflect the current status of the project. For example, the original budget contained a construction contingency of \$63.4 million. The MTA developed this figure to address risks for increases in costs such as unfavorable bid results, as well as unknown but anticipated risks associated with construction. It began producing a revised risk assessment report in December 2003. In light of further project development and the opening of construction bids from the second IFB, which allowed it to more accurately determine risk, the MTA lowered its construction contingency by \$21.8 million to \$41.6 million.

TABLE 4

**Budget Revisions for the Metropolitan Transportation Authority's Metro Gold Line Eastside Extension Project
(in Millions)**

	Before Budget Revision	After Budget Revision	Change
Construction contract	\$508.1	\$598.1*	\$90.0
Special conditions	54.9	19.8	(35.1)
Construction contingency	63.4	41.6	(21.8)
Right-of-way	53.0	35.8	(17.2)
Professional services	145.3	135.3	(10.0)
Other contingencies	24.0	18.1	(5.9)
Vehicles	31.7	31.7	0.0
Total project budget	\$880.4	\$880.4	\$ 0.0

Source: Project budget for the Metropolitan Transportation Authority's Metro Gold Line Eastside Extension Project.

* The revised budget for the tunneling and surface work is \$587.4 million. The remaining \$10.7 million is for a freeway bridge overcrossing contract advertised and administered by the California Department of Transportation and for ticket vending machines.

In addition, the MTA originally identified insurance costs for an owner-controlled insurance program within its special conditions budget of \$54.9 million. Because the insurance policy is now a contractor-controlled insurance program, the MTA reduced its insurance costs from \$43 million to \$12.9 million. It also had previously budgeted funds to cover the development of master cooperative agreements with the three jurisdictions the project must interface with—the city of Los Angeles, the county of Los Angeles, and the California Department of Transportation. The MTA has now executed all three agreements

and therefore reduced its special conditions costs from \$9.9 million to \$5.9 million. In addition, the MTA decreased its \$2 million budget for an art program by \$1 million, yielding a revised special conditions budget of \$19.8 million.

Further, the MTA reduced right-of-way costs and contingencies for its real estate acquisition plan. When it first budgeted for these areas, property acquisitions were in the initial phases. By January 2004, the majority of properties had been fully defined, certified, and in many cases, acquired. As a result, the MTA updated its real estate budget to reflect the actual costs of acquisitions to date and adjusted its contingency for the remaining properties. In addition, because an existing high school is located on a portion of the property needed for the construction project, the initial budget reflected the cost of environmental clearance, design, and construction of a new high school, and an interim facility to house students pending completion of the new school. After an extensive site selection process, the Los Angeles Unified School District decided to reconfigure the high school, reducing the effects of the project on the school. The MTA predicts these changes will result in decreased costs and accordingly decreased its right-of-way budget by \$17.2 million as well as its right-of-way contingency by \$4.9 million.

The MTA developed a plan to reduce its own administrative and overhead costs related to the project.

Finally, the MTA developed a plan to reduce its own administrative and overhead costs, which are included in the project's professional services budget. The plan includes deferral of new hires, reassignment of staff to other projects, streamlining of procedures, and consolidation of overlapping support areas. The MTA anticipates these changes will reduce costs by \$10 million. It used these and other savings to reduce its budgets for other project costs by \$90 million and to increase its overall construction budget by the same amount. As of March 2004, its new construction budget was \$587.4 million. As noted previously, the MTA received a final offer for base construction work of \$586.7 million, which now falls within the construction budget.

In April 2004, the MTA's chief executive officer approved the final offer for the construction contract. The total contract amount is \$600.4 million, including \$586.7 million for base construction work and \$13.7 million for provisional sums to cover specified additional work that may be necessary. On June 1, 2004, the federal government fully executed and approved a grant agreement that provides \$490.7 million. Total federal funding is expected to be \$524.1 million, or 59 percent,

of the project's \$880.4 million budget. The MTA then sent the notice of contract award to the low bidder. As of early June 2004, the MTA expected to authorize the contractor to begin work by the end of the month.

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: July 14, 2004

Staff: Karen L. McKenna, CPA, Audit Principal
Jim Sandberg-Larsen, CPA
Rob Hughes
Anissa Nachman
Randy Russell

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APPENDIX

The Metropolitan Transportation Authority Discloses Reserves for Incurred and Outstanding Liabilities in Accordance With Accounting Principles

The Los Angeles County Metropolitan Transportation Authority (MTA) properly disclosed its claims and judgments reserves and contingencies in accordance with generally accepted accounting principles for the last two fiscal years. Claims and judgments represent the liability for damages related to property or to the injury or death of an individual. The primary emphasis of risk management activities at the MTA is the prevention or minimization of these kinds of occurrences. Where losses cannot be prevented, the MTA endeavors to self-insure or to assume such losses as it deems advisable and economical, giving due consideration to the frequency and severity of probable losses. It determines the appropriate level of loss to be assumed on an annual basis as part of its financial planning process.

The MTA provides relevant data to PricewaterhouseCoopers LLP's Actuarial & Insurance Management Solutions Group, which in turn provides an estimate of the outstanding reserves needed to fund losses and liabilities of the MTA's self-insurance programs. The MTA reports claims and judgments reserves in its audited financial statements. External auditors' working papers and actuarial letters adequately support its claims and judgments reserves for fiscal years 2001–02 and 2002–03. As shown in Table A.1 on the following page, the MTA increases its beginning reserves for insured events occurring in the current fiscal year and for interest income generated by the reserves, and makes adjustments as needed in provisions for prior years to arrive at total incurred claims expense. The MTA then decreases this amount by payments for events occurring either in the current or prior fiscal years. The result is the reserve figure for unpaid claims at the end of the year. Table A.1 shows that reserves rose 17 percent, from \$199.4 million to \$233.6 million, between fiscal years 2001–02 and 2002–03. Much of the increase related to provisions for workers' compensation incidents occurring in fiscal year 2002–03.

TABLE A.1

Metropolitan Transportation Authority's Claims and Judgments Reserves
Fiscal Years Ended June 30, 2003 and 2002
(in Millions)

	Construction		Property and Casualty		Workers' Compensation		Totals	
	2002-03	2001-02	2002-03	2001-02	2002-03	2001-02	2002-03	2001-02
Unpaid claims and claim adjustment reserve—beginning of year	\$21.0	\$21.0	\$47.8	\$46.6	\$130.6	\$89.3	\$199.4	\$156.9
Provisions for insured events of the current fiscal year			26.9	24.9	47.9	50.7	74.8	75.6
Increase in provision for insured events of prior fiscal years	16.0						16.0	
Interest income			2.1	2.5	6.0	3.4	8.1	5.9
Total incurred claims and claims adjustment expense	37.0	21.0	76.8	74.0	184.5	143.4	298.3	238.4
Payments attributable to insured events of the current fiscal year						(4.0)		(4.0)
Payments attributable to insured events of prior fiscal years			(32.6)	(26.2)	(32.1)	(8.8)	(64.7)	(35.0)
Total unpaid claims and claim adjustment reserves—end of year	\$37.0	\$21.0	\$44.2	\$47.8	\$152.4	\$130.6	\$233.6	\$199.4

Source: Metropolitan Transportation Authority's fiscal year 2002–03 comprehensive annual financial report.

The MTA also discloses information on litigation and other contingencies in its audited financial statements. Generally accepted accounting principles require an entity to disclose a contingency if the loss is probable and can be reasonably estimated. For the last two fiscal years, the MTA has disclosed that, in the opinion of management, the resolution of pending lawsuits would not have a material adverse effect on the financial condition of the MTA. Its external auditors' work papers, including attorney confirmation letters and the MTA's management representation letters for fiscal years 2001–02 and 2002–03, adequately support its assertion that pending litigation would not have a material adverse effect on the MTA's overall financial condition.

Agency's comments provided as text only.

Los Angeles County Metropolitan Transportation Authority
One Gateway Plaza
Los Angeles, CA 90012-2952

June 29, 2004

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

Dear Ms. Howle:

Based on your audit report for the Joint Legislative Audit Committee (JLAC) there is no indication that the Los Angeles County Metropolitan Transportation Authority (MTA) litigation and audit practices jeopardize public transportation funds, increase procurement costs or adversely effect the viability of transportation projects in the Los Angeles region.

The primary objective of the JLAC's audit request to the MTA was to review the Agency's litigation and audit practices to determine their impact on procurement costs. The audit request stated that Senator Richard Alarcon believed that these practices might jeopardize public transportation funds and the viability of key transportation projects in the Los Angeles region. The Bureau of State Audits (BSA) did not conclude or comment on the audit objective in their report, but rather focused their efforts on providing "best practice" recommendations for legal case management.

Further, we believe that several of the legal case management audit findings reported by the BSA are not significant enough based on Generally Accepted Government Auditing Standards (GAGAS) to warrant a reportable item and should be omitted from the report. County Counsel has been very successful in the past at representing the MTA's best interests through effective case management and diligent review of outside legal costs. Their management techniques in case management, including yearly budgets and intensive daily oversight of outside counsel, are just as effective at mitigating risk as the BSA recommended task based billing, legal phase budgets and case plans.

Your performance audit report does not conform to GAGAS as set forth by the United States General Accounting Office (GAO). The California State Auditor is required by Section 8543 et seq. of the California Government Code to perform performance audits in accordance with GAGAS. The audit report only addresses the scope and methodology that the State Auditor used in its testing of the MTA. The following GAGAS requirements were not addressed by this report:

- Audit objective was not identified and included

* California State Auditor's comments begin on page 51.

- Conclusion of the audit findings as it pertains to the audit objective was not made
- Significance of the audit findings relative to the audit objectives are not stated

GAGAS specifically require the BSA to include these reporting and fieldwork criteria in performance reports. The exclusion of these reporting elements renders this report incomplete and it does not provide the report user the necessary information to understand the materiality of the audit findings.

In conclusion, the MTA is committed to providing an efficient and effective transportation system in a fiscally responsible manner. We believe our internal control practices sufficiently safeguard taxpayer resources. We appreciate the opportunity to review and respond to the BSA's audit report regarding the MTA.

Respectfully,

(Signed by: Richard D. Brumbaugh)

Richard D. Brumbaugh
Chief Financial Officer

COMMENTS

California State Auditor's Comments on the Response From the Los Angeles County Metropolitan Transportation Authority

To provide clarity and perspective, we are commenting on the response to our audit report from the Los Angeles County Metropolitan Transportation Authority (MTA). The numbers below correspond to the numbers we placed in the margin of the MTA's response.

- The MTA has confused the audit request with the audit objectives approved by the Joint Legislative Audit Committee (audit committee). In preparation for hearings of the audit committee, the state auditor prepares an analysis of each audit request, including the objectives to be accomplished, the scope, and the cost of the audit. This analysis of the audit request is distributed to all audit committee members for their review when considering whether to approve the audit request. Furthermore, when the audit committee votes to approve an audit request it is approving the objectives, scope, and cost as outlined in the state auditor's analysis of the audit request. This document was provided to the MTA to ensure that it clearly knew the objectives and scope of the audit. As outlined in the Scope and Methodology section of the audit report beginning on page 9, we describe the audit objectives approved by the audit committee and the steps taken to address each of them.
- The report presents tools for managing outside counsel that are recommended in the literature of the legal industry and by the Public Contract Code. It is a significant finding that these tools, which are generally included in the contract provisions for the MTA's outside counsel, are not used by the MTA. By dismissing our audit recommendations, the MTA is passing up an opportunity to improve its oversight of outside counsel.
- Because the MTA has mistaken the audit request for the committee-approved audit objectives, it has also erroneously concluded that our report does not meet generally accepted government auditing standards. In fact, our report fully complies with generally accepted government auditing

standards. We have identified each of the objectives approved by the audit committee in the Scope and Methodology section of this report. In our report, we have also addressed and concluded on each of the audit objectives. Further, in keeping with generally accepted government auditing standards, we have provided the MTA's perspective and presented adequate context to help the reader understand the findings and the significance of the issues discussed.

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