

# PERFORMANCE AUDIT

## Procurement of Outside Legal Services & Legal Counsel

### **Five-Year Citywide Review**

**AU15-04**

Office of the City Manager  
Internal Audit Division  
Cheryl Johannes, Internal Audit Manager

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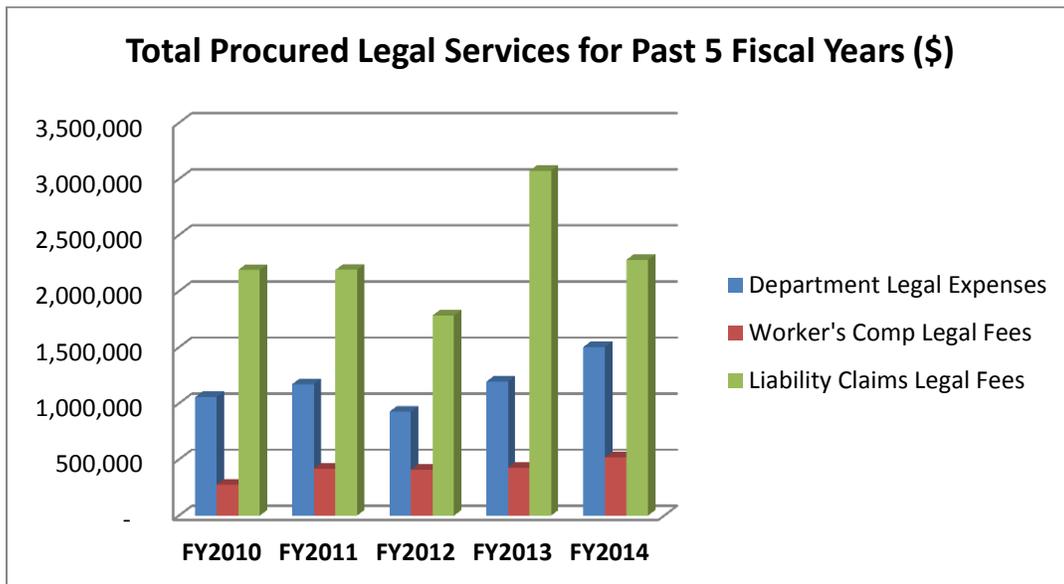
## OBJECTIVE, SCOPE and METHODOLOGY

At the request and direction of the Governmental Affairs Committee on March 4, 2015, we have conducted an audit of outside legal services and counsel procured by the various City departments. The objective of the audit was to provide a comprehensive report of legal services expenditures, as well as ensure that departments are adhering to City procurement policies and procedures.

Our audit focused on legal service and counsel procurement practices and expenditures for the fiscal years 2010 through 2014 (July 1, 2009 – June 30, 2014). To meet our objectives, we queried and extracted data and records from various internal sources/databases. We reviewed procurement processes for compliance to City policy. No information was omitted from this report because it was deemed privileged or confidential.

## SUMMARY

Based on our review, \$19.4 million has been spent by the City over the past five (5) fiscal years for outside/external legal fees and services. The majority of expenditures (\$11.5 million in total) were due to the City's ongoing practice of contracting with legal firms for defense of high-risk lawsuits and liability claims.

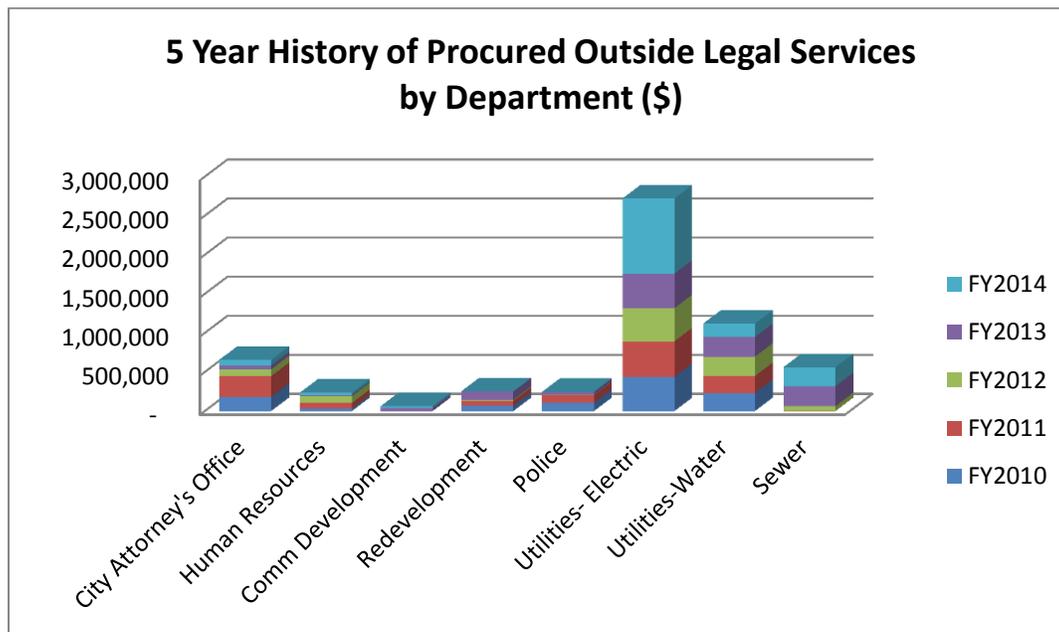


## BACKGROUND

Legal services are needed to ensure that actions are legal and enforceable; to assess and reduce the risks from actions that are contemplated; and to obtain timely advice on issues as they arise. Riverside City Attorney's Office (CAO) provides legal advice and litigation services; related costs are absorbed by the various departments. Like other cities and counties, the CAO hires outside legal service providers and legal counsel to handle legal-related work when subject-matter expertise is needed or when a particular matter

(case) requires knowledge from resources (personnel) not available internally. <sup>1</sup> City Departments may choose to use outside legal service providers for a variety of purposes and absorb the costs directly.

The chart below reflects amounts paid to outside legal service providers, by department, over the past five fiscal years. **Five-year expenditures totaled \$5.9 million.**<sup>2</sup>



	FY2010	FY2011	FY2012	FY2013	FY2014	TOTAL
City Attorney's Office	182,374	264,533	87,052	51,880	67,583	653,422
Human Resources	31,001	72,249	86,232	14,033	31,373	234,888
Comm Development	-	-	-	38,261	24,333	62,594
Redevelopment	68,330	63,002	13,084	104,984	3,891	253,291
Police	106,017	97,402	5,148	36,711	495	245,773
Utilities- Electric	436,080	456,052	425,202	441,695	961,873	2,720,902
Utilities-Water	232,098	216,616	248,196	251,704	169,559	1,118,173
Sewer	-	2,162	61,144	255,467	243,633	562,406

Following is a brief summary description of each Department's utilization of outside legal services/service providers. A list of legal service providers and total amount paid for the period in review (July 2009 through June 2014) can be found in APPENDIX A.<sup>3</sup>

### City Attorney's Office (CAO)

#### Municipal Services

<sup>1</sup> Municipal and litigation services are charged directly to the departments and *not* recorded in the City Attorney's operating expense budget.

<sup>2</sup> This total *excludes* Worker's Compensation legal and litigation fees and Liability Claims legal fees, which totaled an additional \$13.6 million over the past five fiscal years.

<sup>3</sup> In some instances, legal services may have been procured and recorded on the City's records as Professional Services and not specifically as "outside legal services" or "legal fees" and therefore not included in the analysis.

The City's legal department provides advisory services to all departments as well as to the Mayor and City Council. These legal services address the full spectrum of municipal affairs, such as drafting contracts, providing advice on labor and employment matters, CEQA and land use, advice regarding finance, constitutional law, etc. When the attorney's assigned to the various departments (as legal liaisons) are unable to provide expertise on a subject matter, they utilize one of the City Council approved panel of law firms to seek assistance. Generally, the cost of this service is charged back to the related department. In certain instances, when timely information is needed from an outside legal source and is not department-specific, the City Attorney's Office absorbs the cost directly as an "unspecified outside counsel cost."

During the period of our review, the CAO expended \$653K in legal outside counsel costs. The majority of "unspecified outside counsel costs" were with the legal firm of Chatten-Brown, who represented the City on port and rail shipment litigation. Other expenditures were related to general Proposition 218 inquiries and land use inquiries. We did note in our review of transactions that certain expenses from outside legal service providers should have been charged directly to City departments and not absorbed by the CAO.

### Litigation Services

A Supervising Deputy Attorney (vacant) and five additional attorneys in the CAO are litigators, who defend the City's interest in claims and lawsuits filed against or on behalf of the City, its officers, employees and agencies. Lawsuits are litigated in the county, state and federal trial and appellate courts. Examples include high-value personal injury cases, personnel disputes, breach of contract, etc. Litigators take a strategic approach to manage liability and limit the city's financial exposure. The litigation attorneys in the CAO often utilize outside law firms as defense counsel. The defense counsel for each case is selected from the approved panel of law firms. The City Council approves legal strategy of cases in closed sessions.

Related legal costs for litigated claims/lawsuits (cases) are absorbed by the subject-matter department and/or the Liability Trust fund.

### **Human Resources (HR)**

The majority of legal outside services were related to employment relations matters, including representation in negotiations of bargaining agreements. Other expenditures were related to contesting unemployment claims, and conducting personnel investigations.

### **Community and Economic Development & Redevelopment (Successor Agency)**

The Department has sourced for legal services related to the California Environmental Quality Act (CEQA) as well as sign and land use. Redevelopment absorbed the cost of obtaining legal services to the Oversight Board on issues related to the California Community Redevelopment Law and the dissolution of redevelopment. Other expenditures were related to affordable housing projects.

### **Police**

The majority of outside legal service expenditures were related to consulting and representational services pertaining to employment and employee relations matters.

### **Public Utilities**

Costs for advice/consulting on specialized legal issues related to the construction of the Riverside Energy Resource Center (for electric power supply operations) as well as advice on legislative issues make up the majority of legal expenditures for the Electric Division. The litigation costs related to Southern California

Edison’s (SCE) closing/decommissioning of the San Onofre Nuclear Generating Station (SONGS) is also reflected in the department/division expenditures.<sup>4</sup>

The majority of outside legal fees for the Water operations are related to the lawsuit settlement in the 1990s regarding groundwater contamination. The City retained the firm of Sher-Miller (now Miller Axline Sawyer) to manage the 40-year term settlement; in exchange the law firm receives a large (30-40%) portion of settlement revenues from the defendants as funds are received by the City.

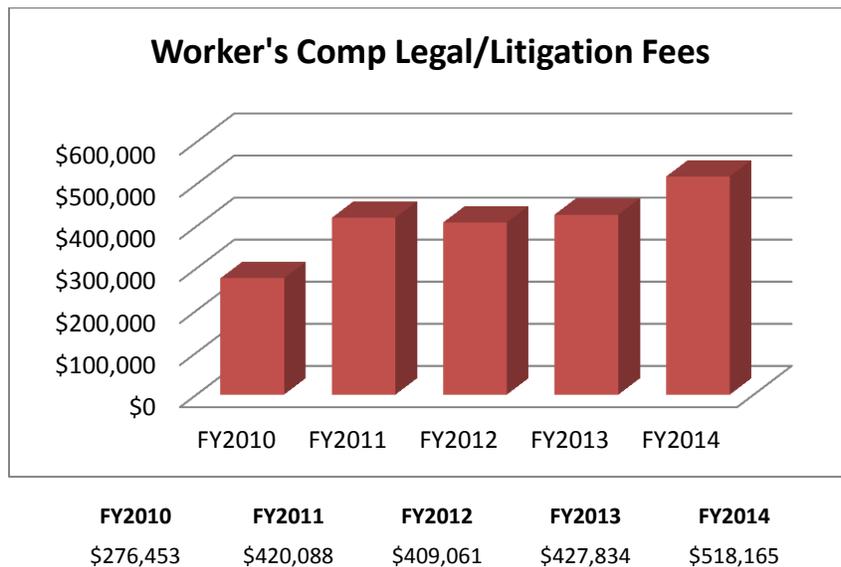
**Public Works – Sewer**

Over the past years, outside legal counsel has been retained for legal expert advice regarding construction projects related to a pump station, the Regional Water Quality Control Plant expansion project, and representation in disputes related to water treatment and sewage disposal.

**Worker’s Compensation Claims**

The City of Riverside is a self-insured employer, and administers its worker’s compensation claims in-house rather than contract with a third party administrator. As such, the City is responsible for paying all of the approved worker’s compensation claims and related administrative expenses, such as legal costs.

The City has an excess worker’s compensation policy with Safety National. Worker’s compensation insurance coverage has a limit of \$25 million with a self-insured retention of \$3 million per occurrence. The purchased policy protects the City financially in the event of a catastrophic worker’s compensation loss. An employee has the right to challenge a denied claim in court. Legal services and litigation fees are recorded as expenditures in the Worker’s Comp Trust Fund. **Total Worker’s Comp legal fees for the five year period in review totaled \$2 million.**



**Personal and General Liability Claims**

The City is exposed to various risks of loss related to torts<sup>5</sup>; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Riverside Municipal Code Chapter 1.05 and 1.06 govern the City of Riverside’s authority and review of all claims filed against the City. A self-

<sup>4</sup> The City reached a settlement agreement of over \$1M with SCE in April 2015 for recovery of legal costs.

<sup>5</sup> A tort is a civil wrong (grounds for a lawsuit) due to alleged negligence.

insured retention limit of \$3 million has been established for Auto and General Liability Claims. The Risk Management Division is also responsible for the procurement and administration of commercially purchased insurance, in the amount of \$20 million, for all other applicable City exposures.

Claims against the City are filed with the City Clerk’s Office using a City of Riverside claim form; a copy is forwarded to the City Attorney’s Office (CAO) and Risk Management Division.<sup>6</sup> The City of Riverside has contracted with a Third Party Administrator (TPA), Carl Warren & Company, to manage the liability claims process with direct guidance from litigation attorneys in the CAO. Each claim filed against the City is unique and the amount of time that is taken to resolve a claim is dependent on several factors, including but not limited to the nature and type of damage.

The City has established various levels of approval for the settlement of all payments for liability claims.

**Levels of Approval**

Risk Manager/TPA (Carl Warren & Company) <sup>(1)</sup>	\$ 5,000 or less
Risk Manager/City Attorney’s Office	\$ 5,001 - \$ 14,999
City Manager’s Office/Finance Director <sup>(2)</sup>	\$ 15,000 - \$ 24,999
City Council	\$ 25,000 or more

- (1) On behalf of the Risk Manager, the TPA is given the approval to negotiate claims in the amount of \$5,000 or less.  
 (2) On behalf of the City Manager, the Finance Director can approve the settlement of claims in the amount of \$15,000 - \$24,999

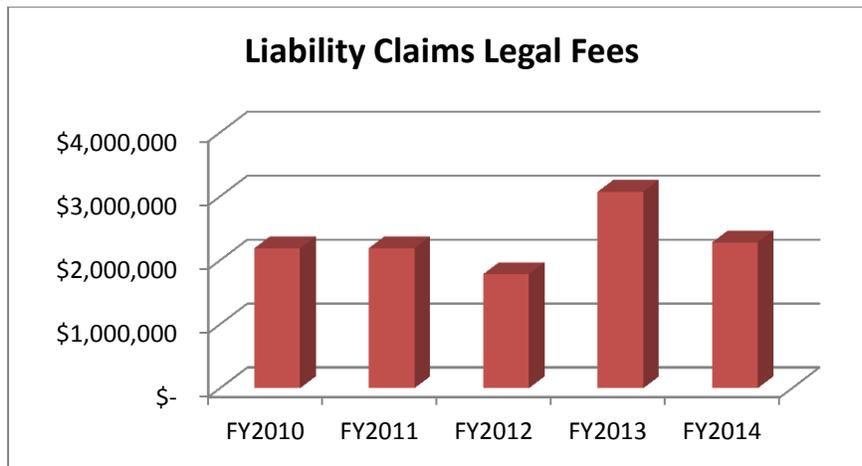
As of June 30, 2014, 11,572 liability claims in total filed against the City have been closed at a cost of \$65 million. Refer to the chart below. As of June 30, 2014 there were 489 open liability claims (refer to APPENDIX D).

Dollar Range of Claim	Claim Count	Total Incurred
\$1,000,001 or more	8	\$12,127,874.27
\$500,001 - 1,000,000	10	\$7,034,825.28
\$100,001 - 500,000	80	\$18,899,306.20
\$25,001 - 100,000	150	\$7,399,339.19
\$15,001 - 25,000	126	\$2,553,162.30
\$5,001 - 15,000	1,037	\$8,990,628.74
\$5,000 or less	5,535	\$8,086,142.65
\$0 (No amount paid)	4,626	-
<b>Total</b>	<b>11,572</b>	<b>\$65,091,278.63</b>

Source: Carl Warren & Company

All payments related to claims are paid via the City’s Accounts Payable process and recorded in the City’s financial system. The majority of legal fees are for defense attorneys assigned to litigate complex cases on behalf of the City. **Legal fees for liability claims for the past five fiscal years totaled \$11.5 million.**

<sup>6</sup> Per [California Government Code Section 911.2](#), a claimant has six months from the date of occurrence of the event to file a claim. If the date of filing the claim is later than six months after the occurrence, the claim is considered to be a late claim and different procedures apply.



FY2010	FY2011	FY2012	FY2013	FY2014
\$2,189,572	\$2,189,731	\$1,783,852	\$3,072,984	\$2,279,581

## ASSESSMENT and RECOMMENDATIONS

There are risks to be considered when procuring outside legal services, such as:

- Over-charging
- Actual or potential conflicts of interest
- Failure to provide timely services
- Not familiar with current regulatory laws and practices
- Failure to observe confidentiality
- Inconsistent legal advice
- Perception of favoritism

It is critical that all department managers and staff follow City policies and procedures to ensure financial costs and related risks are minimized.

The CAO has recently adopted new procedures<sup>7</sup> to ensure outside legal services have the appropriate retainer agreements and letters of engagement on file in-house and with the City Clerk. On April 1, 2015, the City Council approved a panel<sup>8</sup> of law firms to retain on an as-need basis. The CAO should:

- ***Evaluate the performance of the outside legal services selected at the conclusion of each contract/case; and***
- ***Effectiveness measures should be developed and targets identified to provide external accountability for legal services, as well as internal decision-making information about the allocation of resources and strategic approach to legal matters.***

### Enforcement of Procurement Policies

During the course of our review, we identified exceptions to the City's procurement policies, including lack of documentation to support selection of a legal service provider (vendor); lack of a competitive procedure; lack of a current, executed contract/agreement to support scope of work/services, billing rates and invoices.

<sup>7</sup> Refer to APPENDIX B

<sup>8</sup> Refer to APPENDIX C

To improve internal controls Citywide and ensure compliance with City administrative policy:

- I. ***All departments should be required to follow the City's competitive selection process<sup>9</sup> when procuring legal service providers, to avoid favoritism or the appearance of favoritism, which can erode public confidence in the integrity and fairness of the City/department. Competitive procedures help to ensure that quality service is obtained at a reasonable price without the fact or appearance of favoritism. Selection procedures could range from formal to informal, depending on the cost of service and professional skills of potential legal service providers.***
- II. ***All departments should be required to execute a written and signed contract/agreement with outside legal service providers.<sup>10</sup> Contracts/agreements should include basic provisions - the basis of payment, scope and duration of the engagement/service, maximum budget or billing amount; be approved by the CAO; signed copies retained by the originating department, Purchasing and the City Clerk.***
- III. ***Purchasing should consider assigning a specific identifier to each executed contract/agreement, including Professional Services Contractual Agreements (PSAs), to include not-to-exceed (NTE) amount and term (start and end) dates.***

### **Monitoring of Contracts/Agreements**

Contract monitoring is an integral component of internal controls. Our review of invoice payments to various legal service providers identified internal monitoring weaknesses. Expenses/invoices were approved for payment without ensuring there was a current agreement on file to support the invoices.

***Before departments enter invoices in the City's financial system for payment or forward invoices to Finance/Accounting, they should verify there is an active contract/agreement on file and that the invoice does not exceed the terms of the agreement.***

***When Finance/Accounting receives legal service provider invoices for processing, accounting staff should verify there is an active contract/agreement on file, and that the invoice does not exceed the terms of the agreement. Invoices should not be processed for payment if there is 1) no agreement on file, and/or 2) payment results in terms being exceeded.***

This report, in draft, was provided to the City Attorney and the Finance Director for review. Their comments have been considered in the preparation of this final report. We believe implementation of the above recommendations will promote transparency, increase oversight and provide assurances to taxpayers that their monies are being appropriately spent.

-Cheryl Johannes, Internal Audit Manager

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<sup>9</sup> Refer to Administrative Manual section 07.015

<sup>10</sup> For approval/signing authority, refer to Admin Manual sections 2.004 and 2.005

## AUDITING STANDARDS

Our review was conducted in accordance with the *Standards for the Professional Practice of Internal Auditing* of the Institute of Internal Auditors. Those standards require that the audit is planned and performed to afford a reasonable basis for judgments and conclusions regarding the department, Division, program, activity or function under review. An audit also includes assessments of applicable internal controls and compliance with requirements of laws and regulations when necessary to satisfy the audit objectives. We believe our audit provides a reasonable basis for our conclusions.

## APPENDIX A

The following chart lists outside legal service providers for the period of July 2009 through June 2014, whose total 5-year expenditures exceeded \$100K.

Outside Legal Service Provider	5-Year History of Expenditures (\$)	Services Provided
BEST BEST & KRIEGER	4,168,388	Various legal services
GREINES MARTIN	2,331,559	Appellate expertise
THOMPSON COBURN	2,287,532	Federal Energy Regulatory Commission (FERC) expertise
GIBBS GIDEN LOCHER & TURNER	1,597,101	Construction and public works expertise
LIEBERT CASSIDY WHITMORE	1,363,605	Employment and labor expertise
ARENT FOX LLP	1,227,666	Utilities regulations expertise
LEWIS BRISBOIS BISGAARD & SMITH	712,365	Negligence and liability (torts) expertise
GREENBERG TRAUIG	675,003	Public liability litigation expertise
ORROCK POPKA FORTINO & BRISLIN	487,169	Accident and property damage expertise
BURKE WILLIAMS & SORENSEN LLP	441,169	Public law expertise
CHATTEN-BROWN & CARSTENS	424,940	Land use expertise
ROTH CARNEY KNUDSEN LLP	358,961	Employment and labor relations services
HAWKINS DELAFIELD & WOOD LLP	268,074	Bond counsel
CALLOPY INVESTIGATIONS	230,666	Investigations and process server
LAW OFFICE of BRENDA DIEDERICHS	179,125	Employee relations expertise
SMITH LAW OFFICES APC	134,292	Tort litigation
GRESHAM SAVAGE NOLAN & TILDEN	119,480	Legal services to Oversight Board - Successor Agency
ENERGY MANAGEMENT LLC	104,807	SONGS decommission expertise

## **APPENDIX B**

**Approved by the Governmental Affairs Committee  
April 1, 2015**

### **Policy for Retention of Outside Counsel**

1. The City Attorney shall create a panel consisting of attorneys and firms who can provide advice and counsel on various matters and to assist with litigation either initiated by or against the City.
2. The panel shall be approved by the City Council every three (3) years.
3. Each firm/attorney on the panel shall execute a retainer agreement approved by the City Attorney. The retainer agreement shall be for an initial period of three (3) Years.
4. The hourly rate shall be for the term of the agreement and shall be the most favorable rate available.
5. The City Attorney can retain outside attorney/firm from the panel on an as needed basis, and based on their expertise.
6. All outside counsel retained will provide a letter of engagement, which will include an estimated budget for both litigation and non-litigation matters and projects.
7. Engagement letters will be signed by the City Attorney and transmitted to the City Clerk as a public record. The City Attorney has \$25,000 authority limit for the retention of outside counsel. Anything over \$25,000 requires City Council approval.
8. Upon receipt of monthly billing, the City Attorney will review to ensure all charges are reasonable and necessary.
9. The City Council shall be informed when outside counsel is retained in all litigation matters.
10. The City Attorney will provide quarterly reports to the City Council with the attorneys/firms retained, the project/litigation, the initial budget, costs incurred for that quarter and the total costs incurred to date.
11. Any firm not on the panel requires City Council approval.

## **APPENDIX C**

### **Approved April 1, 2015 PANEL OF OUTSIDE COUNSEL**

1. Best Best & Krieger - Various municipal matters
2. Burke Williams & Sorensen - Various municipal matters
3. Liebert Cassidy Whitmore - HR and employment and RPD personnel
4. Manning & Kass - General litigation
5. Orrock Popka Fortino - Tort litigation
6. Greines Martin Stein & Richland - Appellate
7. Lewis Brisbois Bisgaard & Smith - Police, civil rights and tort litigation
8. Smith Law Offices - Police, employment, tort litigation
9. Gibbs Giden Lochner Turner & Senet - Construction, public works
10. Sabine & Morrison - Sign code
11. Sohagi Law Group - CEQA and land use
12. Jones Hall - Public Utilities, water and electric refinancing
13. Leibold McClendon & Mann - Housing
14. Thompson Coburn - FERC
15. Miller Axline & Sawyer - Public Utilities matters
16. Michael Colantuono - Prop 218, general matters
17. Silver and Wright – Receiverships

## APPENDIX D

### Open/outstanding liability claims as of June 30, 2014

Dollar amounts noted in each column are estimated costs per the claims adjuster, Carl Warren & Company

	Claim Count	Net Reserve Loss	Net Reserve Expense	Net Payment Loss	Net Payment Expense	Total Incurred
ADMINISTRATION	2	\$25,000.00	\$56,342.87	\$0.00	\$485,778.69	\$567,121.56
ADMINISTRATIVE SERVICES	2	\$10,500.00	\$10,000.00	\$0.00	\$0.00	\$20,500.00
BUILDING SERVICES	2	\$40,000.00	\$43,033.12	\$0.00	\$31,966.88	\$115,000.00
CITY ATTORNEY'S OFFICE	1	\$10,000.00	\$175,313.81	\$0.00	\$824,686.26	\$1,010,000.07
CODE COMPLIANCE/WEEK ABATAMENT	12	\$34,700.00	\$141,049.85	\$0.00	\$34,040.15	\$209,790.00
DEVELOPMENT	1	\$15,000.00	\$48,684.00	\$0.00	\$1,316.00	\$65,000.00
ELECTRIC SERVICES	24	\$142,644.67	\$100,229.50	\$0.00	\$9,845.50	\$252,719.67
FINANCE	1	\$100.00	\$0.00	\$0.00	\$0.00	\$100.00
FIRE	4	\$16,700.00	\$0.00	\$0.00	\$0.00	\$16,700.00
GENERAL GOVERNMENT	2	\$600.00	\$0.00	\$0.00	\$0.00	\$600.00
GENERAL INVESTIGATIONS	1	\$100.00	\$0.00	\$0.00	\$0.00	\$100.00
PARKS	3	\$3,507.00	\$0.00	\$0.00	\$0.00	\$3,507.00
PARKS & RECREATION ADMIN	1	\$10,000.00	\$10,000.00	\$0.00	\$0.00	\$20,000.00
PARKS & RECREATION TRANSPORT	8	\$17,858.72	\$18,353.70	\$0.00	\$1,646.30	\$37,858.72
PLANNING	1	\$100,000.00	\$0.00	\$0.00	\$0.00	\$100,000.00
POLICE (GENERAL)	75	\$1,402,542.37	\$1,007,210.82	\$266,282.95	\$1,789,499.58	\$4,465,535.72
PROPERTY SERVICES	1	\$0.00	\$54,667.49	\$240,000.00	\$270,332.51	\$565,000.00
PUBLIC PARKING	1	\$500.00	\$0.00	\$638.33	\$0.00	\$1,138.33
PUBLIC WORKS	43	\$162,125.59	\$6,838.76	\$2,308.24	\$661.24	\$171,933.83
REFUSE COLLECTION SERVICES	8	\$8,725.08	\$10,000.00	\$0.00	\$0.00	\$18,725.08
SEWAGE SYSTEMS SERVICES	17	\$763,811.00	\$5,000.00	\$986.73	\$0.00	\$769,797.73
STREET MAINTENANCE/ST SWEEPING	73	\$446,137.23	\$264,108.01	\$25,000.00	\$137,966.99	\$873,212.23
STREET TREES	2	\$14,340.00	\$1,500.00	\$0.00	\$0.00	\$15,840.00
STREET TREES - SEWER ACTIONS	84	\$219,157.52	\$0.00	\$8,654.65	\$0.00	\$227,812.17
STREET TREES - TREE LIMB/BRANCH	30	\$86,408.52	\$0.00	\$0.00	\$0.00	\$86,408.52
STREET TREES - WATER LINE ACTIONS	8	\$18,851.00	\$0.00	\$0.00	\$0.00	\$18,851.00
STREET TREES - YARD ACTIONS	13	\$33,964.00	\$0.00	\$0.00	\$0.00	\$33,964.00
STREET TREES- CONCRETE DAMAGE ACTIONS	41	\$233,999.00	\$0.00	\$0.00	\$0.00	\$233,999.00
TRAFFIC ENGINEERING	4	\$10,000.00	\$60,548.91	\$75,000.00	\$439,451.09	\$585,000.00
UNDER REVIEW	1	\$7.00	\$0.00	\$0.00	\$0.00	\$7.00
WATER SERVICES	23	\$47,025.00	\$17,238.93	\$50,000.00	\$4,838.87	\$119,102.80
	<b>489</b>	<b>\$3,874,303.70</b>	<b>\$2,030,119.77</b>	<b>\$668,870.90</b>	<b>\$4,032,030.06</b>	<b>\$10,605,324.43</b>

Reserve Loss - Additional amount set aside to be paid out for settlement of the claim.  
Reserve Expense – Estimated amount set aside to be paid out for anticipated expenses.  
Payment Loss – Settlements that have been paid out.  
Payment Expense – All expenses related to the claim (Attorney fees, investigations, etc.).