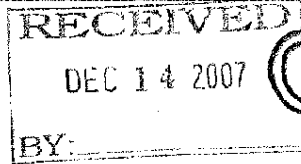


EDMUND G. BROWN JR.  
Attorney General

State of California  
DEPARTMENT OF JUSTICE



COPY

110 WEST A STREET, SUITE 1100  
SAN DIEGO, CA 92101  
P.O. BOX 85266  
SAN DIEGO, CA 92186-5266  
Public: (619) 645-2001  
Telephone: (619) 645-2275  
Facsimile: (619) 645-2319  
E-Mail: Gary.Schons@doj.ca.gov

December 12, 2007

Honorable Jerry Sanders  
Mayor, City of San Diego  
202 "C" Street, 11th Floor  
San Diego, California 92101

Honorable Scott Peters  
President, City Council  
City of San Diego  
202 "C" Street, 10th Floor  
San Diego, California 92101

Honorable Michael Aguirre  
City Attorney, City of San Diego  
1200 Third Avenue, Suite 1200  
San Diego, California 92101

RE: Investigation of Possible Criminal Activity in Connection with the Billing Practices of the San Diego City Attorney's Office

Dear Mayor Sanders, Council President Peters, and City Attorney Aguirre:

We have completed our investigation into possible criminal violations concerning past billing practices of the city attorney's office. Based on the extensive evidence that we have reviewed, and other considerations discussed below, we conclude that no criminal charges should be filed.

This matter began on December 6, 2004, when then-Deputy City Attorney William Newsome complained about certain billing practices of the San Diego City Attorney's Office to each of the prosecution offices located in San Diego, the San Diego County Grand Jury, and the San Diego City Ethics Commission. After a July 21, 2006 Union Tribune editorial questioned these billing practices, City Attorney Michael Aguirre immediately commenced a criminal investigation into them. This office took over the investigation on July 31, 2006, because the city attorney lacked jurisdiction to investigate possible felony violations and the district attorney declared a conflict because former City Attorney Gwinn was then employed by her office. The

United States Attorney's Office declined to become involved.

Over the next several months, pursuant to our requests, and with the full cooperation of the city attorney's office, including the invaluable assistance of City Attorney Principal Investigator Dan Andrews, we collected, numbered, indexed, and reviewed 11,906 pages of documents from the city attorney's office and approximately 15 other city departments. The various reports, memoranda of understanding (MOUs), e-mails, and other documents dealt with the city attorney and other departments' billing practices over the last 20 years, primarily concerning the payment for legal services by the use of "enterprise funds." Enterprise funds are generated from consumer user fees to pay for services by a specific department, such as the City Water Department and the Metropolitan Waste Water Department.

#### **A. FACTUAL BACKGROUND—OVERVIEW OF MOUs AND BILLING PRACTICES**

As far back as 1987, the city attorney's office entered into agreements/understandings with certain departments to render legal services to be funded by the respective departments. By 1996 there had been a significant increase in the use of these types of MOUs, also known as Service Level Agreements (SLAs). In Fiscal Year (FY) 1996, the city attorney's office provided legal services to eight city departments, paid by enterprise funds, totaling \$2,091,000, based on SLAs or MOUs. ("Enterprise funds" are contrasted to "general funds" (derived from non-"earmarked" tax revenue), which fund the bulk of the budgets of general fund departments, such as the budget of the city attorney's office.)

In 1996, there is evidence of a change in the city attorney's office billing protocol for SLA enterprise-funded departments. The hourly billing by investigators, paralegals, secretarial staff, and to a large extent, attorneys, began to be based on projected time to be spent on services as predicted or contracted for in the SLAs, and not actual time. This change occurred under City Attorney John Witt's tenure. Casey Gwinn became city attorney in late 1996, remaining in office until late 2004, when Michael Aguirre took over.

By FY 2001, nineteen SLAs accounted for 25% (\$7,289,939) of the city attorney's budget. Of that amount, \$6,842,431 was derived from Enterprise Funds or Block Grants, and only \$447,507 was derived from General Fund SLAs.

In late 2004, then Deputy City Attorney Newsome brought the enterprise funding billing practices to the attention of various public agencies. Newsome essentially complained that the city attorney's office was falsifying billing records, including time sheets, and billing for services not performed under the various SLAs. In December 2004, newly elected City Attorney Aguirre commenced an internal inquiry into Newsome's allegations. On December 21, 2004, Chief

Investigator Abel sent an e-mail to a city attorney billing analyst confirming that only actual hours would be billed, and on January 3, 2005, sent an e-mail to his investigative staff to that effect.

However, it appears that not all of the clerical staff and attorneys immediately changed from projected time billing to actual time billing. One city attorney unit, the Civil Enforcement Unit (CEU), continued to bill pursuant to pre-determined hours through mid 2006. In mid 2006, the city attorney returned all monies billed by the unit to the enterprise fund departments for FY 06 via a journal voucher. CEU was funded primarily by enterprise funds (84%), with the total funding coming from five different departments in varying amounts.

In 2006, the San Diego County Grand Jury and various city agencies published reports examining the city-wide abuse of enterprise funds through SLAs and noted, among other things, the lack of monitoring, controls, and accountability. The various reports severely criticized the enterprise fund SLA practices of numerous departments, including the city attorney's office. San Diego City Mayor Sanders established a task force and implemented numerous reforms, primarily based on report recommendations.

## B. ANALYSIS OF BILLING ABUSES

In our opinion, there are several contributing reasons for abuses by the city attorney's office in connection with enterprise fund-related billing. These include: (1) an antiquated city-wide hourly billing system, which made it impossible to accurately reflect actual hours expended by city attorney staff on services under the SLAs; (2) enterprise funds, and to a lesser extent, other sources of funds (e.g., block grants), which provided a means for numerous general fund departments to tap into much needed non-general fund resources; and, (3) a number of "budget crises" over the years, which fueled and exacerbated the billing abuses at the city attorney's office, and most likely other departments, because certain general fund city departments had become dependent on enterprise fund monies for staffing when adequate staffing could not be attained through general fund appropriations. However, there is no evidence that anyone in the city attorney's office derived any "personal benefit" from the SLA billing practices.

The time billing protocol for the City of San Diego, and the manner in which the reimbursement provisions of the City Attorney SLAs were drafted, mandated inaccurate billing and reimbursement. The city attorney used average salary figures for categories of employees (e.g., attorneys, investigators) to establish the respective job category reimbursements under the SLAs. The average salary cost was adjusted by various factors, such as anticipated continued seasonal/pool (hourly) assistance, actual and anticipated turnover, furloughs when applicable, anticipated merit increases, and other personnel adjustments. The SLAs were entered into prior

to the particular FY, with the total reimbursement based on the hypothetical average salaries and overhead figure (usually a low estimate) for a specified number of unnamed employees in each employee category. These employees were expected, over the next FY, to be dedicated to the particular department's need for legal services. The number of attorneys or other staff could be designated in less than full increments (e.g., five attorneys was common in the SLAs), and on occasion, the fragmentation devolved to unmanageable depths, such as .05 attorneys for FYs 2002-2004 under the Financial Services Department SLA, and .053 attorneys for the San Diego Geographic Information Systems SLA for FY 2002.

The city hourly billing system appears to have been set up to capture only whether an employee worked an eight hour day, was on vacation, sick leave, etc., for purposes of an employee's paycheck. The system was not suitable for the purpose, nor did it function well, as a direct payment reimbursement tool to "bill" for or account for services to justify the transfer of enterprise funds under SLAs from the various departments to the city attorney's office. The billing system allowed an employee to bill only eight hours a day--no overtime billing was possible. Further, sick leave, vacations, and furloughs incurred by a "dedicated" employee had to be absorbed by the city attorney's office from general funds under a specified set of codes. Additionally, although positions dependent on SLAs were already "budgeted" for an upcoming FY, the city attorney obtained funds for such positions only through billing time directly to the enterprise funded departments and the transfer of funds from those departments to the city attorney's budget. If there was not sufficient billing under the SLA to support the position, the city attorney was required to make up the deficit from general funds in his budget. This situation could result in the city attorney's office operating in the "red" and having to recoup such funds at the end of the FY by means of a general fund adjustment, approved by the city council. Thus, in a situation where a staff member designated in an SLA to provide services to a particular enterprise fund department left the office, and there was no replacement available, the city attorney automatically operated in the "red" (could not bill) as to that SLA position. Even when other "non-designated" attorneys worked overtime to cover work specified by an SLA, the billing system did not recognize anything beyond an eight hour day, and as a consequence the city attorney's office was still operating in the "red." Various e-mails and memoranda document billing problems, such as, no overtime, vacations, mandatory furloughs, dedicated attorneys leaving the city attorney's employ, etc.

As time went on, and in large part because of the above problems, the city attorney's office's analysts calculated pre-ordained "billable" hours for "dedicated" employees under the SLAs to ensure that the city attorney would be fully reimbursed under the agreements. The pre-arranged billing hours would often be adjusted during the fiscal year to remain on track with reimbursement targets. Interoffice e-mails made it clear that employees were to bill the pre-arranged hours, irrespective of the actual hours the employee worked on the SLA job project.

Honorable Jerry Sanders

December 11, 2007

Page 5

A city attorney's outline for a January 25, 2003 presentation to department directors acknowledged that SLAs subsidized other services, that problems in billing were caused by the ebb and flow of work, employee tenure, and the need to develop expertise, and, that even if an attorney did not work 100% of his time on the dedicated project, it was to everyone's benefit to "share" attorneys. It concluded that department directors ought to view the SLAs as Retainers for Services. The point was made that if legal services were out-sourced to private attorneys, it would be at a significantly higher cost to the respective departments. It is clear, then, that these departments were aware of the shortcomings in the billing protocols and practices under the SLAs and did not require reforms. The city attorney's office has, as late as April 2006, continued to contend that the SLA billing protocol was a "retainer-like" arrangement.

The documentation clearly supports the conclusion that the city attorney billing protocols and inaccuracies were not a "secret." In interviews and a July 26, 2006 e-mail by a high ranking deputy city attorney, it is represented that former City Attorney Gwinn publically acknowledged, on various occasions, the shortcomings in the city attorney's office's billing system and that former City Auditor Ed Ryan and Mr. Gwinn had an agreement as to these billing practices.

Other examples abound. An August 14, 2002 memorandum circulated among high level Water Department officials expressed concern that the department did not know how time paid for by the department for city attorney services had been dedicated to non-Water Department business, based on representations of city attorney employees that they were billing 100% of their time to Water Department matters, yet did not track time spent on individual cases. Additionally, the Water Department director approved a request by the city attorney in March 2004 to bill four (4) hours a week to the Water Department through the SLA for a deputy city attorney's "leadership development program." It appears, at least on occasion, that where a department and the city attorney desired an increase in city attorney employees to provide services for a new project or matter, that the city manager required that a SLA be entered into by the respective parties. Further, George Loveland, Assistant City Manager at the time, was instrumental in implementing the multi-department funded City Attorney/CEU SLA, helping to arrange the funding participation by the various departments. It also appears that the city manager's office devised a method to fund the City Attorney Title VII/Sexual Harassment Program, primarily from enterprise-funded departments.

The city attorney's office and other city departments faced budget crises over the years. A City Attorney's Office memorandum, dated April 4, 2004, asserts that the MOUs (SLAs) existed because the general fund had not been able to provide needed resources; the city manager created the MOUs/SLAs as an alternative source of funding and the city manager desired to expand their use. A memorandum from City Attorney Gwinn with respect to the FY 2001 proposed budget noted that a particular formula had been followed prior to FY 1995 to staff

criminal prosecution positions. However, that formula had not been followed since, and no new staff had been authorized. The memorandum noted that had the formula been followed, the city attorney would have been authorized to staff 20 additional positions. This is noteworthy because of allegations that some criminal deputies were being billed out (supported) on SLAs.

The April 25, 2006 Grand Jury report, the August 2, 2006 Mayer, Hoffman, McCann reports, and the August 8, 2006 Kroll Report detail extensive abuses of enterprise funds by various general fund departments. The Kroll Report, in Addendum Q, analyzes the city attorney's offices billing abuse. Other reports and memorandum have documented or addressed the SLA problems, including the May 2006 Independent Budget Analysis (IBA) Memorandum, IBA October 2006 Status Memorandum, the July 31, 2006 City Attorney Internal Control Memorandum, and the January/February 2006 Office of Audits and Advisory Services reports.

There is no question that the city attorney's office billed many thousands of dollars of legal work to enterprise fund departments over the years for work hours that were not performed. This was acknowledged in the July 28, 2006 City Attorney Report. Evidence shows that the billing protocol evolved into a complex and sophisticated process, involving spread sheets and continued adjustments to set and maintain pre-determined billable hours to ensure full reimbursement under SLAs. Staff were even instructed to fill out their time cards in pencil so that supervisors could adjust the time, if, and as needed, to meet billable time quotas. To further this end, time cards were submitted before the bi-weekly work/pay periods had expired. The city attorney's office conducted training classes for new employees about SLAs and how to fill out their time cards. On the other hand, it is also true that the billing protocol did not capture the extensive overtime work that many deputies/staff members put in on respective SLA projects. However, it appears that the over billing substantially outweighed the non-captured overtime.

### C. REFORM

As indicated above, shortly after Mr. Aguirre took office in late 2004, he implemented a policy to bill only for actual time expended in performing legal services under the SLAs. The city attorney sent an e-mail instructing all employees to fill out their time cards in ink. Further, on July 31, 2006, the city attorney disseminated an Interoffice Controls Memorandum. There is evidence that this change in policy significantly impaired the revenue generated from SLAs. For example, there is evidence that during FY 2006 the city attorney was billing under the Water Department SLA at a pace that would result in a \$1.3 million shortfall.

The mayor's office responded quickly to recommendations for reform, pledging to implement all the recommendations of the August 2006 Kroll Report. About the time of the Kroll report, the mayor's office instituted the placement of budget specialists in specific

departments throughout the city. Even before the August 2006 Kroll Report, the mayor implemented various reforms, such as tasking SLA oversight responsibilities to the newly created Purchasing & Contracting Department, with the objectives of monitoring SLAs, limiting the use of SLAs/MOUs, documenting performance, and otherwise ensuring accountability. The mayor also created a task force to further inquire into the city-wide SLA/MOU issues.

The documents we reviewed reflect the impact of the reforms on the city attorney's office. A mid-year FY 2007 fund expenditure report indicates fiscal year-end expected revenue shortfall of \$2.5 million, partly due to an estimated \$3.8 million shortfall in unrealized SLA billings caused by changes in billing practices. Further, the terms of the current SLAs detail performance, require that only actual hours are billed, and mandate status reports and accountability. Interim FY quality control performance reports have also been generated.

#### **D. CONCLUSION**

Viewed solely from the perspective of the criminal law, it is possible that criminal law violations occurred and were committed as a consequence of these billing practices. These violations could include violations under Penal Code section 424, misappropriation or misuse of public funds (albeit, there is absolutely no evidence that any public funds were "pocketed" for personal use), and violations of Government Code section 6200, altering or falsifying government records (time cards). Both of these offenses are general intent crimes and impose nearly strict liability for the specified acts. Additionally, the statutes do not require any intent to defraud or to obtain personal benefit or advantage. That said, fixing individual accountability would be difficult, if not impossible. The very records which might support these charges are inherently unreliable, as were the systems under which they were created, much of which contributed to and caused the abuses noted. There is no evidence of fraud, in the sense that all the parties to these SLAs—city management, the enterprise fund departments, and the city attorney's office—were aware of the endemic abuses in the system and processes and sooner or later, at least implicitly, condoned them. As noted, there is absolutely no evidence of any personal profiteering. Additionally, there are gradual shadings of responsibility among the officers, directors, managers and employees of the various city offices and departments in connection with these violations. Finally, as the enterprise-funding practices had been underway for nearly 20 years, there is the issue of the statute of limitations being a potential bar to prosecution as to much of the activity. Prosecution ethics require that we be able to say, before bringing charges, that we can prove individual guilt beyond a reasonable doubt to a unanimous jury. It would be difficult to attain that level of certitude and proof in these circumstances.

With respect to the discretionary factors bearing on prosecution, it is clear that budgetary pressures, participation or tacit approval among high ranking city officials, and an antiquated

Honorable Jerry Sanders

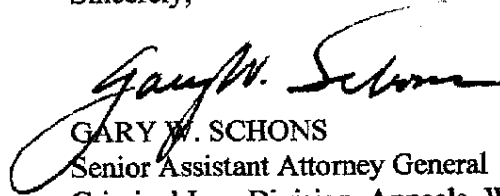
December 11, 2007

Page 8

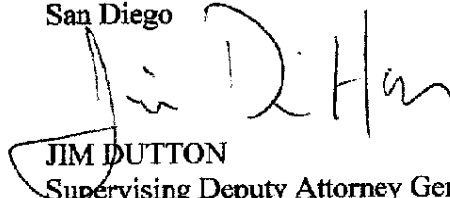
city-wide billing system all contributed to the billing abuses. Additionally, there is nothing to recover, in terms of public monies, which would be one of the principle aims of a criminal prosecution in these circumstances. Moreover, it would be impossible to fix, with any precision, the amount of any potential recovery or transfer of funds. Critically, the SLA billing abuses have been publically aired and appear, for the most part, to have been rectified by the city attorney. City-wide enterprise fund abuses appear to have been corrected as a result of the various reports and the rapid implementation of reform measures by the mayor. Thus, none of the criminal law's goals of retribution, rehabilitation, deterrence, incapacitation and restitution would be well served, if served at all, by prosecution under these circumstances. Finally, the resources necessary to charge and sustain a criminal prosecution would be significant and not a warranted expenditure of the limited resources of this office.

Accordingly, the Attorney General will decline to bring any prosecution in connection with the city attorney's office billing practices and is closing the matter.

Sincerely,



GARY W. SCHONS  
Senior Assistant Attorney General  
Criminal Law Division, Appeals, Writs & Trials-  
San Diego



JIM DUTTON  
Supervising Deputy Attorney General  
Criminal Law Division, Appeals, Writs & Trials-  
San Diego

For EDMUND G. BROWN JR.  
Attorney General

cc: Bonnie Dumanis  
District Attorney  
County of San Diego

Karen Hewitt  
United States Attorney  
Southern District of California