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REPORT BY THE

Comptroller General

OF THE UNITED STATES

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Information On U.S. Railway Association Contracts With Law Firms

GAO evaluated the U.S. Railway Association's procedures for contracting with law firms and assuring that charges made are accurate. This report provides the requested information and also shows that the Association is not requiring all law firms to follow its procedures for monitoring contractor expenditures and performance. GAO is making a recommendation to correct the weaknesses noted.

This report was requested by the Chairman, Subcommittee on Transportation and Commerce, House Committee on Interstate and Foreign Commerce.



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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-164497(5)

The Honorable James Florio, Chairman
Subcommittee on Transportation
and Commerce
Committee on Interstate and
Foreign Commerce
House of Representatives

HSE 02306

Dear Mr. Chairman:

This report responds to your February 27, 1979, letter, requesting that we review procedures used by the U.S. Railway Association in contracting with law firms. As you requested, we also evaluated the audit and administrative procedures used by the Association and the law firms themselves to assure accurate charges. Detailed answers to your questions are in appendix I. CNG
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Our review showed that the criteria the Association used to select contractors and award contracts for legal services were reasonable and in conformity with its procurement policy and procedures. Because of its status as a "mixed ownership" Government corporation, the Association is not required to follow Federal procurement regulations in awarding and administering contracts. The Association's procurement policy and procedures, however, are in general accord with procurement standards applicable to federally funded programs, as set forth in attachment O, Federal Management Circular 74-7.

We reviewed costing and billing procedures used by two of the principal law firms involved with the Association, Hogan and Hartson, and Wilmer, Cutler and Pickering. They have similar systems and both follow good cost accounting practices. We found, however, that some invoices submitted by other law firms did not contain the degree of specificity the Association needs for good contract management. The Association has recognized this problem and has taken corrective action through contract modification. Beginning with billings for March 1979, all contractors will be required to provide narrative reports corresponding to elements of approved work plans. We believe this is a step toward better contract management and control of appropriated funds. DLG
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We also reviewed the Association's procedures for monitoring law firm contracts. We found that it mostly relies on various informal controls to monitor law firms and assure the accuracy of charges. Formal progress reports are not required from law firms. Instead, the Association relies heavily upon daily personal, telephone, and written contact between its own lawyers and outside attorneys.

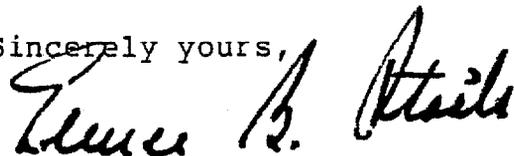
In April 1978, the Association's Office of Audits circulated a draft report criticizing the administration of contracts for legal services. The Association's General Counsel's Office took corrective action in October 1978 by issuing new procedures for monitoring contractor expenditures and performance. The contract management procedures were designed to reemphasize the Association's responsibility for planning and defining contractor work and to document the continuing management and evaluation of each contractor's work. These objectives were to be met, in part, through such management tools as contractor status reports and performance evaluations, but we found the new procedures have not been required of two of the principal law firms.

We believe the Association's procedures for monitoring contractor expenditures and performance would provide a good framework for contract monitorship if fully implemented. However, their effectiveness depends on the degree they are applied to all such contractors. Our review disclosed that these procedures have not been uniformly applied. Therefore, we are recommending that the President of the Association direct that the revised procedures be applied to all contractors. 6/

As requested by your office, we did not obtain formal comments from the Association. We did, however, discuss the matters in this report with Association officials and considered their views in its preparation.

As arranged with your office, we plan no further distribution of this report until the subcommittee completes its consideration of the Association budget authorization and notifies us that we may release the report to other interested parties.

Sincerely yours,



Comptroller General
of the United States

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INFORMATION ON THE U.S. RAILWAY
ASSOCIATION CONTRACTS WITH LAW FIRMS

BACKGROUND

In a February 27, 1979, letter, the Chairman, Subcommittee on Transportation and Commerce, House Committee on Interstate and Foreign Commerce, and seven subcommittee members asked us to review procedures used by the U.S. Railway Association in contracting with law firms. We were also asked to evaluate the audit procedures used by the Association and the law firms themselves in assuring accurate charges.

Status of the litigation
concerning the valuation of
properties conveyed to Conrail

The Association is a principal party in one of the largest, most complex, and important legal controversies involving the valuation of property and potential Government financial responsibility ever to come before the courts.

The Regional Rail Reorganization Act of 1973 (45 U.S.C. 701 et seq. (1976)) required the Association to fix a value for rail properties conveyed to Conrail, including 48,000 miles of track, 400,000 acres of land, 185,000 pieces of rolling stock, and about 4,000 buildings which were inventoried and valued. The net liquidation values of the properties transferred under the Final System Plan, as certified by the Association to the Special Court, total \$685 million. The value of the properties conveyed to Conrail was \$534 million. The valuation certified for each of the bankrupt carriers was: Penn Central Transportation Company, \$415.3 million; Erie Lackawanna, \$53.1 million; Reading, \$32 million; Lehigh Valley, \$20.6 million; Central of New Jersey, \$10.2 million; Ann Arbor, \$1 million; Lehigh & Hudson River, \$1.2 million.

These valuations and the method by which they were determined were challenged by creditors and the trustees of the bankrupt estates. They claim the Association undervalued the transferred properties by using appraisals based on the assumption that the railroads would have been liquidated instead of assigning values representing continued use as operating railroads. In June 1978, the Court ruled that continuing rail use and not scrap value alone must be a criterion in setting property values for the bankrupt railroads. The Penn Central alone, for example, claimed that key "rail use" properties should have been valued

at \$2.2 billion and that certain terminals in New York and Pennsylvania were worth \$116 million. Penn Central filed these claims with the Court in December 1978.

At a pretrial conference on February 26, 1979, the Special Court established July 31, 1979, as the cutoff date for discovery with respect to the testimony filed by the transferors in December. The Association was given until November 1, 1979, to submit the remainder of the Government's evidence in response to assertions by the transferors that they could have received \$4.5 to \$5 billion for the properties retained for rail use purposes in the absence of the act.

The Association has stated that in the coming months it will be gathering sworn statements from approximately 143 opposition witnesses to assist in preparing the testimony due on November 1, 1979. Contractors will continue to be used for developing information to be used in challenging the values asserted by the transferors. The law firms will be used extensively in preparing the November filing.

According to the Association, after it submits its evidence in November 1979, the transferors are expected to take depositions from Association witnesses and submit rebuttal evidence. The Association will then seek to cross-examine that evidence. The Association estimates that briefs on the rail use issues will be submitted to the Court in the summer or fall of 1980.

After the Court determines the values to be assigned to properties that might have been sold for rail use, it must consider the remaining assets and determine their values for nonrail or scrap use. The assets that the transferors agree would not have been sold for rail use constitute over half of the total rail properties. The Association believes the duration of this second trial process will depend both on the nature of the Court's decision on the rail use portion of the case and whether the parties will be able to agree on a method for trial of those portions of the case that remain after the rail use decision.

ASSOCIATION PROCEDURES FOR CONTRACTING LAW FIRMS

In our opinion, the Association has adhered to consistent and reasonable criteria in contracting with the three principal and four other law firms providing legal support to it in this case. Association officials told us

it would have been impossible, within the stringent time schedules imposed by the Regional Rail Reorganization Act; to assemble a group of lawyers within the Association's Office of General Counsel with the range of specialty skills and experience needed to prepare and handle this valuation litigation. They further stated that they recognized they would need to retain outside counsel from the outset of the case. We interviewed representatives of the Department of Justice's Office of Legal Counsel and the Department of Transportation's Office of General Counsel, and they substantiated this view. Furthermore, each Department stated it would not have been able to handle the litigation.

The Association is a "mixed ownership" Government corporation and is not required to follow Federal procurement regulations in the award and administration of contracts. The Association's stated procurement policy, however, is to be in general accord with procurement standards applicable to federally funded programs, as set forth in attachment O, Federal Management Circular 74-7.

The Association generally procures services through negotiated contracts. According to the Association, proposals are solicited from enough qualified sources to assure adequate competition. The proposals are supposed to include the offeror's plan for performing the work, the resources which will be applied, the contractor's qualifications and experience, and relevant details as to price. The Association's procedures call for its contracting officer, an attorney, to select, where practical, at least three firms whose offers appear most advantageous. A record covering the strengths and weaknesses of each of the offers and the rationale supporting the final selection is included in the Association contract files.

The Association also awards contracts through sole source procurements, where only one possible contractor is qualified to perform the contract. Sole source selections are supported by a memorandum stating the justifying circumstances.

The selection criteria or major factors the Association said it considered in its search for the principal law firms were:

- Specific experience. Firms with demonstrated competence in particular areas involved in the valuation process and litigation.

- Absence of conflict of interest. Firms with any conflict or potential conflict were considered ineligible to represent the Association. Many of the best qualified firms already represented the various estates in the litigation. Therefore, it was essential to find firms without a conflicting interest or conflicting client representation.
- Range of skills and depth of resources. Firms with extensive personnel resources and a broad range of skills were desired since the litigation would involve complex issues and, therefore, require many legal specialties.
- Location. Local firms were most desirable since the Special Court and the Association are located in Washington, D.C.

The Association screened available law firms based on the above criteria and determined that four firms were most qualified. Two firms were eliminated from further consideration because the Association believed they lacked the specific experience and skills needed for the litigation. The firms of Hogan and Hartson, and Wilmer, Cutler and Pickering were selected. According to the Association, Hogan and Hartson best met the criteria for the role of litigation counsel. When Hogan and Hartson was selected, it had recently completed successful litigation involving a local transit agency, in which asset valuation had been the principal issue.

Wilmer, Cutler and Pickering was selected in early 1974 by the Department of Transportation on behalf of the Association, which had not been fully organized. The firm represented the Association in the constitutional and statutory litigation of the Rail Act and the fairness of processes used in reorganizing various bankrupt railroads. The Association stated that in the course of that successful representation, the firm acquired invaluable experience and expertise in matters relating to the general operation of the Rail Act and was therefore retained.

The Association said it used similar criteria to select Steptoe and Johnson as another principal law firm whose primary responsibility is to review, analyze, and prepare real estate appraisals for trial testimony. Three other law firms were considered but rejected because they did not have sufficient background in railroading or real estate valuation or because they did not have a local office, which would inhibit daily consultation.

The Association currently has contracts with four other law firms, two of which were sole source procurements. The names of the law firms selected, a brief description of their assignments, and the selection justification used in each case follows.

- Highsaw, Mahoney and Friedman provides specialized legal assistance and advice in the labor area. The Association identified and considered three firms that were sufficiently expert in labor law, and chose Highsaw, Mahoney and Friedman because it was the only firm without conflicting interests.
- Conner, Moore and Corber provides the Association with specialized legal advice and assistance in connection with Interstate Commerce Commission (ICC) issues. A partner in this firm is a former ICC commissioner. Another lawyer with ICC experience was considered, but he declined to consider the assignment.
- Finkelstein, Thompson and Levenson was contracted on a sole source basis because one of the principal partners has unique experience in complicated major economic regulatory matters. This firm is working directly with the firm of Wilmer, Cutler and Pickering on issues relating to the Federal role in the alternative scenario concerning rail use value as opposed to scrap value.
- Smith and Schnacke was also contracted on a sole source procurement. This firm was employed in connection with the inventorying and determination of title quality and the land conveyed by the bankrupt estates. A senior partner in this firm was the only lawyer who had both the experience and background needed and was available to conduct the project within the necessary time frame.

We reviewed all legal service contracts and applicable contract and correspondence files at the Association and at two of the principal law firms. We found that the Association generally followed its stated criteria in selecting outside law firms.

LAW FIRM PROCEDURES FOR
BILLING THE ASSOCIATION

The Association reported that as of March 20, 1979, it had paid law firms over \$8.5 million for legal services. Two of the law firms, Hogan and Hartson, and Wilmer, Cutler and Pickering, have received over \$8.1 million. The Association estimates that \$4.5 million, or about 16 percent of its \$28.4 million requirement, will be spent on law firms in fiscal year 1979.

The two principal law firms under contract with the Association (Hogan and Hartson, and Wilmer, Cutler and Pickering) use similar costing and billing procedures. The Association's contract provides for payment of labor hours and expenses at rates which include charges for necessary administrative and regular secretarial time and normal office overhead expenses and supplies, for which no direct charges are to be made. Direct charge expenses include items such as transportation, postage, telephone and duplicating services. The contract fee schedule of hourly rates to be paid these firms includes the services of partners (\$110 per hour), associates (\$70 per hour), and paralegals (\$25 per hour). The current hourly rates charged by the law firms are based on fee structures originally established for the Penn Central's attorneys by the United States District Court for the Eastern District of Pennsylvania.

The Association, through a recent contract modification, has required each law firm, beginning with its billing for the month of March 1979, to include a narrative report summarizing legal services provided with each bill it submits. The narrative is required to correspond to the principal elements of the firm's approved work plan and should also identify the Association's attorney involved with each element of the work plan. More specifically, the contract modification requires the law firm's bill to summarize work done during the billing period; the name, professional level, and total billable hours of each professional contributing to the work described; the reimbursable travel and transportation costs incurred; the reimbursable duplicating and reproduction costs incurred in connection with the work described; and other reimbursable costs incurred. The Association took these measures to get better documentation of the work progress made by the contracted law firms. The law firms advised us that only minor adjustments will be needed to their current billing procedures to be in compliance with the contract modification. These adjustments should be reflected in the next invoices sent to the Association.

In our opinion, the added specificity required by the contract modification is necessary for good contract management. Although the two principal law firms' invoices have included some descriptions of the legal services provided, invoices submitted by other contractors did not contain such specificity. We believe the Association's action is a step toward better contract management and control of appropriated funds.

A detailed description of each firm's procedures for determining its costs and billing for legal services follows.

Hogan and Hartson

It is this firm's policy that each individual maintain an informal daily record in quarter hours of the time spent on client billable assignments. Client billable assignments are broken down into "matters" (equivalent to projects or tasks) and by "item" within each matter. Each day, the individual's secretary prepares a separate time record for each billable item shown on his or her informal daily time record. The official time record identifies the attorney, the client, the matter involved, a brief description of the item of work done, and the time spent. The official time records are then sent to the accounting department where they are reviewed and keypunched and then given to an outside computer contractor for processing. Direct billable expenses are also recorded by individuals and submitted to the accounting department twice each month. These expenses are reviewed, keypunched, and forwarded to the computer contractor.

A preliminary billing report is prepared monthly by the computer contractor for each client. The billing report lists each matter and indicates the total monthly billable time charged to the matter by each partner, associate, and paralegal. The billing report shows the total value of the services rendered for each client in terms of each individual's standard hourly billing rate established by the firm. Either the cognizant administrative partner for each client or a team captain (senior partner) then adjusts the totals to reflect contract rates which differ from the firm's standard billing rates and prepares a narrative description of work performed during the period. The final invoice for services rendered is prepared by the accounting department, reviewed and approved by the administrative partner, and forwarded to the Association.

Wilmer, Cutler and Pickering

This firm requires each partner, associate, and paralegal to maintain a separate daily diary ticket specifying the name of the client, the "matter" (the particular item being worked on), the time charged, and a brief description of the service rendered. Diary tickets are given to office secretaries who compile weekly time summaries. The time summaries and diary tickets are provided to the accounting department, which reviews the time summary for accuracy, keypunches the time and direct charge expenses, and forwards the computer cards to an outside service bureau where a monthly billing memorandum is prepared. The firm's chief accountant stated that because the billing memorandum is compiled on the basis of the firm's standard billing rates, manual adjustments (always downward) are required to reflect rates specified by the Association's contract.

The billing memorandum and the diary tickets are then forwarded to the firm's cognizant billing partner for review. The billing partner and senior partners associated with the client (team leaders) prepare a narrative description of legal services performed for the month covered by the bill. After a final review by the accounting department, the bill is forwarded to the Association.

ASSOCIATION PROCEDURES FOR
MONITORING CONTRACT EXPEN-
DITURES AND PERFORMANCE

The Association relies on various, mostly informal, controls to monitor the progress of contracted law firms and to assure the accuracy of their charges. Law firms are not required to prepare formal progress reports, but Association officials told us that daily personal and telephone contact and frequent written contact between Association lawyers and technical experts and the outside attorneys is an effective means of monitoring work progress. We agree that such contacts are useful. However, we believe the Association should impose a more formalized progress reporting requirement, such as contractor status reports, especially since the case is complex and unprecedented. Such reports would provide more effective means of assuring high quality work by the law firms, wise use of resources, and appropriate charges for services rendered.

Association audits

The Association's Office of Audits is responsible for internal and contract audits. Contract audits are performed

by the Office of Audits or the Defense Contract Audit Agency and are normally done when a contract expires. However, two of the principal law firms whose long-term contracts have never expired have been audited several times for the allowability of changes in accordance with the provisions of their contracts. The Defense Contract Audit Agency's most recent audit of the firms of Hogan and Hartson, and Wilmer, Cutler and Pickering was May 1978. Audit reports were issued reflecting the billing versus costs incurred by both firms.

In April 1978, the Association's Office of Audits issued a draft report on the administration of contracts for legal services. The report criticized the Association for its informal, undocumented system of assigning tasks to the law firms; the lack of progress reports and adequate documentation for effective monitoring and evaluation; and the lack of specificity in contractor invoices which could lead to inappropriate bills and misuse of law firm resources. The final report was issued in March 1979.

Association procedures
for monitoring contractors

The Association's General Counsel's Office, although strongly opposed to the audit report's observations, issued revised procedures for monitoring contractor expenditures and performance on October 13, 1978. These procedures were to

- reemphasize the Association's responsibility for planning and defining the work needed to produce relevant, appropriate, and usable information for litigation and related activities;
- document the Association's continuing management and evaluation of each contractor's work during the life of the contract through such management tools as contractor status reports and performance evaluations;
- minimize the potential for differences in the perception of what is needed or likely to be produced between the Office of General Counsel and the contractor;
- improve the documentation of the care taken to avoid misuse or waste of taxpayer funds; and
- increase the probability that funds for contractual support are available when needed.

The contract management procedures rely on a project officer concept of management. According to the procedures, each project officer, an Association attorney, is responsible for monitoring a specific contractor and for alerting management of any indication of inadequate quality, untimely work performance, or costs in excess of plan. The project officer's review is intended to lead to a determination that the contractor has or has not met the contract requirements. Additionally, in the case of labor hour contracts, the project officer is to determine whether the number of hours billed by the client is reasonable in light of the difficulty and amount of work accomplished.

Our discussions with officials of the Association's General Counsel's Office and two of the principal law firms showed that determining whether the number of hours billed by the law firms is reasonable and assessing whether the right mixture of partner versus associate and paralegal time is charged are largely matters of judgment by the Association's General Counsel's Office. There have been only a few instances where the Association questioned labor hour charges made by the law firms.

The Defense Contract Audit Agency has, on occasion, questioned the allowability of certain charges in accordance with the provisions of the contracts. The Association reported that certain small administrative charges by the law firms are currently in dispute.

The contract management procedures (see p. 9) require contractor status reports and provide for contractor performance evaluation appraisals as management tools for evaluating the quality of legal services. Contractor status reports are required for any contract for work to be done over a period of 60 days or more. The procedures call for these reports to be submitted at least once each month and to identify work accomplished during the reporting period, appropriately cross-referenced to tasks identified in the contract and relevant confirmation memorandums. Association officials stated that status reports were not required for two of the principal law firms. They explained that the status report requirement is intended primarily for consultants, appraisers, etc. However, in our opinion, all contractors should be required to comply with the procedures designed to increase monitoring of contractor's performance.

The contractor performance evaluation form is intended to document, for each invoice, the project officer's assessment of (1) the quality of work, (2) timeliness of the end

product, (3) reasonableness of the number of hours billed, and (4) whether the invoice should be paid. Association officials stated that the above assessments are currently made before final payment of contractor invoices. However, we noted that the performance evaluation appraisals required by the contract management procedures were not always being used. Instead, for the two principal law firms, the Association requests that cognizant project officers provide a memorandum only when they believe items should be further examined before payment. Association officials stated that under this method verbal comments were sometimes substituted for written memorandums. Officials representing the General Counsel's Office stated that contractor evaluation forms will be used for the next invoices received. Such action will more clearly document the Association's decisions resulting in the expenditure of public funds.

CONCLUSIONS AND RECOMMENDATION

Generally, we believe the Association's written procedures for monitoring contractor expenditures and performance provide a good framework for contract monitorship. However, the effectiveness of the monitoring procedures depends on the degree of application to all contractors. Our review disclosed that these procedures have not been applied uniformly, especially with respect to the two principal law firms involved in the litigation. Therefore, we are recommending that the President of the Association direct that the revised procedures be applied to all contractors.

SCOPE OF REVIEW

We made our review at the Washington, D.C., headquarters of the U.S. Railway Association. We examined pertinent records, documents, and contract files and discussed matters covered in the report with Association officials. We also visited the law firms of Hogan and Hartson, and Wilmer, Cutler and Pickering, located in Washington, D.C, to review the firms' policies and procedures for billing the Association. Additionally, we examined and verified several of the law firms' invoices for work performed for the Association. In addition, we talked with representatives of the Department of Justice's Office of Legal Counsel and the Department of Transportation's Office of General Counsel.

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