LSC

Legal Services Corporation
Office of Inspector General

December 11, 2003

Mr. José R. Padilla
Executive Director
California Rural Legal Assistance, Inc.
631 Howard Street, Suite 300
San Francisco, CA 94105

Dear Mr. Padilla:

Attached is our final report on the results of the Program Integrity audit of California Rural Legal Assistance, Inc. Your comments on the draft report did not agree with the audit's findings and recommendations. We reviewed the comments and concluded that they did not provide a basis for significantly modifying the findings and recommendations. We deleted the finding related to rent payments at the Madera office. Other minor changes were made, but the substance of the report is the same as the draft. We reaffirm our findings and the recommendations for corrective actions. Please provide a corrective action plan to implement the recommendations within 60 days of the date of this letter.

Your comments are briefly summarized in the body of the final report and incorporated in full as Appendix I.

Sincerely,

Leonard J. Koczur
Acting Inspector General

Enclosure

cc: Richard P. Fajardo
Chair, CRLA

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LEGAL SERVICES CORPORATION
OFFICE OF INSPECTOR GENERAL

REVIEW OF GRANTEE'S TRANSFER OF FUNDS AND COMPLIANCE WITH PROGRAM INTEGRITY STANDARDS

Grantee: California Rural Legal Assistance, Inc.

Recipient No. 805260

Report No. AU 04 -02
December 2003

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RESULTS OF AUDIT

The Legal Services Corporation (LSC) Office of Inspector General (OIG) conducted this audit to determine whether California Rural Legal Assistance, Inc. (grantee) complied with certain requirements of 45 CFR Part 1610. This regulation prohibits grantees from transferring LSC funds to an organization that engages in activities prohibited by the LSC Act and LSC appropriation acts, and LSC regulations. To comply with these requirements, grantees must be legally separate from such organizations, not transfer LSC funds to them, not subsidize any restricted activity, and maintain physical and financial separation from them. An exception applies for transfers of LSC funds solely for private attorney involvement activities.

Between January 1, 2000 and May 10, 2002 the grantee did not maintain objective integrity and independence from a legal organization that engaged in prohibited activities in violation of 45 CFR 1610.

In addition, the grantee:

- did not prepare statements of facts and identify clients in certain cases, and
- improperly made rental payments for an organization in violation of 45 CFR 1630.

The OIG reviewed cases initiated under California Business & Professional Code Section 17200 and concluded that the grantee did not violate LSC regulations covering class action suits or eligibility determinations.

Recommendations for corrective action are on pages 6 and 7.

OBJECTIVE INTEGRITY AND INDEPENDENCE

The grantee did not maintain objective integrity and independence from the California Rural Legal Assistance Foundation (Foundation) a legal organization that engages in LSC restricted activities.

Program Integrity Requirements

Section 1610.8 of LSC's regulations states that grantees must have objective integrity and independence from organizations engaged in LSC restricted activities. The grantee meets the requirements of this section if:

- the other organization is a legally separate entity,

- the grantee does not transfer LSC funds to the organization and LSC funds do not subsidize restricted activities, and

- the grantee is physically and financially separate from the other organization.

The preamble to Section 1610.8 requires grantees to ensure that it is not identified with restricted activities and that the other organization is not so closely identified with the recipient that there might be confusion or misunderstanding about the recipient's involvement with or endorsement of prohibited activities. A grantee will be considered to be subsidizing the activities of another organization if it provides the use of its resources for restricted activity without receiving fair value for such use. Guidance promulgated by LSC interpreting the program integrity requirements discusses the issue of separate personnel, and states that the greater the responsibilities of the staff who are employed by both organizations, the more danger that program integrity will be compromised.

COMPLIANCE WITH REQUIREMENTS

The grantee satisfied the first requirement. The Foundation is a separate legal organization. The second and third requirements were not met. The grantee did not improperly transfer LSC funds to the Foundation but it subsidized restricted activities. The grantee maintained a close relationship with the Foundation that makes it difficult to distinguish between the two organizations and results in a violation of the program integrity regulation. The specific problem areas are:

- Co-counseled cases
- Shared staff
- Rent subsidy
- Physical separation of facilities

Each issue is discussed in the following.

Co-counseled Cases

The grantee co-counsels cases with the Foundation. Grantee attorneys are the lead counsel in most cases and in one case a Foundation attorney was the lead counsel. For some cases a part time CRLA attorney was the lead counsel. On one case the same individual was the lead attorney for the Foundation.

The organizational structure of the grantee is important to the discussion of the co-counseled cases. The grantee has four Directors of Litigation, Advocacy and Training (DLATs), each responsible for oversight of grantee operations in approximately one-quarter of the State of California. One of the grantee's DLATs works part time for the grantee and part time for the Foundation. The DLATs report directly to the grantee's Executive Director. One step below, and reporting to, the

DLATs are the Office Directors, each responsible for direct oversight of one of the grantee's branch offices.

We reviewed six co-counsel agreements the grantee had with the Foundation. The grantee was the lead counsel in five cases and the Foundation for one case.

- The Foundation was the lead counsel on case A. The lead Foundation attorney for the case was the grantee's part time DLAT. The grantee attorney on the case was another DLAT.

- The grantee was the lead counsel on case B. The grantee's lead attorney was an office director for one of its branch offices. The Foundation's attorney was the grantee's part time DLAT who was the lead attorney for the Foundation on case A.

- The grantee was the lead counsel on the four remaining cases. In one case, the grantee's part time DLAT was the grantee's attorney of record. She had no involvement in these cases as an attorney for the Foundation.

The co-counsel agreements for the five cases on which the grantee was the lead counsel were similar. In these five cases the vast majority of legal work was to be done by the grantee. The grantee was responsible for:

- Maintaining the master case file
- Maintaining a calendaring system for all litigation related dates
- Insuring all filings and other actions occur in a timely manner
- Developing and/or overseeing the development of any discovery plan and its implementation
- Coordinating responsibility for court appearances, including responsibility for preparation for the appearances
- Initial drafting of pleadings and moving and supporting papers
- Polling of parties regarding significant decisions which must be made
- Coordinating contact with the media, approving written press releases, and maintaining a media file

The Foundation was responsible for the review and edit of pleadings and moving and supporting papers drafted by the grantee. The grantee was responsible for all costs and expenses of the litigation. The Foundation was allowed to seek attorneys' fees.

The co-counsel agreement for the case on which the Foundation was lead counsel did not list the responsibilities of the lead counsel. Costs were to be shared.

Shared Staff

Two senior level grantee attorneys also worked with the Foundation. A DLAT in the San Francisco office worked part time for the Foundation. The former office director of the Oceanside office was a full time employee but also worked for the Foundation. LSC guidance in an October 30, 1997 Program Letter states that "… the greater the responsibilities of the staff who are employed by both organizations, the more danger that program integrity will be compromised."

The part time DLAT who also worked for the Foundation was to work 90 percent of the time for the grantee and 10 percent for the Foundation. The DLAT is one of the grantee's most senior positions. This DLAT was responsible for the grantee's cases dealing with workers' wage cases. She was also responsible for supervising offices in one–quarter of the state.

The grantee's full time manager of the Oceanside office also worked simultaneously for the Foundation. This individual was the office director for the grantee's Oceanside branch office until January of 2001, when she left her grantee job. During this time she also held a director's position with the Foundation. After leaving the grantee's employment the individual continued to work for the Foundation.

On the Foundation's web site the individual was identified as the Director of the Border Project. Her telephone number was the same number as her listing at the grantee's Oceanside branch. Newspaper articles from 1999 and 2000 identified her as a Foundation director. Two letters to high ranking U.S. Department of Justice officials identified the individual as director of the Foundation's Border Project. Both letters dealt with illegal immigrants. An article in the San Diego Union Tribune newspaper on illegal immigration also identified the individual as a project director for the Foundation.

We verified that the individual was a full time grantee employee until January of 2001. Until she left the grantee's employment publicly available information indicated that this individual was doing prohibited activities, lobbying Federal Government officials on behalf of illegal aliens. Grantee staff in the Oceanside office and the individual's supervisor told us that they did not know of the Office Director's relationship with the Foundation.

Rent Subsidy

The grantee subsidized the Foundation by routinely allowing late payment of rent over a long period of time. Between June 2001 and May 2002 the Foundation seldom paid its rent for three offices on time.

The grantee leased office space to the Foundation in San Francisco, Modesto and Fresno. The leases provided that rental payments were due on or before the first day

of each month. The leases were unusual in that they did not provide for late payment fees or interest charges in the event rents were not paid when due.

From June 2001 through April 2002, the Foundation paid its rent at three or four month intervals rather than monthly. In September 2001, the Foundation paid the grantee the current rent due for September and the rents overdue for June, July, and August 2001. The October 2002 rent was paid on time. Five months later, in February 2002, the Foundation paid the grantee the current rent due for February 2002 and the rents overdue for November and December 2001, and January 2002. Three months later, in May 2002, the Foundation paid the grantee the current rent due for May 2002 and the rents overdue for March and April 2002.

The following chart shows the total amount of late payment by each Foundation office.

San Francisco	$ 14,959
Modesto	7,000
Fresno	6,708
Total	$ 28,667

After a brief period of on time payment, the Foundation made $ 4,128 in late rent payments for its Fresno office from October 2002 until May 2003.

By allowing the interest free use of these funds the grantee subsidized the Foundation activities. Subsidizing the Foundation through allowing late rental payments is an old unsolved issue for the grantee. A review by LSC's Office of Compliance and Enforcement in 2000 disclosed the same problem with late rental payments but the grantee failed to correct the problem.

The problem with late rental payments was mitigated in mid 2002 when the Foundation moved from the space it rented from the grantee in San Francisco and Modesto. The fact remains that over a lengthy period of time the grantee subsidized the operations of an organization that did prohibited and restricted activities.

Physical Separation of Facilities

The grantee did not physically separate itself from the Foundation in the shared office space in Modesto. A large sign outside the building indicated that the grantee and the Foundation occupied separate suites of offices. However, inside the building the grantee and the Foundation were located in the same office suite. The grantee's space was not separated from the Foundation's space and the two organizations were indistinguishable. Each organization had a separate entrance but there was no separation of offices inside the suite. We were told that the grantee's staff has been instructed to not enter Foundation space. Subsequent to completion of on-site audit work, the Foundation moved from the shared space.

Conclusion

Considering all the factors, the grantee maintains a relationship with the Foundation that violated LSC's program integrity regulation. While the problem has been somewhat mitigated by the departure of a grantee employee and the Foundation vacating space previously rented from the grantee, the sharing of senior staff and the close relationship on co-counseled cases continues. This needs to be corrected.

Recommendations

The grantee's management needs to take steps to provide adequate separation from the Foundation. Specifically, we recommend that the Executive Director:

1.1 Preclude the part time litigation director from participating on cases that are co-counseled with the Foundation

1.2 Adopt policies and procedures precluding senior staff, DLATs and office directors, from co-counseling case with the Foundation

1.3 Preclude senior staff from working for the Foundation on a part time basis

1.4 Adopt procedures so that in the future full time grantee employees are precluded from working simultaneously for the Foundation

1.5 Require that future leases for space rented to other organizations follow standard commercial practices and provide for late payment penalties

STATEMENT OF FACTS AND CLIENT IDENTIFICATION

The grantee did not prepare statements of facts nor identify all clients as required by 45 CFR 1636.2. These cases were identified as 17200 cases in reference to the section of the California Code they were filed under (see page 8 for further discussion of these cases). The grantee provided information that indicated approximately 435 plaintiffs were represented and 238 were named and identified in the pleadings. The remaining 197 were not identified. Statements of facts were not prepared for the unidentified 197 plaintiffs.

Section 1636.2 of LSC's regulations requires that when a grantee files a complaint in court or participates in litigation, it must identify each plaintiff and prepare a statement of facts that each plaintiff signs.

Grantee management stated that it complied with the regulation and that 45 CFR 1636.2 does not require statements of facts or client identification for clients in these cases.

We disagree with the grantee. A review of pleadings indicated that the unnamed and thus unidentified plaintiffs were parties to the litigation. Specific facts concerning their situations were cited in the pleadings. The requirements of 45 CFR 1636.2 apply. The grantee needs to adopt procedures to ensure compliance with 45 CFR 1636.2. All plaintiffs should be identified and they should sign statements of facts.

Recommendation

2.1 We recommend that the Executive Director implement procedures to ensure that statements of facts are prepared for all 17200 type cases and that all clients are identified

IMROPER RENT PAYMENTS

The grantee improperly paid rent for a separate organization, the San Luis Obispo Legal Alternatives Corporation (SLOLAC). This organization is co-located with the grantee's branch office in San Luis Obispo. In total, the grantee provided $6,845 in subsidization during 2000 and 2001.

SLOLAC is a separate legal organization that provides legal services to the elderly. The grantee used LSC grant funds to pay SLOLAC's rent from 2000 through 2001. SLOLAC does not screen clients for their citizenship/alien status and therefore may serve clients who are ineligible to receive LSC assistance under 45 CFR Part 1626. Grantee staff told us that the payments were made as part of its PAI program. The grantee's financial records did not support this contention. We calculated that the grantee improperly spent $6,845 in LSC grant funds over the two year period.

Section 1630.3(a) (2) of LSC's regulations provides that expenditures by a grantee are allowable under the grantee's grant or contract only if the grantee can demonstrate that the cost was reasonable and necessary for the performance of the grant or contract as approved by LSC. The rent payments for SLOLAC did not meet the requirements of this regulation.

Recommendations

To correct the rent payment problem, we recommend that the Executive Director:

3.1 Require SLOLAC to pay their fair share of the rent

3.2 Require the managing attorney in the San Luis Obispo office to review all rental payments and allocations quarterly to ensure that the subsidization does not reoccur.

CASES UNDER SECTION 17200 OF THE CALIFORNIA CODE

The grantee initiates cases under California Business & Professional Code Section 17200 which allows actions for unfair competition to be brought on behalf of individuals and the general public. Two questions about these cases are: do they violate the prohibition on doing class action cases and is the grantee representing clients without determining their eligibility?

Part 1617 of LSC's regulations precludes grantees from initiating or participating in class action suits. These suits are defined as "… a lawsuit filled as, or otherwise declared by the court … to be a class action pursuant…" to various Federal, state, or local rules of procedure. Part 1611 requires grantees to determine the financial eligibility of clients and Part 1626 requires that only citizens or eligible aliens (with some specific exceptions) be accepted as clients.

For 17200 cases, the grantee accepts individuals as clients after determining they meet LSC eligibility requirements. Some of the clients are named plaintiffs and others are unnamed plaintiffs in the lawsuit the grantee files. Other individuals, who are in the same situation and have the same cause of action as the grantee's clients, may benefit from the lawsuit and could receive monetary awards. No eligibility checks are made on these individuals because they are unknown to the grantee when the action is filed.

An example of a 17200 type of case involves agriculture workers having a pay dispute with their employer. One or more workers meet the LSC eligibility requirements and become the grantee's clients. A lawsuit is filed under Section 17200 for the disputed pay. The grantee wins or settles the case and the clients as well as all the other workers, who may or may not be eligible for LSC funded assistance, benefit in a monetary award or settlement.

The grantee provided information on 55 cases filed under Section 17200. Most of the cases involved wage claims and farmworker housing issues. These cases had approximately 460 eligible clients and an additional 779 individuals who benefited from the litigation and whose eligibility was not determined. The grantee informed us that as many as 2,610 additional individuals, whose eligibility had not been determined, could benefit from lawsuits in process as of August 2002. In some cases the court directs the grantee to distribute settlement funds to the individuals involved in the suit. The grantee would therefore provide services to individuals who may or may not be eligible.

In eight cases, only injunctive relief was sought and the general public will benefit.

Settlements had been reached in 33 cases. Plaintiffs were the only beneficiaries in eight cases. The grantee established financial and citizenship eligibility for all plaintiffs. In the remaining 25 cases the beneficiaries included unknown individuals

whose eligibility had not been established. We estimated that about 3,800 individuals who were not party to the litigation may ultimately benefit.

Settlement had not been reached in the remaining 14 cases and both plaintiffs and the general public could benefit. We were unable to estimate how many individuals could benefit from the litigation.

The OIG concluded that the grantee had not violated 45 CFR 1617, 1611 or 1626. The 17200 cases were not filed as nor have the courts certified them as class actions. Therefore 45 CFR 1617 has not been violated. The grantee determined eligibility for all named and unnamed plaintiffs. The other individuals who may benefit from the suits are not grantee clients nor are they represented by the grantee. Parts 1611 and 1626 do not require the grantee to determine the eligibility of individuals who benefit from, but are not a party to, litigation.

BACKGROUND

The grantee is a nonprofit corporation established to provide legal services to indigent individuals who meet eligibility guidelines. It receives both a basic field grant and a migrant grant from LSC. The basic field grant services specific counties in the state of California (including two service areas acquired through merger effective January 1, 2001) and the migrant grant services the entire state. The grantee is headquartered in San Francisco, California. Branch offices are located in throughout the state. At the time of our visits, the grantee had total staff of 128, including 43 attorneys. The grantee received total funding of about $8.6 million during their most recent fiscal year, which ended December 31, 2001. LSC provided about $5.9 million, or about 69 percent of the total funds received by the grantee during that year. LSC is provided about $5.9 million to the grantee during 2002.

Our audit was initiated when the OIG received a letter from the Western United Dairymen about activities engaged in by the grantee. A letter from the Honorable Calvin M. Dooley subsequently followed, also expressing concern about activities and relationships of the grantee.

Grantees are prohibited from transferring LSC funds to another person or organization that engages in restricted activities except when the transfer is for funding PAI activities. In these instances the prohibitions apply only to the LSC funds that were transferred to the person or entity performing within the PAI program. Grantees must also maintain objective integrity and independence from organizations that engage in restricted activities. Grantees may not use grantee resources to subsidize restricted activity. “Subsidize” means to use grantee resources to support, in whole or in part, restricted activity conducted by another entity.

OBJECTIVES, SCOPE, AND METHODOLOGY

This audit assessed whether the grantee complied with requirements established in 45 CFR Part 1610 relating to the transfer of funds to other organizations and program integrity standards.

Our review covered the period January 1, 2000 through May 10, 2002. The OIG began the audit fieldwork in early January 2002 and visited the grantee's offices in San Francisco, Fresno, Modesto, Marysville, Salinas, Oceanside, and San Luis Obispo during the periods January 7-18, February 25 to March 8 and April 29 to May 10, 2002. At LSC headquarters in Washington, DC, we reviewed materials pertaining to the grantee including its Certifications of Program Integrity, audited financial statements, grant proposals, and recipient profile. OIG staff discussed issues relating to the grantee with LSC management officials.

We reviewed the leases and subleases of the grantee to ascertain any relationship between the grantee and entities that may be engaged in LSC restricted activities. If such a relationship was revealed, we conducted an analysis to ensure that the lease payments to the grantee had been calculated at fair market value. Additionally, we reviewed the rental revenue account to ensure that payments to the grantee were made on a timely basis.

We conducted on-site visits of the central office in San Francisco and the following six grantee branch offices: Modesto, Fresno, Marysville, Salinas, Oceanside and San Luis Obispo. We toured the office space and the building they were located in, assessing compliance with the criteria set forth in 45 CFR Section 1610.8(a)(3). We visited the grantee's financial statement auditor.

A legal services provider, California Rural Legal Assistance Foundation, was located in the same building as the grantee's offices in San Francisco, Fresno, Modesto and Oceanside but Foundation staff would not speak to us. A different legal services provider, San Luis Obispo Legal Alternatives Corporation, was located in the same building as the grantee's office in San Luis Obispo. The OIG interviewed the Project Director of San Luis Obispo Legal Alternatives Corporation.

During the on-site visit, the OIG interviewed and collected information from the Executive Director, senior management, case handlers, and other staff. We ascertained whether the grantee's employees were generally knowledgeable regarding the guidelines set forth in Part 1610. The audit included an assessment of the grantee policies and procedures applicable to the transfer of funds to other organizations and program integrity requirements.

The OIG gained an understanding of the client intake process utilized by the grantee. We identified the grantee's controls regarding its oversight of its Private Attorney Involvement program.

The OIG identified and reviewed cases that had been filed in court to determine if the grantee had engaged in a restricted or prohibited activity. All cases were discussed with a Director of Litigation and Training or a Directing Attorney employed by the grantee.

The OIG reviewed three separate populations of cases that had been filed with the courts as follows:

- a sample of 97 cases selected from the case listing provided by the grantee used to support CSR submissions to LSC (An additional 10 cases were selected, for a total sample size of 107 cases);

- a sample of 19 co-counseled cases, totaling 127 client case files; and

- 55 cases identified by the grantee as involving actions taken on behalf of the public pursuant to California Business & Professions Code Section 17200. (In addition, 10 client case files were sampled for review.)

We reviewed fifty-five cases identified by the grantee as involving actions taken on behalf of similarly situated members of the public pursuant to California Business & Professions Code Section 17200. The pleadings from each of these cases were reviewed in order to determine whether the cause of action involved restricted and/or prohibited activities and to ascertain the beneficiaries of this cause of action. Additionally, the existence of any co-counsel arrangement was confirmed and the parties identified. Furthermore, the settlement agreements (if applicable) were reviewed to ascertain the number of people benefiting from this action and whether any fees and/or costs were awarded to any parties to the litigation.

The OIG reviewed the grantee's financial accounts for vendors including contractors, employees, and consultants. From the 1,633 vendors identified in the grantee's Master Vendor List, we judgmentally selected 129 vendors and examined 100 percent of the activity. We reviewed 820 transactions totaling $1.08 million. In addition to the vendor charges reviewed, we reviewed $465,000 in payments related to three subgrants to the Foundation to determine whether LSC funds were used.

We also reviewed three miscellaneous income categories during CY 2000 and 2001—donations, rents, and attorneys fees. Of the $363,581 received through 1,342 donations, we reviewed 264 donations totaling $149,900. We also reviewed 116 rental payments totaling $81,510 received from 9 tenants, and $47,581 received in attorneys fees, court and transcription costs, and sanctions.

For the branch offices located in Madera and San Luis Obispo, we reviewed the office space expenses, by funding source, for the years 2000 and 2001. We calculated LSC's funded portion of these costs to assess allowability.

The OIG assessed the process used by the grantee to allocate direct and indirect costs to LSC and non-LSC funds. Policies and procedures relating to payroll and timekeeping were evaluated. The grantee's employees were interviewed to determine their understanding as to which fund they should charge their time relative to case handling.

All agreements between the grantee, and other organizations and individuals, were requested. The OIG reviewed all materials provided including grant funding instruments, leases, and contracts.

We performed this audit in accordance with *Government Auditing Standards* (1994 revision) established by the Comptroller General of the United States and under authority of the Inspector General Act of 1978, as amended and Public Law 105-277, incorporating by reference Public Law 104-134.

SUMMARY OF GRANTEE'S COMMENTS ON DRAFT REPORT AND THE OIG'S RESPONSE

The grantee's comments stated that the report confirms that it is "… in full compliance with applicable LSC rules and policies." The comments disagreed with the report's findings and recommendations and asked that the OIG reconsider its conclusions. The grantee's comments are in Appendix l.

The grantee stated that the OIG audit focused on its relationship with the California Rural Assistance Foundation (Foundation) and "ultimately expanded into a review of CRLA compliance with LSC regulatory changes implemented by Congress in 1996." The grantee also stated that the OIG review required it to produce hundreds of pages of specially prepared legal memoranda and required thousands of hours of staff time.

The OIG's review of compliance with program integrity requirements necessitated a review of the grantee's relationship with the Foundation, an organization engaged in LSC restricted activities. The OIG also reviewed the grantee's relationships with other organizations. Contrary to the grantee's assertion, the OIG did not undertake a comprehensive review of compliance with the restrictions imposed by Congress in LSC's 1996 appropriation. The OIG did not request and did not require the vast majority of legal memoranda and attachments prepared by the grantee, nor did the audit require the grantee to expend the inordinate amount of staff time it allegedly devoted to the audit process. The memoranda were prepared and time was spent primarily at the grantee's discretion.

The OIG considered the grantee's comments in finalizing the report and made some revisions. The OIG does not agree with the grantee's statement that it complies with LSC rules and regulations. To the contrary, the grantee did not comply with 45 CFR Parts 1610, 1636, and 1630 during the audit period. We made a few minor revisions in the text of the report that do not impact on our findings.

The grantee provided extensive comments, some of which were not directly relevant to the OIG's findings. The OIG summarized and addressed what it considered the grantee's significant and relevant comments. Not all comments were addressed. The fact that a specific comment was not addressed should not be interpreted as meaning that the OIG agrees with the comment.

A summary of the grantee's comments and OIG response for each finding follows.

GRANTEE COMMENT – PROGRAM INTEGRITY

The grantee disagreed with the report's finding that it did not comply with program integrity requirements.

The OIG finding was based on four specific problem areas as follows: co-counseled cases with the Foundation, shared staff, rent subsidy, and physical separation of facilities. The grantee's comments disputed each specific problem area.

The grantee disagreed that its overall co-counseling relationship with the Foundation violated 45 CFR 1610. According to the grantee, co-counseling was an effective means of involving the private bar in the delivery of legal services to the low income community and the grantee has identical co-counseling arrangements with over two dozen other firms. The comments confirmed the co-counseling relationship between the grantee and the Foundation described in the draft report. The comments stated that the part time DLAT who co-counseled the case for the Foundation did not supervise the Directing Attorney who was the grantee attorney for the case as stated in the report.

The report included a discussion of the Director of the Oceanside office position as director of the "Border Project" for the Foundation while a full time grantee employee. Her telephone number on the Foundation's web site was the same as her grantee telephone number. Grantee comments stated that to the best of management's knowledge the individual was an unpaid volunteer for the Foundation and did not engage in the practice of law. The comments agreed that the telephone number listing was inappropriate.

The grantee stated that LSC's regulations do not provide specific limits on sharing personnel. According to the grantee, the LSC guidance focuses on the number of shared staff as a percentage of the total staff. A small percentage of the staff was involved with the Foundation and the grantee asserted that it complied with the regulation.

The grantee disagreed with the finding that it subsidized the Foundation by allowing late rent payments for space leased in three grantee offices. The information provided confirmed that the Foundation had paid its rent late without interest being charged. According to the grantee, its accounting procedures became more rigorous before the issuance of the draft report and fully meet the OIG recommendation. Documentation was provided indicating that in May 2002 and October 2003 the Foundation was billed for interest charges related to late payments. Subsequent rent payments were asserted to be on time.

The grantee stated that the report's conclusion that the space rented to the Foundation in Modesto was not physically separated from the grantee's space appeared to extend the 1610 requirements beyond what was commonly understood. According to the grantee, the Foundation's space was identified by appropriate signs and confusion was unlikely because the distinction between the grantee's space and the Foundation's space was apparent to the public. The grantee also stated that this Foundation lease was terminated in mid-2002.

In disagreeing with the OIG's findings, the grantee referred to a review conducted by LSC's OCE that preceded the OIG's audit. The grantee stated that OCE examined the same issues as the OIG and found no violation of the program integrity requirements of 45 CFR Part 1610. According to the grantee, OCE indicated that the grantee's relationships with the Foundation did not raise material concerns and did not violate the objective integrity and independence standard of 45 CFR Part 1610.

The grantee declined to implement the OIG's five recommendations related to these findings.

OIG RESPONSE

The comments did not provide information to change the OIG's conclusion that the grantee did not comply with the program integrity requirements.

Part 1610 of LSC's regulations requires that program integrity be accessed under three criteria, the third of which is physical and financial separation, 45 CFR §1610.8(a)(3). Physical and financial separation is determined through a review of the totality of the circumstances. The OIG evaluated the overall relationship between the grantee and the Foundation and concluded that the program integrity requirements were not met. The grantee addressed each of the four OIG identified problem areas as discrete issues and did not discuss the need for an assessment of the totality of the circumstances.

LSC guidance on shared personnel states that percentage of staff shared should be considered when assessing the separateness of organizations. The guidance also requires that the responsibilities of the staff shared be considered. The grantee had two senior level attorneys co-counsel cases with the Foundation. One of the attorneys was the attorney for the grantee on a case and the attorney for the Foundation on another case. This arrangement does not provide for adequate separation between the grantee and the Foundation. The grantee raised an issue about the description of a supervisory relationship. The OIG deleted the reference to supervision in the report.

A third senior level attorney, the Director of the Oceanside office, was identified as occupying an important position with the Foundation. The grantee stated that it was unaware of this arrangement but now understands that the individual was an unpaid volunteer for the Foundation. Given the close relationship between the grantee and the Foundation it is difficult to understand how the grantee did not recognize the individual's significant position with the Foundation. The grantee's part time DLAT, who also worked for the Foundation, supervised the Director at the Oceanside office, underscoring the rationale for limiting the sharing of senior staff discussed above. The listing of the director's grantee telephone number as her Foundation telephone number indicates that she used grantee assets for conducting Foundation business. The grantee violated 45 CFR Part 1610.

In summary, the grantee did not provide any information that would warrant significantly changing the co-counseling and shared staff discussion in the report. Accordingly, the only change made was to delete the reference to supervision as mentioned above.

It is difficult to understand the grantee's disagreement with the finding that it subsidized the Foundation by allowing late rental payments. The grantee provided information that substantiated the finding. The comments did not dispute that the Foundation's rent payments were late and interest was not charged. Clearly, this resulted in a subsidization of the Foundation.

The grantee did begin to bill the Foundation for interest on late payments in May 2002, after the OIG pointed out the problem and insisted that such billings were needed. The grantee provided information indicates that shortly after the OIG staff completed on-site audit work Foundation rental payments were again late and interest was not charged. In October 2003, the grantee billed interest for late rental payments that were made between September 2002 and January 2003. The OIG did not change the finding on subsidization.

The OIG disagrees with the grantee's assertion that the Foundation's space in the Modesto office was physically separate from the grantee's space. The grantee's comments stated that signs distinguished the Foundation space from the grantee's space. A sign outside the building indicated that the Foundation and grantee occupied separate suites. In fact, the two offices were in a single suite and were not separated by a physical barrier. Foundation and grantee staff moved freely within the suite. There were no signs inside the building that distinguished between the Foundation and the grantee. We recognize that the Foundation no longer shares space with the grantee in Modesto. At the time of our review a physical separation problem existed and we did not change the finding.

In disagreeing with the report findings the grantee's comments cited a review done by OCE that found no program integrity violations. In December 2000 OCE completed a limited review that covered some program integrity issues. A comprehensive program integrity review was not done.

The OIG reaffirms its recommendations. Based on the comments provided by the grantee, we renumbered the recommendations in this section as 1.1 through 1.5.

GRANTEE COMMENT – STATEMENT OF FACTS

The grantee disagreed with the finding that it did not comply with the statements of facts and client identity requirements of 45 CFR Section 1632.2. The grantee stated it obtains statements of facts from and identifies all plaintiffs in 17200 type cases. From time-to-time the grantee documents an attorney client relationship with individuals through a non-litigation retainer agreement. These retainers may be for the purposes of counseling and advising, but they do not authorize the grantee to file suit on the client's behalf. According to the grantee, these clients are not plaintiffs or parties to the litigation and statements of facts are not required. Consequently, the grantee did not agree to implement recommendation 2.1.

OIG RESPONSE

The OIG does not agree with the grantee's assertion that it complies with 45 CFR Part 1636. The grantee's comments discussed its retainer agreements with clients who were unnamed plaintiffs in the 17200 cases. Retainer agreements are not the issue.

In 17200 cases, the grantee files complaints on behalf of named plaintiffs and members of the general public who are similarly situated individuals and who would benefit from the litigation. In certain of these cases, the grantee has clients it refers to as "unnamed plaintiffs." The grantee represents these "unnamed plaintiff" clients in connection with the 17200 litigation. At times, the grantee pleads specific facts about these clients in the complaints but does not name them as plaintiffs because they are members of the general public who are similarly situated individuals and would benefit from the litigation. This is precisely the type of situation Part 1636 was intended to cover. The grantee need not name these individual clients in the complaint, but under Part 1636, it must identify these clients to the defendant and prepare a written statement of facts.

The OIG reaffirms its recommendation.

GRANTEE COMMENT – IMPROPER RENT PAYMENTS

The grantee disagreed with the OIG's finding that it improperly paid rent for two organizations co-located with the grantee's offices in San Luis Obispo and Madera.

The grantee's comments stated that rent was paid for a legal clinic that engaged in non-restricted activities at the San Luis Obispo branch office. The grantee stated that the clinic's clients were overwhelmingly LSC eligible and the clinic fulfilled the grantee's PAI obligation. The grantee stated that the rent payments for the legal clinic were reasonable and necessary for the performance of its grant and are proper PAI expenditures. According to the grantee, its accounting staff inadvertently discontinued allocating the rent payment to the PAI account, but this did not cause the expense to be ineligible as PAI.

The grantee provides a room rent free to a non-profit organization that promotes community and economic development in its Madera branch office. The grantee stated that the organization is not a legal services provider and does not engage in restricted activities. The organization provides volunteers to work on community education and maintains records of the volunteer hours. The value of the volunteer's activities far exceeded the value of one room that is provided rent free. The grantee stated that it rents the entire building and the amount it pays is not increased by allowing the community organization to occupy one room. The grantee stated that LSC's Property Acquisition and Management Manual allows it to provide the space rent free and requires that rent be charged only to organizations that engage in restricted activities.

Consequently, the grantee declined to implement recommendations 3.1 and 3.2.

OIG RESPONSE

We reviewed the grantee's comments and confirmed our finding that the grantee did not comply with LSC requirements at its San Luis Obispo office. We deleted the part of the finding related to the Madera office.

The legal clinic located in the San Luis Obispo branch office does not screen for citizenship/alien eligibility status. Consequently, it is unclear how the grantee can assert that the clients are "overwhelmingly [LSC] eligible clients." The grantee has no assurance that the legal clinic is only serving LSC eligible clients. Therefore, LSC provided funds cannot be used to pay the clinic's rent. The grantee agreed that during the audit period the rent costs were not charged to the PAI program as the OIG reported.

The grantee's position on providing a rent free room to the community organization at its Madera office has not completely persuaded us. However, we note that the grantee explained that it incurred no additional costs. Due to the minor amounts involved, we deleted that part of the rent finding relating to the Madera office and modified our recommendations accordingly.

We do not agree that LSC's Property Acquisition and Management Manual requirement to charge rent applies only to organizations engaged in restricted activities.

The OIG modified recommendations 3.1 and 3.2 to apply only to the San Luis Obispo office.

CALIFORNIA RURAL LEGAL ASSISTANCE, Inc.

APPENDIX I

November 14, 2003

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Salinas
San Luis Obispo
Santa Barbara
Santa Cruz
Santa Maria
Santa Rosa
Stockton
Watsonville

Leonard J. Koczur
Acting Inspector General
Legal Services Corporation
3333 K Street, NW, 3rd Floor
Washington, DC 20007-3522

Re: **CRLA's COMMENTS IN REPLY TO**
OIG DRAFT AUDIT REPORT
Recipient No. 805260 ***[Faxed to (202)-337-6616]***

Dear Mr. Koczur:

Thank you, again, for extending the time period for our comments. The week extension from November 7 to November 14 allowed us provide you with more extensive comments than we otherwise could have provided.

Accompanying this report are CRLA's comments to your draft report issued September 30, 2003. I hope the comments allow you to modify some of the draft recommendations made in your initial (draft) report.

If our comments require further information or discussion, please call me at (415)-777-2752. It is our intent that any information provided the general public would not unnecessarily reduce the support for legal services that exists nor in any way result in any public misunderstanding regarding how CRLA serves its rural clientele.

Sincerely,

Jose R. Padilla
Executive Director
California Rural Legal Assistance Inc.

Enclosure

LSC

CALIFORNIA RURAL LEGAL ASSISTANCE, INC.

CRLA's COMMENTS IN REPLY TO OIG DRAFT AUDIT REPORT (issued September 30, 2003) re "REVIEW OF GRANTEE'S TRANSFER OF FUNDS AND COMPLIANCE WITH PROGRAM INTEGRITY STANDARDS"

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November 14, 2003

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EXECUTIVE SUMMARY

After a two-year compliance review by the Office of the Inspector General that is to the best of our knowledge unprecedented in its breadth, the OIG's Draft Audit Report by and large confirms that CRLA is a well-regulated recipient of Legal Service Corporation funding in full compliance with applicable LSC rules and policies. However, the Draft Report specifies a few, limited areas in which the OIG contends that different practices are necessary. CRLA respectfully disagrees, and in these Comments explains how and why.

Specifically, the OIG's Draft Report argues that CRLA has violated LSC Regulation Part 1610 by failing to maintain adequate "program integrity" between CRLA and an entity–the "Foundation"--that undertakes activities in which an LSC recipient is precluded from engaging. The Report reaches this conclusion because it finds that CRLA has: (1) co-counseled with Foundation legal staff; (2) "shared" two of its staff with the Foundation on a part-time basis; (3) "subsidized" the Foundation by failing to charge interest on late Foundation rent payments; and (4) insufficiently separated the physical space that the Foundation previously leased in one of CRLA's offices. Ironically, these very same issues were examined by LSC's own Office of Compliance and Enforcement only eight months prior to commencement of the OIG review, and OCE found no violation with the "program integrity" requirements of Part 1610.

For reasons set out more fully below, we conclude that CRLA's co-counseling and shared staff have been in full compliance with all LSC requirements, including 1610 "program integrity". [See, Sections I.A. and I.E., below.] We have revised our accounting procedures both to diminish the likelihood that the Foundation will tender rent payments after their due dates and to assure that our invoicing for any late-payment interest occurs promptly. [See, Sections I.C. and I.E., below.] And any issue regarding separation of space has been mooted by termination of the lease some time ago. [See, Section I.D., below.]

The Draft Report also concludes that CRLA has not complied with LSC Regulation 1636.2 requiring programs to obtain plaintiff statements of fact and provide plaintiff identification. Here, the Draft Report simply errs; CRLA is in full compliance. [See, Section II.A., below.]

The Draft Report further concludes that CRLA improperly provides space to the San Luis Obispo seniors legal clinic and to the Madera coalition that provides volunteers to undertake CRLA activities. Here, again, the Report errs: these practices are consistent with all applicable LSC requirements. [See, Section II.B., below.]

Contrary to the Draft Report's conclusions in these limited areas, we believe the OIG's findings demonstrate that CRLA has been conscientiously and rigorously in compliance with LSC's mandates in these areas just as it has been in all others. We respectfully urge the Inspector General to reconsider his conclusions.

INTRODUCTION

California Rural Legal Assistance, Inc. ("CRLA") hereby comments in response to the Office of the Inspector General's Draft Report of his recently-completed audit covering the period January 1, 2000 through May 10, 2002.

The OIG Draft Report culminates a review process that began on June 11, 2001, and extended through the September 30, 2003 issuance of the Draft Report. The OIG's initial audit notice of June 11, 2001, stated that an audit of CRLA's "program integrity" as defined under 45 C.F.R., § 1610 would be conducted. The actual audit focused on our relationship with the California Rural Legal Assistance Foundation ("Foundation"), and ultimately expanded into a review of CRLA compliance with LSC regulatory changes implemented by Congress in 1996. The audit process included: on-site fieldwork involving four separate audit-team field visits (including the visit for the exit interview) totaling nearly seven weeks; production of hundreds of case files;[1] CRLA's transmission to Washington of thousands of pages of case and advocacy materials plus hundreds of pages of specially-prepared legal memoranda between and after visits; and literally thousands of hours of CRLA staff time in responding to OIG's document and other information requests.

We are gratified that this extensive review has confirmed the propriety and regularity of CRLA's operations in most respects, and in no respect concludes that penalties should be imposed. The Draft Report does, however, provide a limited number of prospective recommendations for future practices. The OIG's determination that CRLA failed to maintain program integrity from the Foundation is predicated upon extremely limited circumstances that we do not believe support the conclusion. We also believe that certain OIG recommendations (and their underlying findings or reasoning) regarding other compliance issues misapprehend facts or are inconsistent with longstanding

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[1]The Draft Report (at page 11) characterizes CRLA as having delayed in providing access to some of these files. We find the statement inexplicable. Upon the OIG's identification of an initial sample of 97 cases for file review, we promptly informed the audit team that some 30 of those files were administrative proceedings in agencies under which the identity of the party and/or information revealing that party's participation in proceedings was confidential under applicable state or federal law. We were prepared to make these administrative-proceeding files immediately available for audit team review under alternative procedures we proposed to protect the identities of those particular clients and/or "insulate" their identities from the proceedings in which they participated, as we believed state and federal law required. The OIG declined to review the files under conditions protecting client confidentiality, and subsequently requested that CRLA provide legal memoranda in support of our positions. We responded with five separate memoranda (corresponding to the various agency and/or administrative schemes) within 24 hours, and thereafter CRLA and the OIG engaged in a number of discussions (including a meeting of our Executive Director with the Acting Inspector General in Washington). Ultimately, the OIG proposed a different procedure which satisfied CRLA's client-confidentiality concerns, and review of these administrative files thereafter occurred at the audit team's convenience. The OIG subsequently added another 10 files to the sample, which also were promptly provided.

LSC policies and the Corporation's expectations about implementation of those policies. We comment in Section I regarding Part 1610 "Program Integrity" *vis a vis* the Foundation, and in Section II on other, non-1610 issues.

I. PART 1610 "PROGRAM INTEGRITY" *vis a vis* THE FOUNDATION

CRLA is a private California non-profit corporation that was formed in 1966 to provide free legal counseling and representation to low-income communities throughout rural California. CRLA has been a "qualified program" or "recipient" within the meaning of the Legal Services Corporation Act (42 U.S.C. §§ 2996 *et seq.*, § 2996e) since commencement of the Corporation. CRLA is governed by a Board of Directors; its senior management structure includes an Executive Director, a Deputy Director, a Controller and a Human Resources Director. CRLA's administrative headquarters is in San Francisco. As of the commencement of the audit, CRLA had 23 field offices in 21 locations. Senior-level advocacy-management includes four Directors of Litigation, Advocacy and Training (DLATs), each of whom provides senior-level oversight and supervision to a group of assigned Regional Offices (and affiliated satellites), and each of whom is also responsible on a program-wide basis for specific substantive areas of advocacy.

The Foundation was incorporated as a Section 501(c)(3) non-profit corporation in January 1982, and has existed as an independent non-profit corporation at all times thereafter. The Foundation's Board and management are entirely separate from CRLA. The Foundation's administrative headquarters are in Sacramento.[2] The Foundation is not an LSC recipient, and does engage in restricted activities not permitted to LSC recipients. As permitted under Section 1610, CRLA transfers certain amounts of non-LSC funds to the Foundation.

CRLA believes that it has conscientiously and vigorously maintained "program integrity" from the Foundation, as required by 45 C.F.R. Section 1610.8. Nevertheless, the Draft Report concludes that CRLA failed to maintain "objective integrity and independence" from the Foundation because--in the OIG's view–CRLA "subsidized" the Foundation in certain ways and we failed to maintain physical separation from the Foundation. The Draft Report also concludes that CRLA maintains a "close relationship with the Foundation that makes it difficult to distinguish between the two organizations" in violation of program integrity requirements. These conclusions are predicated upon findings in four "specific problem areas", discussed in turn below, none of which is expressly tied in the Draft Report to any specific provisions of Section 1610.8. We respectfully do not believe that the findings support the conclusions.

Before addressing these issues, however, we note that the OIG audit followed a complaint from the Western United Dairymen--transmitted through a member of Congress--that replicated an earlier

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[2]At one time CRLA had a legislative advocacy office in Sacramento but, since 1996, has not had an office in that city.

complaint by the Dairymen to the Legal Services Corporation. In response to that earlier complaint, in October 2000, LSC's Office of Compliance and Enforcement (OCE) had reviewed CRLA's relationship with the Foundation under Part1610 standards--including the issues reviewed by the OIG beginning less than 12 months later: co-counseling, shared staff, rent payments, physical and financial separation. OCE also reviewed financial data related to the division of costs between CRLA and the Foundation in bringing specific co-counseled litigation. The October 2000 OCE audit also reviewed CRLA leases to the Foundation which then existed in Modesto, Fresno and San Francisco. The OCE review of these leases produced one specific recommendation: that CRLA improve our office security in San Francisco by placing a lock on the door between our space and the space leased by the Foundation; CRLA immediately complied. Ultimately, approximately 8 months before the OIG review began, OCE indicated to CRLA that our overall implementation of 1610–specifically, our various relationships with the Foundation–did not raise a material concern and did not violate the "objective integrity and independence" standard of 1610.

A. Co-counseled Cases

The Draft Report concludes that co-counseling arrangements between CRLA and the Foundation demonstrate a lack of independence between the two entities not consistent with the program integrity requirements of Part 1610. This conclusion is reached with no apparent reference to most of the relevant facts provided to the OIG, and does not withstand informed scrutiny.

CRLA attempts to secure "private", *i.e.*, non-LSC-funded, attorneys to co-counsel with our staff attorneys in significant litigation. Co-counseling is, of course, common in litigation and other types of legal practice, and is consistent with the Act and Regulations. CRLA undertakes co-counseling to satisfy our obligation under LSC Regulations to expend 12 ½ % of our annualized basic field award to involve private attorneys in delivery of legal services. ("Private Attorney Involvement" or "PAI", 45 C.F.R., § 1614.)[3]

In CRLA's experience, co-counseling is a synergistically effective means of involving the private bar in service to the low-income constituency we serve for a number of reasons: (1) in some cases, co-counseling obtains the benefit of more experienced litigators who can enable a local office staffed by limited-experience staff to undertake representation that we could not otherwise provide; (2) in some instances, co-counseling provides the added staffing and physical resources of a private law firm that

[3]We use the term "co-counseling" to refer to joint representation between CRLA and outside attorneys of LSC-eligible clients with whom CRLA has retainers. In this joint representation and pursuant to a provision in the co-counseling agreement, outside counsel execute their own independent retainers with the clients represented by CRLA. From time to time, CRLA represents clients in litigation in which outside counsel represent other parties with parallel interests, claims or defenses, i.e., co-plaintiffs or co-defendants–but who do not jointly represent CRLA's clients. We do not characterize these situations as "co-counseling", and do not enter co-counseling agreements.

enables CRLA to pursue extensive litigation for which we otherwise would not have adequate professional and/or support personnel to undertake; and, (3) in some cases, co-counseling enables CRLA to use our "expertise" to acquaint and train members of the local private bar in specialized areas of poverty law with a goal of expanding the availability of private-bar representation to low-income clients including the vast number of non-LSC-eligible poor people in rural California. CRLA takes pride in our years of efforts to involve the private bar in rural poverty-law cases in the face of challenges posed by issues of distance, language, often-perceived conflicts of interest by local attorneys and, frequently, relatively-limited recoveries in comparison to time and resource demands of the cases.

CRLA implements litigation co-counseling arrangements through written co-counseling agreements, generally based upon a 9-page "model" agreement that is tailored in individual cases as appropriate to the particular circumstances of the case and/or the needs and resources of outside counsel. The audit team requested that CRLA identify all litigated cases with co-counseling agreements that were in effect at any time during calendar years 2000 or 2001. We identified agreements in 42 separate cases including six in which the Foundation co-counseled, and made forty-one agreements available for review.[4] In these 42 cases (including some cases in which we co-counseled with more than one firm), CRLA co-counseled with at least 26 different law firms one of which was the Foundation.[5] We co-counseled on more than one case with at least 9 of these firms.

The audit team remarked during on-site field visits that they had never previously encountered recipient co-counseling arrangements documented in such detail. More germane to the Draft Report's conclusion, the on-site team reported to CRLA management that they found no distinctions or discrepancies between the written co-counseling agreements CRLA entered with the Foundation and those CRLA entered with other law firms, and further found no distinctions or discrepancies between actual implementation of the co-counseling arrangements CRLA entered into with the Foundation and those CRLA entered into with the other firms.

By disregarding the extensive nature of CRLA's co-counseling arrangements with many non-LSC-funded counsel, the Draft Report implies a unique or "close" relationship between CRLA and the Foundation when the reality is that the co-counseling "relationship" is identical to that with all of the numerous law firms with whom CRLA co-counsels. We cannot understand why the Draft Report treats this completely appropriate activity as demonstrating "lack of independence" from the Foundation when (although the Draft Report fails to mention it) CRLA engages in identical co-counseling arrangements with over two dozen firms in addition to the Foundation.

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[4]As we reported previously to the Inspector General, CRLA was unable to locate the co-counseling agreement in one, non-LSC-funded case (which was not co-counseled with the Foundation).

[5]These firms included both traditional, for-profit, private law offices and other non-profit entities that provide legal representation.

The Draft Report expresses concern because, in the five co-counsel agreements with the Foundation in which CRLA was lead counsel, the agreements included a provision spelling out in some detail lead-counsel's responsibilities; that provision did not appear in the one agreement in which the Foundation was lead counsel. This again ignores the fact that this circumstance was by no means limited to co-counseling agreements with the Foundation. The 41 total co-counsel agreements designated CRLA as lead counsel in 25 agreements, and outside law firms as lead counsel in 16 agreements. Of these forty-one agreements, five (approximately 12%) did not include the provision detailing lead-counsel's responsibilities referenced in the Draft Report: Of these latter five, CRLA was lead counsel in three and outside counsel was designated lead counsel in the remaining two (including the one referenced in the Draft Report–in which the Foundation was co-counsel). Thus, the absence of the provision spelling out lead counsel's responsibilities was not limited to one agreement with the Foundation and, indeed, occurred more often in agreements designating CRLA as lead counsel.

The Draft Report notes that CRLA was responsible for all costs and litigation expenses in cases co-counseled with the Foundation; that provision actually was included in five of the six agreements. The same cost-allocation provision was included in fourteen of the remaining 35 agreements with other outside counsel. Another 13 agreements provided that outside counsel would cover their own travel, photocopying and postage costs, while CRLA would advance all other costs. The remaining eight included other variations. This observation merits three responses: *First*, CRLA's payment of these costs for outside counsel is an appropriate PAI expenditure fully authorized by LSC rules. (Indeed, it would be appropriate to pay all of outside counsel's costs *and fees* as PAI expenditures, but CRLA "leverages" these relationships through encouraging outside counsel to underwrite costs to the maximum extent feasible and to seek fees through fee-shifting awards.) *Second*, CRLA's advancement of costs is a condition negotiated with outside counsel (including those other than the Foundation) to obtain their participation; outside counsel's willingness to assume costs varies from case to case depending upon their respective evaluations of the costliness of the litigation and the timing and likelihood of recovery, as well as counsel's perceptions of their own respective financial capacities. *Third*, the agreements provide that costs awarded by the court or recovered from defendants will be paid proportionally to the party that incurred the costs–thus, outside counsel do not have a preferential position in recovering costs.

CRLA takes pride in the documentation and transparency of our co-counseling arrangements. We are frankly puzzled by the OIG's conclusion that our co-counseling with the Foundation--in a manner which OIG's audit team confirmed demonstrates neither favoritism nor other special consideration--demonstrates lack of either objective integrity or of CRLA independence from the Foundation, or suggests an "identification" between CRLA and the Foundation that does not exist in other co-counseled arrangements.

B. Shared Staff

During the first year of the audit period, one full-time CRLA employee served as a volunteer

with the Foundation. During both years a second, part-time employee was employed by the Foundation during time neither pledged to nor paid by CRLA. We believe these positions did not, and do not, offend 1610 program integrity requirements. However, the Draft Report expresses concerns about the participation of shared staff in cases co-counseled with the Foundation, as well as the management-level and number of shared staff. We address these in order.

1. Participation of Shared Staff in Co-Counseled Cases

The Draft Report concludes at page 3 that CRLA's overall co-counseling relationship with the Foundation is problematic due to shared staff between the two organizations. We respectfully disagree.

As noted above, CRLA's day-to-day advocacy is overseen by four DLATs. Each has oversight over approximately one-quarter of CRLA's regional offices, and each further has responsibility as a program-wide resource and senior policy advocate in one or more designated substantive areas (*e.g.*, housing; *e.g.*, employment). The DLATs hold twice-monthly meetings to review and approve proposed litigation, and to jointly review CRLA's advocacy in general. One of the four DLATs is part-time, working for CRLA on a 90%-time appointment and for the Foundation on a 10% basis.

In "Case A" co-counseled with the Foundation, CRLA's part-time DLAT--utilizing her non-CRLA time--served as lead counsel for the Foundation, and throughout that case entered her appearances as counsel for the Foundation. The lead attorney in that case for CRLA was another (full-time) DLAT; thus CRLA staffed the case with an equivalent senior litigator who was not under the supervision of the part-time DLAT staffing the case for the Foundation.

In Case "B" co-counseled with the Foundation, CRLA's part-time DLAT again served as a counsel for the Foundation (again utilizing her non-CRLA time and, again, entering her appearances only as counsel for the Foundation). CRLA's lead attorney was the Directing Attorney for the CRLA regional office in which the case originated. The Draft Report errs in stating that the part-time DLAT participating in the case for the Foundation was the regional-office Directing Attorney's supervisor; in fact, the Directing Attorney (and corresponding regional office) in question was supervised not by the part-time DLAT participating in the case for the Foundation but by a different DLAT.

2. Number and Status of Shared Staff

The Draft Report, at pages 3-4, concludes that the sharing of 2 "senior level attorneys" with the Foundation contributed to a violation of "program integrity" requirements.

Section 1610.8 provides that

[w]hether sufficient physical and financial separation exists will be determined on a

> case-by-case basis and will be based on the totality of the facts. The presence or absence of any one or more factors will not be determinative. Factors relevant to this determination shall include but will not be limited to . . . (i) the existence of separate personnel . . .

(45 C.F.R., § 1610.8(3).) LSC's regulations do not articulate specific limits on shared personnel. However, LSC has provided additional guidance through other formal communications to programs. For example, a recipient may have an overlapping board with an organization that engages in restricted activity so long as the recipient otherwise maintains objective independence and integrity from the other organization. (LSC Memorandum, to LSC Program Directors, Board Chairs, from John A. Tull, Director/Office of Program Operations (Oct. 30, 1997), p. 2 fn. 3.) Although permitted by LSC, CRLA and the Foundation have never had overlapping boards.

LSC has also advised that,

> [g]enerally speaking . . . the more staff "shared" or the greater the responsibilities of the staff who are employed by both organizations, the more danger that program integrity will be compromised. Sharing an executive director, for example, inappropriately tends to blur the organizational lines between the entities. Likewise, sharing a *substantial number or proportion* of recipient staff calls the recipient's separateness into question.

(*GUIDANCE IN APPLYING THE PROGRAM INTEGRITY STANDARDS*, attachment to LSC Memorandum, *supra*, emphasis added.) LSC then advises that "[f]or larger organizations, 10% of the recipient's attorney/paralegal staff should serve as a guide" to interpreting "substantial portion". (GUIDANCE, *supra*, p. 3 fn. 2.) CRLA implemented this 10 % guideline as our limitation on shared part-time staff. With approximately 70 attorneys/paralegals during the audit period, the LSC guideline would trigger consideration of CRLA's program integrity upon the existence of 7 shared staff.

The Draft Report, however, raises the concern where only 2 staff were shared between CRLA and the Foundation. One of these two shared-staff positions ended nearly three years ago upon resignation of that individual who was the former full-time Directing Attorney of CRLA's Oceanside office. The Inspector General concludes that, during her CRLA tenure, this individual was also the Director of the Foundation's "Border Project". To the best of CRLA's knowledge, this individual's role with the Foundation was as an unpaid volunteer.[6]

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[6]The Inspector General determined that the Foundation's web site listed the "Border Project" Director's telephone as her CRLA office number. CRLA was unaware of this during the time we employed the individual as our Oceanside Directing Attorney. We agree that such a listing was inappropriate.

In sum, CRLA took care to comply during the period under examination with published LSC guidelines, falling far under the suggested limits on shared staff. We are, again, puzzled at the OIG's criticism of practices substantially within LSC criteria on which CRLA was encouraged to rely.

C. Rent Subsidy

The Draft Report, at pages 4-5, concludes that CRLA subsidized the Foundation by allowing late payments of rent for space leased to the Foundation in three CRLA offices. We believe the facts do not justify that conclusion, and in any case our accounting procedures regarding tenant rent payments had already become more rigorous before the Draft Report issued, and now fully meet the OIG recommendation.

Prior to October 2000 when CRLA was reviewed by LSC's Office of Compliance and Enforcement (OCE), CRLA management did not consider late rent payments by the Foundation or any other tenant to be subsidies. This was consistent with our treatment of other receivables including those due from federal agencies. Thus, it was and is quite common for CRLA to carry Accounts Receivable balances for grants that are many times greater than the rent owed CRLA by the Foundation at any time. HUD, for example, often pays CRLA four or five months after grant income has been accrued and the corresponding receivable has been earned. Of course, neither HUD nor any other granting entity would pay CRLA interest on the amount owed, as the OIG proposes should have been the case with the Foundation.

Nevertheless, after OCE in late 2000 raised the question of late rents potentially constituting subsidization,[7] CRLA's Executive Director and then-Controller advised the Foundation's Executive Director and Board Chair in February 2001, that late rent payments could be considered a subsidy unless appropriately compensated. CRLA further urged the Foundation to implement automatic, timely rent payments inasmuch as we preferred not to start the practice of invoicing rent, which we received from several tenants, because of late payments by one. CRLA informed LSC of this communication in March, 2001.[8] Thereafter, the Foundation made timely rent payments for a number of months in early 2001.

In mid-2001, CRLA's incumbent Accountant and Controller each left their positions, and we re-filled those positions. In late April, 2002, we re-hired the former Controller who, upon reviewing the Foundation's record of payments, determined that there had again been late payments, and promptly invoiced the Foundation on May 1, 2002 for interest on late payments. (Copy attached.)

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[7]OCE did not find the late-payment situation to be a material violation and did not recommend any specific corrective action. Nevertheless, CRLA took corrective action.

[8]Letter from CRLA Executive Director Jose R. Padilla to Legal Services Corporation David de la Tour (LSC Office of Compliance and Enforcement), dated March 23, 2001.

The Foundation thereafter made a number of timely rent payments in mid-2002, but again fell behind in late 2002 and early 2003. On October 17, 2003, CRLA again invoiced the Foundation for interest on these late payments. (Copy attached.) Beginning July, 2003, CRLA has been invoicing the Foundation for rent on the 15th of each month preceding the following month's rent. Since then, the Foundation has timely made all rent payments.

D. Physical Separation of Facilities.

CRLA rents or sublets space in our various office properties to numerous tenants dependent upon our contemporaneous space needs and consistent with the provisions of 45 C.F.R. Section 1630. The Draft Report concludes at page 5 that space rented to the Foundation in CRLA's Modesto regional office was not physically separated from CRLA's own space. That conclusion appears to extend the requirements of 1610 beyond what has been commonly understood.

CRLA's lease with the Foundation for Modesto specified discrete space to be occupied and used by the Foundation, for which fair-market rent was charged. The Foundation's separate space was identified by appropriate signs that were clearly visible to the public and were equivalent to the signs identifying other commercial entities in adjoining suites in the same building complex. The distinction between CRLA space and Foundation space thus was apparent to the public, and confusion was unlikely.

Regardless of any differences in opinion on this point, that lease was terminated in mid-2002, as CRLA required the space for a new Seniors Project. The Foundation no longer has a presence at this address.

E. OIG Prospective Recommendations re Program Integrity *vis a vis* the Foundation:

The Draft Report correctly concludes that CRLA and the Foundation are legally separate entities, but opines that CRLA did not maintain objective integrity and independence from the Foundation based upon the factors described above. CRLA respectfully does not believe that the circumstances described by the Draft Report support its conclusion. We here respond to the individual Draft Report Recommendations (set out in bold).

1.1. ***The grantee's management needs to take steps to provide adequate separation from the Foundation. Specifically, we recommend that the Executive Director:***

(Although the Draft Report's enumeration of this first set of recommendations is confusing, we infer that No. 1.1 is simply the general introductory clause to the following specific recommendations.)

1.2 *Preclude the part time litigation director from participating on cases that are co-counseled with the Foundation*

The Draft Report has identified no problems of time-keeping, misuse of resources, subsidization, or even public confusion that can be traced or attributed to our part-time DLAT spending her 10% outside time during 2000, 2001 or 2002 in serving as an employee of the Foundation (and the presumptively no-greater time she may have spent as Foundation counsel in *two* of six cases that were co-counseled with CRLA.)

As we have described, this individual's appearances for the Foundation in the two cases co-counseled with the Foundation were scrupulously entered on behalf of the Foundation (and Foundation clients). No court or party was mislead or confused about her role or about the role of the CRLA attorney in representing CRLA's clients. The Draft Report draws no distinction between her effectiveness when litigating as a CRLA attorney staffing other cases co-counseled with other law firms compared with her performance as a CRLA attorney staffing other cases co-counseled with the Foundation. The on-site team expressed the view that this DLAT devoted hours often well in excess of her 90 % time to her cases and administrative responsibilities for CRLA.

Although Section 1604 does not apply to part-time employees, CRLA's policies are stricter. CRLA evaluated whether this individual's outside practice (in her part-time employment by the Foundation) would interfere with efficient performance of her duties with CRLA or involve conflicts of interest with CRLA clients[9] or conflicts with her duties and responsibilities to CRLA. In the two cases in which this individual appeared for the Foundation, CRLA and she ensured that she would not be responsible for CRLA's client files or for CRLA's representation.

In short, no instances of public confusion between the entities have been shown, no compromise of client (or institutional) interests has been found, no conflict with the employee's performance of her CRLA duties has been shown, and no violation of any professional responsibility standard has been suggested. And there is also no LSC regulation that prohibits this employee (or any other DLAT) from co-counseling with any firm. The OIG's recommendation, under the actual circumstances presented here, responds to no specific practical or public-policy need.

1.3. *Adopt Policies and procedures precluding senior staff, DLATs and office directors, from co-counseling case [sic] with the Foundation*

We have already explained why co-counseling is important and appropriate. CRLA believes this Recommendation responds to no practical or policy imperative, and is not consistent with

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[9]Of course, full duty of loyalty to, and absence of any conflict of interest, are required of both firms jointly representing the same client as co-counsel. These duties require co-counsel keep each other fully apprised of information and developments material to the co-counsel engagement.

longstanding LSC guidance on this issue. Its implementation would eliminate for many CRLA offices any possibility of co-counseling in our most critically-needed advocacy priorities.

Generally, co-counseling occurs in cases that are larger or more complex–the very cases which CRLA will, and ethically must, staff with more senior attorneys who have the experience and expertise to provide adequate representation in these cases. The Recommendation requires that CRLA staff cases co-counseled with the Foundation only with junior staff–a proposal that not only requires CRLA's disparate treatment of the Foundation compared to all other co-counseling partners, but raises serious issues of professional responsibility *vis a vis* our clients in those cases.

Moreover, CRLA encounters the greatest difficulty in obtaining co-counsel in employment representation and litigation–a CRLA priority. In many of our rural service areas, local private attorneys will not participate in these cases due to their perceived conflicts with the agricultural industry that is the local economic engine, their lack of experience and/or expertise in employment law, and the fact that virtually all plaintiffs, witnesses and beneficiaries do not speak English. Not uncommonly, the Foundation is the only source for co-counsel in these cases.

A number of these rural offices are "single-attorney" offices, in other words, the local (management-level) Directing Attorney (referred to as the "office director" in the Recommendation) is the *only* local CRLA attorney. CRLA's backup for these over-burdened (or otherwise unavailable) Directing Attorneys consists of the DLATs, who travel extensively to work with our regional offices. By prohibiting both the DLATs and the "office director"/Directing Attorney from co-counseling with the Foundation, the Recommendation effectively prevents representation in these cases, and leaves dozens or hundreds of often-sub-minimum wage workers without remedy.

For all these reasons, we respectfully suggest that this Recommendation is fundamentally inconsistent with efficient provision of quality legal services consistent with the Act.

1.4. *Preclude senior staff from working for the Foundation on a part time basis*

Part 1610 does not prohibit shared staff. Longstanding LSC guidelines contemplate sharing at every level of management below Executive Director. Since the 1996 implementation of "program integrity" CRLA has never had 10 % of its attorney/paralegal staff serve as part-time shared staff with the Foundation (or with any other entities doing restricted work). The entire shared attorney staff between CRLA and the Foundation (since the end of Year 2000) consists of one of CRLA's four, third-tier-level managers[10] working for the Foundation 10% of her time. In the context of the LSC's

[10]CRLA's Executive Director is the first level of management; the Deputy Director is the second level of management; and the Directors of Litigation, Advocacy and Training (4 positions) are the third tier. The last have responsibility only over advocacy and have no responsibility over financial or other

published guidelines discussed above, this constitutes 1.4% of CRLA's (70-member) attorney/paralegal staff (and only 0.14% on a full-time-equivalent basis). Acknowledging that program integrity is a flexible concept and that the weight accorded shared staffing must consider the extent of responsibilities, we respectfully conclude that this part-time shared staff position does not violate any LSC regulation or policy.

CRLA has conscientiously observed the program integrity standard with scrupulous observance of the letter and spirit of the regulation. We respectfully urge that the Recommendation is unmerited.

1.5. *Adopt procedures so that in the future full time grantee employees are precluded from working simultaneously for the Foundation*

Beyond the policy concerns of 45 C.F.R. Section 1610, the outside employment of *full-time* CRLA attorneys is expressly regulated by 45 C.F.R. 1604. This provision generally precludes outside practice of law but permits certain limited compensated and uncompensated practice. Since 1996, CRLA has not only prohibited outside practice of law for compensation, but in an approach stricter than required by LSC, CRLA has conditioned other gainful employment upon prior review and approval by the Executive Director based on a number of factors. (CRLA Case Handling and Office Procedures Manual, § III.D.9., pp. III-44 to III-45.)

CRLA's understanding of our former Oceanside Directing Attorney's outside activities (with the Foundation) was that she performed these as an uncompensated volunteer, and that her activities did not include engaging in the practice of law. Thus, our understanding is that neither Regulation 1604 nor CRLA's formal policies were implicated by her activities even if the latter involved restricted activities.

We can, and do, address employees' personal-time volunteer activities that communicate or suggest to the public that CRLA sponsors or is associated with the activities or that the employee is undertaking the activity as a CRLA employee. We cannot–and should not--prohibit employees from volunteer participation in personal activities once the employee meets the threshold of avoiding conduct or communication that implies CRLA is sponsoring or participating in the activity.[11]

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administrative areas.

[11]By way of example, CRLA prohibits employees from passing out CRLA literature or CRLA-identified materials during their personal-time participation in a lawful demonstration. We do not–and believe we cannot–prohibit employees from such First Amendment activities during their personal time so long as they do not promote confusion as to sponsorship or affiliation. As noted earlier, we do not condone associating CRLA with restricted activities that may have occurred as a result of the Oceanside employee's posting of her CRLA work telephone number as the contact for her (personal-time) volunteer activities. We learned of that only following the employee's resignation. And this Recommendation does

1.6. *Require that future leases for space rented to other organizations follow standard commercial practices and provide for late payment penalties*

First, we again note that CRLA does now advance invoice the Foundation for rent on the 15th of each preceding month, and its payments are now timely. We also invoiced the Foundation for interest on prior late payments.

The OIG recommends that "future leases for space rented to other organizations follow standard *commercial* practices and provide for late payment penalties." (Draft Report, Recommendation 1.6, emphasis added.) CRLA believes that our current policy of advance-invoicing rents and our demonstrated history of charging interest where late payments have occurred meet the spirit of the recommendation. But we also observe that the OIG's recommendation appears to be inconsistent with LSC's Property Acquisition and Management Manual which provides that :

> [i]f a recipient uses real property acquired in whole or in part with LSC funds to provide space to another organization which engages in [restricted]activity . . ., the recipient shall charge the other organization an amount of rent which shall not be less than that which *private non-profit organizations in the same locality charge* for the same amount of space under similar conditions.

(66 Fed. Reg. No. 178, 47697, § 5(f), emphasis added.)

The notion of applying "standard commercial practices" to relationships between non-profits is not a non-profit community practice, i.e., renting to a non-profit is not the same as renting to a for-profit. CRLA has tenant relationships with other non-profits and has used the same standards with them as with the Foundation, consistent with the guideline in the Property Acquisition and Management Manual.

II. OTHER ISSUES BEYOND 1610 "PROGRAM INTEGRITY"

A. Compliance With Section 1636.2: Statements of Facts and Client Identification in "17200" Litigation[12]

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not address that situation in any event.

[12]The Draft Report separates the discussion of CRLA's litigation under California Business & Professions Code Sections 17200 *et seq.* ("17200 litigation") into two non-contiguous sections. Under the subtitle, "Cases Under Section 17200 of the California Code", the Draft Report concludes at pages 8-9, and we agree, that CRLA complies with 45 CFR Sections 1611, 1617 and 1626 in our "17200" litigation. The Draft Report addresses CRLA's compliance in our "17200 litigation with 45 Section 1636.2 in a

1. CRLA Complies With Section 1636.2 by Obtaining Statements of Facts From and Furnishing Identification As To All Plaintiffs It Represents In "17200" Litigation.

Sub-Part 1636.2 requires CRLA to identify the plaintiffs we represent and to obtain written factual statements signed by those plaintiffs. CRLA fully complies. The Draft Report concludes at pages 6-7 that CRLA clients who are *not* plaintiffs and *not* parties to litigation should nevertheless be considered "plaintiffs" and that CRLA should similarly identify these non-plaintiff clients to adverse "parties" and obtain signed fact statements. This is consistent with neither the plain language of, nor the policy reason for, the rule.

Part 1636 is not ambiguous. Sub-part 1636.1 provides in relevant part that,

> **[t]he purpose of this rule is to ensure that, when an LSC recipient files a complaint in a court of law or otherwise . . . the recipient identifies the *plaintiff* it represents to the defendant and ensures that the *plaintiff* has a colorable claim.**

Sub-part 1636.2(a), which establishes the affirmative requirements, further provides,

> **When a recipient files a complaint in a court of law or otherwise . . . participates in litigation against a defendant . . . on behalf of a client who has authorized it to file suit in the event that the settlement negotiations are unsuccessful, it shall:**
>
> **(1) Identify each *plaintiff* it represents by name in any complaint it files . . .; and**
>
> **(2) Prepare a dated written statement signed by each *plaintiff* it represents, enumerating the particular facts . . .**[13]

From time to time CRLA will have an attorney-client relationship, documented through a non-

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separate section on pages 6-7 under the subtitle "Statement of Facts and Client Identification".

[13]The dictionary definition of a "plaintiff" is, unsurprisingly, consistent with the assumption underlying these regulations: "A person who brings an action; the party who complains or sues in a civil action and is so named on the record . . . ." (BLACK'S LAW DICTIONARY (5th ed., 1979); "1. one who commences a personal action or lawsuit to obtain a remedy for an injury to his rights . . . 2. the complaining party in any litigation . . ." (WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY (1986).)

litigation retainer, with one or more individuals who are potentially members of the general public eligible for remedies in a 17200 action,[14] conditioned upon the plaintiff(s) ultimately prevailing. The retainers may be for purposes of investigation or for purposes of counseling and advising concerning the subject matter of the 17200 litigation, but they do not authorize CRLA to file suit on the individual's behalf. These clients are not, however, plaintiffs nor otherwise parties to the litigation, and do not have party standing before the court to participate in, affect or control the litigation any more than any other stranger.[15] These retainers are completely appropriate: Neither the Legal Services Corporation Act nor any other federal or state law limits CRLA to representing clients to individuals who authorize litigation and are named parties (plaintiffs or defendants) thereto.

Apparently, the Inspector General believes that any client with whom CRLA executes a retainer with regard to a matter that may be the subject of litigation brought under Bus. & Profs. Code Sections 17200 et seq. is a "plaintiff" although these persons do not appear as plaintiffs in the litigation, have no standing to appear before the court, and have not authorized CRLA to file a lawsuit on their behalf. That characterization has no basis in federal or state law nor in fact, and Section 1636.2 does not require recipients to identify clients to adverse interests when those clients are only counseled rather than named as parties to litigation.

2. OIG Prospective Recommendation re 1636.2 Compliance

2.1 *We recommend that the Executive Director implement procedures to ensure that statements of facts are prepared for all 17200 type cases and that all clients are identified*

The Draft Report goes astray by equating all CRLA clients regardless of the nature of their representation, and referring to counseling clients as "unnamed" and/or "unidentified plaintiffs."[16] There is no such thing.

Part 1636 requires neither executed statements nor client identification for clients who are not

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[14]California Business & Professions Code Sections 17200 *et seq.* provide multi-person relief where the plaintiff brings the suit for the interests of members of the general public. As recognized previously by LSC and the Inspector General, these suits are not Rule 23 class actions unless the plaintiff specifically pleads them, and the Court certifies them, as such.

[15]The majority of CRLA's 17200 actions seek injunctive relief. The fact that CRLA may allege that injuries are occurring, or likely to occur, to members of the general public which merit injunctive relief does not convert those members of the general public into plaintiffs by any theory of which we are aware (whether or not they have consulted with CRLA without authorizing it to file litigation on their behalf).

[16]The Draft Report repeats this mischaracterization in further discussion of CRLA's "17200" cases at page 8.

named parties to litigation (whether under Section 17200 or some other statute). Beyond repeatedly employing the term of art "plaintiff" (rather than, for example, the broader term "client"), the applicability of sub-part 1636.2 to a particular client is conditioned upon that client's express authorization to file suit–which these non-plaintiff clients have not done. Particularly in poverty law, where the consulting client's potential adversary is often an employer or landlord or other party in a position of power, revelations of the client's potentially critical perspective can have devastating consequences, including job termination, eviction, or other forms of retaliation. These clients' interests are protected by privacy considerations recognized in both state and federal law.[17] Long-developed, well-understood principles of discovery predicated upon the rationale of promoting fair litigation appropriately govern when these non-parties' identities may be appropriately disclosed.

B. PROVISION OF SPACE FOR OTHER ORGANIZATIONS

CRLA provides space for a seniors law clinic staffed by volunteer private attorneys in San Luis Obispo. In Madera, we provide a local, non-profit that does not undertake restricted activities an otherwise unused room in the former residence we lease for our offices in return for that project's providing volunteers to undertake community outreach and education for CRLA advocacy within our priorities. The Draft Report characterizes both as "improper rent payments". In fact, both are valid and valuable components of LSC-sanctioned priorities.

1. Rent Payment for San Luis Obispo Legal Alternatives Corporation ("SLOLAC") Senior Legal Services Clinic

CRLA maintains a regional office in San Luis Obispo, seat of the Central Coast county of the same name. Although nominally staffed with two attorneys, in recent years the office has been often staffed below this level due to budget limitations. CRLA also pays rent for a separate, single-room office of approximately 240 square feet[18] to house a seniors' legal clinic operated pursuant to a grant from the local Area Agency on Aging, by a local non-profit organization, the San Luis County Legal Alternatives Corporation ("SLOLAC"). The room is in the same office building as, and is adjacent to, our San Luis Obispo regional office. The clinic's clients are advised and represented by volunteer private attorneys through the County Bar Association.

The OIG's Draft Report concludes that CRLA's payment of rent for this seniors clinic does not meet the requirements of LSC Regulation Section 1630.3(a)(2), which provides that expenditures by a

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[17]The issue here should not be confused with any rights of LSC (or the OIG) to know the clients' identities.

[18]Rent has gradually increased from $300 monthly in the first year of this arrangement to $418 during 2003.

grantee are allowable "only if the recipient can demonstrate that the cost was . . . reasonable and necessary for the performance of the grant or contract as approved by . . . [LSC]", and that this expense cannot be credited as a Private Attorney Involvement (PAI) expenditure due to an accounting oversight.

As we further explain below, the seniors' legal clinic engages in non-restricted activity in undertaking CRLA priority work for overwhelmingly eligible clients. We underwrite the space cost to enable the clinic to exist in furtherance of our internal priorities and to fulfill our PAI obligation.

In 1982, CRLA began its Private Attorney Involvement ("PAI") program as mandated by LSC, initially focusing on co-counseling to meet our PAI obligation. In 1985, CRLA retained a consultant to assess our existing PAI program and make recommendations on how to strengthen it. One of the consultant's recommendations stated:

> . . . Although CRLA should continue its focus on co-counseling, it should also revisit the issue of the feasibility of more traditional pro bono referral systems and pro bono clinics. It is clear that in a number— if not all— of the CRLA offices informal programs through an in-house referral program or small pro bono effort have sprung up which supplement the co-counseling program and appeal to attorneys who cannot make the time commitment required by co-counseling. CRLA should encourage such efforts and should provide technical assistance to offices seeking to implement a pro bono referral or clinic program.

(Esther R. Lardent, *PRIVATE ATTORNEY INVOLVEMENT/TECHNICAL ASSISTANCE VISIT REPORT: CALIFORNIA RURAL LEGAL ASSISTANCE* (October 1, 1985) pp. 11-12.)

Consistent with this recommendation, in 1987 CRLA began working with the San Luis Obispo County Bar Association to begin a local volunteer lawyer program. By December 1988, the San Luis Obispo County Bar had formally honored CRLA's local Directing Attorney for his work in establishing the *pro bono* referral project. The project was broadened in 1989 to include a "TRO Pro Per Clinic" in collaboration with CRLA.

In 1992, the San Luis Obispo County Legal Alternatives Corporation (SLOLAC) was incorporated as a § 501(c)(3) nonprofit entity.[19] During the audit period, SLOLAC provided four types of advocacy services, including the Senior Legal Services Project housed in the office for which

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[19]SLOLAC's purpose is "to facilitate, provide and promote pro bono and in pro per legal services and alternative dispute resolution." (Articles of Incorporation, SLOLAC; Article II (endorsed Oct. 28, 1992); By-Laws of San Luis Obispo Legal Alternatives Corporation Article I Recitals, Section 3.) SLOLAC's seven board members include one member designated by the San Luis Obispo County Bar Association, and one member designated by CRLA. (By-Laws, *supra*, Article IV.)

CRLA pays the rent in question here.[20]

(a) CRLA's Rent Payments for the SLOLAC Seniors Legal Services Clinic Are Reasonable and Necessary For Performance of the Grant

There has been general acknowledgment that LSC and Area Aging Agencies (AAA) should work hand-in-hand to provide legal services to seniors. In Fiscal Year 2002, over $16 million was provided under the Older Americans Agency Act to LSC-funded legal services programs. Through its State Planning process, LSC has encouraged recipients to coordinate resource development with other local-community groups and has encouraged partnerships that would respond to unmet needs.

The Senior Legal Services Project is the only agency providing legal services for seniors in San Luis Obispo County. (Newsletter of the American Bar Association, *supra.*) Recently, with American Bar Association funding, the Project embarked on a year-long project to reach out to Latino elders and to provide them with legal assistance. (*Id.*)

CRLA's collaboration with SLOLAC and our support of the seniors legal services clinic has been an effort to meet LSC's expectations. Over its history, CRLA has obtained various AAA grants and directly operated seniors legal services programs under AAA provisions. AAA funding does not cover the full cost of operating these programs, and we have no doubt that were we to solicit the AAA grant in San Luis Obispo and directly administer and operate the Seniors Legal Services clinic, CRLA's costs would be substantially higher than the $418 per month we expend to provide space for this clinic operated by the local non-profit SLOLAC. Thus, this arrangement has been favorable to CRLA and has constituted a sound business practice.

Over the years CRLA has kept LSC apprised concerning the existence, operation and success of this clinic–with no question about propriety or nature of our involvement ever raised in response. For these as well as the reasons described earlier in this section, we respectfully disagree with the Draft Report's conclusion that this expenditure is neither "reasonable" nor "necessary" for performance of our LSC grant within the meaning of Section 1630.3(a)(2).

(b) CRLA's Rent Payments for the SLOLAC Seniors Legal Services Clinic Are Proper PAI Expenditures

The underwriting of the space costs of this AAA-funded clinic staffed by members of the private bar was legitimate PAI expense. Unfortunately, an internal miscommunication at CRLA

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[20]SLOLAC's other three projects include a domestic-violence TRO clinic; a conflict-resolution program; and a voluntary legal services pro bono panel. These three projects are housed elsewhere, and receive no financial support from CRLA.

resulted in our Accounting Department's failure to allocate rent payments for the SLOLAC Senior Legal Services Clinic as a PAI expense during the audit period,[21] and for this reason alone the Draft Report concludes that the rental payment did not qualify as PAI. The mere fact that this expense was temporarily not credited as PAI in CRLA's accounts in no way causes the expense to be *ineligible* as PAI.

Since inception of the PAI obligation, LSC continuously has encouraged recipients to provide resource support to other legal non-profits for a number of reasons: to increase the number of low-income legal service providers in areas where little service exists; to better serve poverty communities that need special services (*e.g.*, seniors legal services)[22]; to serve low-income clients that recipients may lack sufficient services or expertise to assist (*e.g.*, victims of domestic violence). LSC has long encouraged CRLA to diversify our PAI program.

Since the late 1980's, CRLA has treated its collaborations with the San Luis Obispo County Bar Association--activities now performed by SLOLAC--as an integral part of our Private Attorney Involvement Program. By December, 1988, our San Luis Obispo Directing Attorney was presenting the San Luis Obispo Volunteer Legal Services Program ("VLSP") to other CRLA offices as a model for PAI compliance. Information provided the OIG audit team demonstrated that CRLA's 1990, 1993 and current PAI Plans (prepared pursuant to 45 C.F.R., § 1614.4(a)) described the Program as an example of a *pro-bono* referral project that could be replicated in other parts of the state. Again, during the recent LSC-driven Reconfiguration (merger plan) of legal aid programs, CRLA presented the SLOLAC model as part of our statewide PAI program.

2. CRLA's Provision of Space in our Madera Office for the Madera Coalition For Community Justice (MCCJ)

CRLA's Madera regional office is housed in a stand-alone, former single-family residence (zoned for commercial use). The house is leased to CRLA as a single unit for a fixed rent, regardless of the portion of the house that is actually occupied. The owner makes no rent adjustment available to CRLA for using less than all existing rooms within the structure. Nor does CRLA incur additional rental cost by expanding our use–or permitting another entity--to occupy an otherwise unused room. In

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[21]At some point, Accounting discontinued this allocation on the assumption that since CRLA was so readily meeting its PAI-expenditure obligation, there was no reason to allocate any additional qualifying expenses including the SLOLAC seniors clinic. Senior management's attempt to correct this upon subsequently discovering the situation was temporarily "derailed" as a result of unexpected turnover in the accounting personnel and considerable resultant lost communication. CRLA has now corrected this oversight.

[22]Since the 1980's LSC has allowed recipients to use LSC funds as a non-Federal match for Older American Act projects. (LSC General Counsel Opinion, July 30, 1980.)

short, we can't rent part of the structure–it's all or nothing; nevertheless, in the Madera commercial rental market, this building provides CRLA the most cost-effective available rental space.

LSC's Property Acquisition and Management Manual (PAMM) provides that,

> [w]hen using real or personal property acquired in whole or in part with LSC funds for the performance of an LSC grant or contract, recipients may use such property for other activities, provided that such other activities do not interfere with the performance of the LSC grant or contract, and provided that such other uses meet the requirements of paragraphs (e) and (f) of this section.

(Legal Services Corporation, *PROPERTY ACQUISITION AND MANAGEMENT MANUAL*, § 5(d), 66 Fed.Reg. 47697 (No. 178, Sept. 13, 2001).)

The Madera Coalition for Community Justice (MCCJ) is a non-profit organization that promotes community and economic development, and promotes local volunteerism. The organization provides a number of community service projects including food sharing, recycling, a community garden, clothing and childcare. The organization is not a legal-services provider and does not engage in restricted activities. Few, if any other, non-profit organizations that serve low-income people exist in Madera County.

In early 1997, CRLA's Board adopted our five-year program priorities including "Community and Rural Economic Development" which further embraced the separate concepts of "community building" and "community economic development". Community education, community building and community volunteerism, are generally accepted descriptions of the work of legal services programs all around the country (see, e.g., LSC's Program Letter 98-6, calling for expanded involvement of eligible individuals and families in self-help activities.) The Board further recognized the need for CRLA to increase "outreach to rural poverty communities". (CRLA Priorities Conference Report to the CRLA Board, adopted May 29, 1997.)[23]

As of May 1997, CRLA was still feeling the 1996 loss of 28% of our LSC grant, amounting to $1.4 million, which had resulted in CRLA losing 41 employees. For the first time in its history, CRLA was forced to staff many of its offices with 1 attorney; indeed, 9 of our then-15 offices (including Madera) were subjected to this reduced staffing. Ultimately, the Madera Directing Attorney recommended that the office use a small AAA grant to keep its second attorney, while at the same time relying on MCCJ instead of a CRLA Community Worker to carry out CRLA's local community

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[23]Recipients are required by 45 CFR 1620 to ". . . . establish . . . priorities for the use of all of all of its Corporation and non-Corporation resources." (45 C.F.R., § 1620.3.) Recipients are then expected to adhere to these priorities. (45 C.F.R., §1620.6.)

education responsibility. The Directing Attorney also recommended allowing MCCJ to use an otherwise unused room in CRLA's "house" for meetings and storing project supplies. Given CRLA's minimum salary of $19,000 for a Community Worker, this presented an exceptionally cost-effective way of conducting some of CRLA's community outreach.

In December 1997, CRLA and MCCJ signed a Memorandum of Understanding pursuant to which CRLA would provide "office space, copier and FAX resources" in return for which MCCJ through volunteers would "work. . . on community-building projects and provid[e]. . . community education on poor people issues" equivalent to fair value for CRLA's resources.[24] The MOU specifically described the implementation of a volunteer system developed by Edgar Cahn[25] and presented at CRLA's priority conference as one of MCCJ's projects. As part of its annual priority-setting process, in February 1998, CRLA's Board added "volunteerism as part of [the] service delivery structure" to the existing "community building and economic development" priority.

The Madera Directing Attorney has maintained records of the hours provided by MCCJ volunteers pursuant to the annual MOUs, and CRLA provided the OIG audit team with a 6-year summary of volunteer hours through June 2003. Excluding 2003, MCCJ volunteer hours averaged 1,714 hours per year, equivalent to 228.5 CRLA work days (7.5 hrs/day) or 45.7 work weeks per year. At current minimum wage ($6.75/hr.), this volunteer activity had a value of $11,570 annually. The total volunteer time generated by the project, 11,484 hours, reflects a value of $77,517 at current minimum wage.

MCCJ thus undertakes legitimate activities in implementation of CRLA priorities. In the absence of this arrangement, CRLA would have to directly hire staff to accomplish the same results. Accepting the Draft Report's valuation of the space at $2,456 for the audit period, CRLA receives considerably more than fair value in this exchange.

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[24]CRLA oversees the MCCJ project through both our Madera Directing Attorney and our Executive Director. The MOU between CRLA and MCCJ (as with all CRLA tenants) provides notice of pertinent LSC regulations and tenant certification of understanding and compliance:

> I certify that I have reviewed the following restrictions imposed on CRLA Inc. by its funder and certify that, where restrictions would apply, the Madera Coalition has not used any CRLA resources in violation of those restrictions or has otherwise paid CRLA Inc. a fair value for CRLA resources that were provided; in the latter case, such use was authorized by the Madera Directing Attorney prior to its use.

[25]Edgar Cahn is generally recognized as the co-founder of national legal services supported by the federal government. His doctrine of exchanging volunteer activities for other services is called "Time Dollars".

3. OIG Prospective Recommendations re Provision of Space To Other Organizations

3.1 *Require SLOLAC and MCCJ to pay their fair share of the rent*

(a) San Luis Obispo/SLOLAC

The seniors clinic provides clients with counsel and representation through the local private bar. The clinic's existence is supported by CRLA's providing the physical facility and by our staff's collaborative efforts with the County Bar Association to establish, administer and fund the project. This expenditure "involve[s] private attorneys in the delivery of legal assistance to eligible clients" (45 C.F.R., § 1614.1(a)) and "encourages the involvement of private attorneys in the delivery of legal assistance to eligible clients through . . . [a] pro bono mechanism (*id.*, subd. .2(a).) The clinic provides direct delivery of legal assistance to eligible clients. (*Id.*, subd. .3(a).) There is virtually no question that the clinic is legitimate PAI activity.

We acknowledge CRLA's recent failing in allocating or expensing this rental cost as a PAI expenditure. We have already rectified that oversight. The seniors clinic obtains client information concerning alienage status but does not deny services on account of status. Therefore, the only PAI issue is to determine a formula based upon percentage of eligible clients for allocating appropriate proportion of the rent to PAI expenditures. [26]

Accordingly, we conclude that the Recommendation is inconsistent with longstanding policies of the Corporation and Congress that CRLA has over many years taken conscientious and reasoned steps to maximize.

(b) Madera/MCCJ

CRLA respectfully believes that the Draft Report misconstrues and misapplies LSC regulations to MCCJ's occupancy of a room in our Madera office.

There is no issue under LSC Regulation Section 1630 because there has been no CRLA out-of-pocket or marginal expenditure for the space that we permit MCCJ to use. A "questioned cost" under Section 1630 is one that "appears unnecessary or unreasonable and does not reflect the actions a prudent person would take in the circumstances." (45 C.F.R., § 1630.2(g)(3).) These factors don't

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[26]Our informal understanding is that the seniors clinic has served one alien-status-ineligible client (out of approximately 2,400 total clients) during the past 8 years. CRLA does not count the AAA/seniors clinic cases for CSR purposes. The amount of space costs attributable to one improper client in many years of representation of thousands of clients is not material from an accounting perspective under either LSC or federal accounting rules. In terms of cost allocation to permissible activity, this was *de minimis*.

exist in the Madera situation: there is no "unnecessary" or "unreasonable" cost because there is *no* avoidable cost–CRLA can't rent less than the whole house; CRLA can't reduce the rental fee by not occupying the room in question; and CRLA's rent hasn't increased by one cent by allowing MCCJ to occupy the otherwise unused room, and CRLA couldn't find smaller suitable office space at a proportionally lower price. As described above, we have obtained services valued at over $77,000 at minimum wage–for a space that the Draft Report values at $2,456. Our actions are those of a prudent person, as sub-paragraph 1630.2(g)(3) requires.

Whether CRLA *could* charge MCCJ rent for the space and thus garner additional income does not raise a subsidization issue under Section 1610 or 1630. "Subsidization" of non-restricted entities is not forbidden, and since MCCJ is not an entity engaging in prohibited or restricted activities, the issue of "subsidization" does not arise under the Act or regulations. This is confirmed in LSC's PAMM which provides that recipients shall charge other organizations using space acquired with LSC funds if the organization engages in activity *restricted* by the LSC Act. (*PROPERTY ACQUISITION AND MANAGEMENT MANUAL, supra*, § 5(f); see, *id.*, par. 5(e) regarding provision of services.) There is no similar requirement for "tenants" that do not engage in restricted activities.

As described earlier, CRLA engages in the relationship with MCCJ and uses the volunteer services provided by MCCJ for the express purposes of meeting CRLA Board-set priorities that promote "community-building" and "community volunteerism". MCCJ provides not only a model for implementation of this "volunteerism" priority, but-- in its absence--CRLA would be obliged to directly hire staff.

3.2 ***Require the managing attorneys' [sic] in the San Luis Obispo and Madera offices to review all rental payments and allocations quarterly to ensure that the subsidization does not reoccur.***

The Recommendation is unnecessary. For the reasons just set out, "subsidization" has not occured in this context, and there is no danger that it will. CRLA's staff, including Directing Attorneys, are regularly advised and trained concerning obligations under Section 1610, specifically including issues of subsidization. Directing Attorneys are required in their regular approval of all local expenses and allocations to ensure that subsidization of an entity engaged in restricted activities does not occur. In this regard, we take pride in already doing more than Recommendation 3.2 proposes.

CONCLUSION

With respect to "program integrity" between CRLA and the Foundation, CRLA has readily corrected the minor oversights (virtually all of an accounting nature) or terminated the facilities lease that concerned the audit team. CRLA's practices in co-counseling and sharing staff were, and are, completely legitimate activities in full compliance with all LSC (and other professional) obligations.

They do not individually constitute violations, nor do they comprise a violation of Part 1610 taken together.

CRLA also respectfully disagrees with the Draft Report's conclusions that we violate Section 1636.2 by treating non-parties as such; and that we provide space improperly to the San Luis Obispo seniors legal clinic or the Madera coalition that provides volunteers to undertake CRLA activities.

In sum, the OIG's factual findings portray a program that is conscientiously and rigorously in compliance with LSC's mandates, and the Draft Report's limited conclusions of noncompliance and remedial recommendations are unwarranted.

ATTACHMENT TO

CRLA's COMMENTS IN REPLY TO OIG DRAFT AUDIT REPORT (issued September 30, 2003)

November 14, 2003

California Rural Legal Assistance, Inc.
631 Howard Street, Suite 300
San Francisco, CA 94105
415-777-2752 fax 415-543-2752

Invoice No. 2002-06

INVOICE

Customer

Name California Rural Legal Assistance Foundation
Address 2424 "K" Street
City Sacramento State CA ZIP 95816
Phone

Date 5/1/02
Order No.
Rep
FOB

Months	Description	Unit Price	TOTAL
	Interest Charges for Late Payment		
2	January 2001	$20.89	$41.78
1	February 2001	$20.89	$20.89
3	June 2001	$21.58	$64.74
2	July 2001	$21.58	$43.16
1	August 2001	$21.58	$21.58
3	November 2001	$21.58	$64.74
2	December 2001	$21.58	$43.16
1	January 2002	$21.58	$21.58
2	March 2002	$21.58	$43.16
1	April 2002	$21.58	$21.58
1	Federal Express: Luke Cole to Dania Gutierrez	$21.06	$21.06

SubTotal $407.43
Shipping & Handling $0.00
Taxes State

TOTAL $407.43

Office Use Only

Due Upon Receipt of Invoice. Interest of 1% (12% per annum) will be charged after 30 days.

Paid by check # 8587 - ck date 05/03/02
RS

California Rural Legal Assistance, Inc.

631 Howard Street, Suite 300
San Francisco, CA 94105
415-777-2752 fax 415-543-2752

INVOICE

Name:	California Rural Legal Assistance Foundation				
Address:	2210 K Street, suite 201				
City:	Sacramento	State:	CA	ZIP:	95816
Attn:	Daniel	Fax:	916-446-3057		

Date: October 17, 2003
Terms:

Invoice No: **2003-39**

QTY	Description	Unit Price	Total
	Interest Charges for Late Payment - 1% of Total Invoice		
10	September 2002 Rent Payment - Paid in June 03	4.73	47.27
4	October 2002 Rent Payment - Paid in Jan 03	5.16	20.64
3	November 2002 Rent Payment - Paid in Jan 03	5.16	15.48
2	December 2002 Rent Payment - Paid in Jan 03	5.16	10.32
6	January 2003 Rent Payment - Paid in Jun 03	5.28	31.69

Please Make Check Payble To:
CALIFORNIA RURAL LEGAL ASSISTANCE, INC.

Sub Total	125.39
Shipping & Handling	0.00
Taxes	0.00
Total	125.39

APPENDIX -- II

OIG STAFF AND CONSULTANT TEAM MEMBERS

Anthony M. Ramirez (Auditor-in-charge)

David Young

Abel Ortunio

Claudette Moore, Consultant

Terry Oehler, Esq., Consultant

John Carter, Esq., Consultant