In the Matter of the Appeals by the
State Compensation Insurance Fund
and
The California Attorneys, Administrative
Law Judges, and Hearing Officers in State
Employment

From the Executive Officer's August 17,
2015, Decision Disapproving the Personal
Services Contracts for Legal Services

APPEARANCES: Judith Sapper, Deputy Chief Counsel, appeared on behalf of the
State Compensation Insurance Fund; Patrick Whalen, CASE General Counsel, the Law
Offices of Brooks Ellison, appeared on behalf of the California Attorneys, Administrative
Law Judges, and Hearing Officers in State Employment.

BEFORE: Kimiko Burton, President; Lauri Shanahan, Vice President; and Patricia
Clarey, Member.

DECISION

The State Compensation Insurance Fund (SCIF) appeals to the State Personnel
Board (SPB or Board) from the August 17, 2015, Decision of the Executive Officer
disapproving 11 personal services contracts for legal services. The California
Attorneys, Administrative Law Judges, and Hearing Officers in State Employment
(CASE) also appealed in part from the Executive Officer's Decision.

Having considered the parties' written and oral arguments, the Board now issues
the following Board Decision and Order affirming the Executive Officer's Decision.

PROCEDURAL AND FACTUAL BACKGROUND

On October 27, 2014, CASE, submitted 13 separate requests that the SPB
Executive Officer review personal services contracts entered into by SCIF with 13
private law firms for compliance with Government Code section 19130, subdivision (b).
The matters were consolidated for review by the Executive Officer. The SPB notified SCIF of CASE's requests for review, and granted SCIF three requests for extensions of time within which to provide copies of the challenged contracts and specific and detailed factual information to the SPB that demonstrates how the contracts meet one or more of the conditions specified in Government Code section 19130, along with documentary evidence and/or declarations in support of SCIF's position.

On January 21, 2015, SCIF provided the SPB with copies of 13 "engagement letters" entered into between SCIF and each of the 13 private law firms identified in CASE's request for review. With one exception,¹ these letters identify general legal practice areas in which the firms would be retained to provide SCIF with legal representation in the future if requested to do so by SCIF. On February 16, 2015, SCIF submitted a response to CASE's request in which it identified specific litigation matters for which it had retained the private firms to provide SCIF with legal representation under the terms of the engagement letters. CASE submitted a reply on February 23, 2015. On March 11, 2015, SCIF filed a supplemental response. On March 27, 2015, CASE filed a supplemental reply. Upon review of the parties' submissions, the SPB requested that the parties provide it with additional information. SCIF submitted its further response on June 25, 2015. CASE submitted its reply on July 2, 2015. The matter was then deemed submitted for review by the Executive Officer.

On August 17, 2015, the Executive Officer determined that the engagement letters did not themselves constitute contracts for purposes of SCIF's obligation to

¹ The one exception concerns SCIF's contract with the firm of Meckler Bulger Tilson Marick & Pearson LLP, which SCIF retained to represent it in a specific litigation matter.
provide notice to CASE under Government Code section 11045, but that contracts between SCIF and the law firms were formed when SCIF retained the law firms to perform work on specific legal matters for which SCIF was legally bound to pay the agreed compensation. The Executive Officer then analyzed whether SCIF had provided sufficient evidence to justify contracting out for each specific legal matter identified by SCIF.

The Executive Officer determined that, with respect to most of the specific legal matters identified by SCIF, SCIF had failed to provide sufficient evidence to establish that the work performed pursuant to the engagement letters was justified under Government Code section 19130, subdivision (b). The Executive Officer approved the work on one matter as justified under Government Code section 19130, subdivision (b)(3). The Executive Officer also approved specific matters performed under two other contracts as justified under Government Code section 19130, subdivision (b)(10), with the instruction that the work should be transitioned to the civil service, and allowed specific work under one additional contract to continue for a period not to exceed six months while SCIF transitions the work to the civil service.

Both SCIF and CASE appeal from the Executive Officer’s determinations.

**ISSUES**

1. Whether any of the contracted work is justified under Government Code section 19130, subdivision (b).

2. What is the appropriate remedy in the event any of the contracts are disapproved?
FACTUAL SUMMARY

This matter arose out of CASE’s challenge to “preferred panel counsel” agreements entered into between SCIF and 13 private law firms to provide a variety of legal services to SCIF. Beginning in 2009, SCIF entered into “engagement letters” with pre-selected private law firms ("preferred panel counsel") who had agreed to provide SCIF representation in specified legal areas upon request by SCIF in the future. The engagement letters themselves did not create any obligation on the part of SCIF to utilize one of the firms for any particular matter (except for the one matter identified above), but set forth the terms and conditions, including payment terms, which would be followed in the event SCIF retained a firm to provide it with legal representation in the future.

Between 2011 and 2013, SCIF entered into engagement letters with the following firms: Clarence Dyer & Cohen LLP (Clarence); Gibson, Dunn & Crutcher LLP (Gibson); Holland & Knight (Holland); Horvitz & Levy (Horvitz); Hueston and Hennigan (Hueston) (formerly Irell & Manella); Manatt Phelps & Phillips LLP (Manatt); Manning and Kass (Manning); Meckler Bulger Tillson Marick & Pearson LLP (Meckler); Rosenbloom Advisors LLP; Sedgwick LLP (Sedgwick); Seyfarth Shaw LLP (Seyfarth); Sheppard Mullin Richter & Hampton LLP (Sheppard); and, SNR Denton (SNR Denton). At some point after the execution of the engagement letters, SCIF retained each of these firms to represent it in specific litigation or other legal matters pursuant to the terms and conditions set forth in the engagement letters.²

² While SCIF has not asserted that the contracts at issue in this case are justified as “cost savings” contracts under Government Code section 19130, subdivision (a), the Board notes that the engagement letters with the firms in this case provide for compensation of up to over $800 per hour.
SCIF notified CASE of its engagement letters with these firms in January 2014, but did not notify CASE when it assigned specific matters to these firms. CASE first learned of the specific matters assigned to the private firms when SCIF identified those matters during a meeting with CASE in January 2015. In its response to the Executive Officer, SCIF identified the following specific litigation matters that it had contracted out under the terms of the engagement letters:

3 In its February 16, 2015, submission to the Executive Officer, SCIF acknowledged that this was not an exclusive list of all matters for which private counsel had been utilized, stating that "many matters handled under the engagements have been completed," and offered to provide supplemental briefing on completed legal matters if requested by the SPB. (SCIF's Response to Requests for Review, dated February 16, 2015, p. 1, footnote 1.)

**Holland & Knight**: *XL Re, Ltd.* matter (reinsurance treaty dispute);

**Meckler Bulger Tilson Marick & Pearson LLP**: *Insurance Company of the State of Pennsylvania (ISOP) v. Alta Vista Solutions, Inc. (Alta Vista), et al.* (workers' compensation coverage for overseas claim);

**Hueston and Hennigan**: *State Fund v. Michael D. Drobot, Sr., et al.* (Racketeer Influenced and Corrupt Organization (RICO litigation);

**Manning & Kass LLP**: *Qui Tam* (fraud whistleblower) lawsuits;

**Seyfarth Shaw LLP**: Distribution of class action settlement funds;

**Manatt Phelps & Phillips LLP**: *Khan/Zaks* litigation (RICO fraud litigation); *Riley and Tendulkar* lawsuits (disability discrimination claims); and,

**Sheppard Mullin Richter & Hamilton LLP**: *EWL Matter* (antitrust claim); *Hablian Matter* (class action restitution claims); *Notis Matter* (collection of judgment).

SCIF asserted to the Executive Officer that the assignment of each of these matters to outside counsel was justified under Government Code section 19130, subdivision (b)(3), in that the services contracted are not available within the civil service, cannot be performed satisfactorily by civil service employees, or are of such a...
highly specialized or technical nature that the necessary expert knowledge, experience, and ability are not available through the civil service system. SCIF further asserted to the Executive Officer that the contract with the Hueston firm was justified under Government Code section 19130, subdivision (b)(10), because the services are of such an urgent, temporary or occasional nature that the delay incumbent in their implementation under civil service would frustrate their very purpose.4

SCIF also asserted to the Executive Officer that the Clarence firm, the Gibson firm, the Horvitz firm, the SNR Denton firm, and the Sedgwick firm did not represent SCIF in any “litigated matters,” but that they provided non-litigation research, advice and counsel on a variety of specialized issues, including but not limited to bankruptcy, tax, and labor issues.5

THE EXECUTIVE OFFICER’S DECISION

The Executive Officer determined that CASE met its burden under SPB Rule 547.61 (Title 2, Cal. Code Reg., § 547.61) to provide specific and detailed factual information that demonstrates how the challenged contracts fail to meet the conditions specified in Government Code section 19130, subdivision (b). The Executive Officer further determined that the engagement letters were not themselves contracts, but merely reflected the parties’ intent to contract. Accordingly, the Executive Officer

4 SCIF also argued to the Executive Officer that the Riley matter handled by the Manatt firm was justified under Government Code section 19130, subdivision (b)(5), in order to protect against a conflict of interest. The Executive Officer rejected that asserted justification. SCIF has not appealed this determination and asserts that the Riley matter has since concluded. Therefore, the Board does not address this justification.

5 It is undisputed that the engagement with Rosenbloom Advisors LLP terminated in April 2014, six months before CASE filed its challenge with the SPB. Accordingly, The Executive Officer did not consider that engagement letter. Neither party has appealed from the Executive Officer’s Decision in this regard.
determined that the contracts were formed only when SCIF retained the law firms on specific matters, at which time the law firms became legally obligated to perform legal services and SCIF became legally bound to pay the agreed compensation for those services. The Executive Officer further determined that, although SCIF violated the provisions of Government Code section 11045\textsuperscript{6} when it failed to give written notice to CASE of specific case assignments, the SPB lacked authority to disapprove the contracts on that basis.

Upon review of the specific legal matters identified by SCIF, the Executive Officer concluded that SCIF had provided sufficient evidence to establish that the work performed by the Holland firm was justified under Government Code section 19130, subdivision (b)(3), in that the services contracted for are not available through the civil service system. The Executive Officer further found that SCIF had provided sufficient evidence to establish that the legal services performed by the Meckler firm were of such an occasional nature as to justify the contract under Government Code section 19130, subdivision (b)(10), despite the fact that this ground was not raised explicitly by SCIF.

The Executive Officer further found that SCIF had failed to establish that any of the remaining contracts were justified under subdivision (b)(3). The Executive Officer determined, however, that the RICO litigation work initiated by SCIF pursuant to its agreement with the Hueston firm and on the Khan matter by the Manatt firm would be allowed to continue pursuant to Government Code section (b)(10) for a limited period of time, due to the urgency of properly litigating the cases, but directed SCIF to take all

\textsuperscript{6} Government Code section 11045 requires state agencies to provide written notice of any proposed contract for outside legal counsel to the designated representative of State Employees Bargaining Unit 2 (CASE). This statute is discussed in further detail below.
necessary and appropriate actions to transition the work to civil service attorneys. The Executive Officer further allowed SCIF six months within which to transfer work to the civil service on the EWL matter from the Sheppard firm.

Given that SCIF provided no justification under Government Code section 19130 for contracting legal work out to the Clarence firm, the Gibson firm, the Horvitz firm, the SNR Denton firm, and the Sedgwick firm, the Executive Officer disapproved each of those engagements.

**POSITIONS OF THE PARTIES**

**SCIF's Appeal**

On appeal, SCIF requests that the SPB give it the opportunity to meet the requirements of Government Code section 19130, subdivision (b), with respect to the work performed by the Manning firm, the Kass firm, the Seyfarth firm, the Manatt firm, and the Sheppard firm. In support of its position, SCIF relies on a 2008 settlement agreement (and its 2001 predecessor) entered into between SCIF and CASE under which CASE agreed not to challenge SCIF's use of outside counsel during the term of the agreement. SCIF contends that, pursuant to this agreement, SCIF did not need to comply, or document its efforts to comply, with the requirements of section 19130, for all matters contracted during the term of the agreement. Accordingly, SCIF asserts that it did not document its compliance with section 19130 for the matters at issue in this case because they all began during the term of the 2008 settlement agreement or its predecessor. SCIF further asserts that it has already begun the process of hiring and recruiting additional attorneys and requests the opportunity to demonstrate its compliance at this time by documenting the expertise needed for the legal work in
question and then engaging in good faith efforts to determine if it can hire qualified attorneys. SCIF further contends that disapproving the contracts now will disrupt its current attorney workload.

SCIF also requests that the Board limit its disapproval of the contracts with the Clarence firm, the Gibson firm, the Horvitz firm, the SNR Denton firm, and the Sedgwick firm to the specific matters being handled by those firms at the time CASE filed its request for review. Thus, SCIF requests that the Board clarify that the panel counsel agreements with those firms are not disapproved, and that SCIF should be able to continue to assign new matters to those firms so long as it complies with section 19130.

Finally, SCIF asks the Board to clarify what it should do if it identifies a civil service classification or personnel in another agency that possesses the requisite skills and expertise. Regarding this request, SCIF contends that, given SCIF's statutory exemption under Government Code section 11041 from having to obtain consent from the Office of the Attorney General (Attorney General) before employing counsel in any judicial proceeding, it should not be required to request representation from the Attorney General, and also that it should not have to identify and seek to hire employees in other state agencies who might have the requisite skills and experience.

CASE contends that the 2008 settlement agreement did not relieve SCIF of its obligation to comply with the requirements of Government Code section 19130, nor could it have done so lawfully. CASE further contends that SCIF should not now be given the opportunity to supplement the record with new evidence in support of its prior decisions to contract out, as it was required to provide all such evidence to the Executive Officer but failed to do so. CASE further contends that there is no need to
clarify that the engagement letters are not disapproved, as that conclusion is clear in the
Executive Officer's Decision, and that SCIF should be required to comply with all notice
requirements.

CASE also contends that SCIF's question about using the Attorney General
reflects a misunderstanding of law in that the focus of the inquiry is not on whether a
hypothetical individual attorney can perform the work but, rather, whether the services
are available within state service. Thus, CASE argues, pursuant to the Board's decision
in Department of Pesticide Regulation (2001) PSC No. 01-09, if the services are of the
type that could and should be performed by civil service attorneys, SCIF is obligated to
hire such attorneys, rather than contract out.

CASE's Appeal

CASE appeals the Executive Officer's conclusion that the SPB lacks the authority
to disapprove a contract based upon the state agency's violation of Government Code
section 11045, and contends that the notice requirements of that section are reflected in
and incorporated into Government Code section 19132, which is within SPB's
enforcement authority. Thus, CASE contends, SCIF's failure to comply with the notice
requirements of both section 11045 and section 19132 requires disapproval of all of the
contracts.

CASE also requests that, in addition to disapproving the contracts for the specific
matters identified in this proceeding, the Board should also disapprove any other
contracts or work that may have been assigned to the specified law firms under the
engagement letters with these firms. CASE contends that, because SCIF elected to
identify and justify only a few out of hundreds of legal matters it outsourced, any other
litigation or non-litigation work that may have been assigned to these firms has not been justified under section 19130 and should similarly be disapproved.

CASE also challenges the Executive Officer's Decision to approve some of the contracts under Government Code section 19130, subdivision (b)(10). Regarding the work performed by the Meckler firm, CASE contends that the Executive Officer improperly relied on a ground not asserted by SCIF and to which CASE did not have the opportunity to respond. In addition, CASE argues that the evidence does not support a finding that the work was temporary or occasional, in that SCIF's assertion only that it has not had "litigation" of the particular type of dispute for seven years did not demonstrate that it had no relevant legal experience in this area, and the litigation matter was still pending over two years later. CASE further contends that any "urgency" concerning the Hueston and Manatt (Khan) matters is entirely of SCIF's own creation, as SCIF itself initiated these civil RICO actions as the plaintiff and had the ability to choose where and when to file, what claims to allege, and how to prosecute. CASE also contends that SCIF could have trained its in-house attorneys or hired new civil service attorneys with the necessary experience prior to initiating the litigation, and that it failed to establish that it took reasonable steps to preserve its rights while seeking civil service counsel.

CASE also asserts that the Executive Officer's admonition to SCIF to transition the work to the civil service is ineffectual because it imposes no firm deadlines, noting further that an August 2015, trial date in the Drobot matter handled by the Hueston firm had been continued to February 2016, so that the transition should have already
begun. Thus, CASE argues the urgency no longer exists, and the contracts should be disapproved. CASE further argues that, if this type of contract is not disapproved, state agencies will have an incentive to manufacture urgency by illegally outsourcing legal work, and then claiming it would be prejudicial to revoke the contract. Finally, CASE contends that the 6-month transition period ordered by the Executive Officer for the Shepherd (EWL) contract is excessive, but does not challenge this ruling, with the understanding that the 6-month period began to run on August 17, 2015.

In response, SCIF argues, first, that the Executive Officer's Decision is correct in its conclusion that the SPB has no jurisdiction to enforce section 11045 and that, in any event it could not have violated the language in section 19132, subdivision (b), because that section did not become operative until all but one of the matters at issue had been assigned. In reply, CASE contends that this proceeding before the SPB commenced after the law became effective and that the law is therefore controlling on this appeal.

SCIF further reiterates its position that CASE waived its notification rights pursuant to the parties' settlement agreement and that CASE knew about all of SCIF's outside assignments when SCIF presented it with a spreadsheet on January 8, 2015, yet failed to challenge them. Thus, SCIF argues, the Board should reject CASE's request to disapprove engagements that were not addressed in this proceeding and

7 After oral argument before the Board in this matter, CASE submitted a "Notice of Supplemental Authority" showing that, on March 22, 2016, the United States District Court for the Central District of California issued an order granting a motion to disqualify the Hueston firm from representing SCIF in the Drobot case, and vacated the trial, pretrial conference, and discovery cutoff dates to allow SCIF to obtain new counsel. SCIF has not objected to the consideration of this newly-discovered evidence, and it is therefore accepted as evidence in this proceeding. (2 Cal. Code Reg., § 547.66.) In light of that order, CASE contends, it is now an appropriate time for SCIF to bring this case back in-house so that civil service attorneys can perform the work. In response, SCIF contends that the court's disqualification order has created a "cataclysmic impact" on SCIF that would be compounded by requiring it to take the litigation completely in-house, arguing that this is still not a case that can be handled in-house by SCIF's attorneys. SCIF further requests that the Board allow it to continue to utilize outside counsel on this matter.
allow SCIF the opportunity to follow the appropriate procedures for providing notice to CASE of each matter.

With regard to the Meckler contract, SCIF argues that, although it did not explicitly assert Government Code section 19130, subdivision (b)(10), as a justification, it provided sufficient information showing that the services were of a temporary and occasional nature, and that CASE knew or should have known about other cases assigned to that firm. With regard to the Hueston and Manatt RICO matters, SCIF argues that it acted reasonably in preserving its litigation rights and that it has already begun the process of recruiting and hiring additional corporate legal attorneys.

**DISCUSSION**

The California Supreme Court has long recognized that, emanating from Article VII of the California Constitution, is an implied "civil service mandate" that prohibits state agencies from contracting with private entities to perform work that the state has historically and customarily performed and can perform adequately and competently. *(Professional Engineers in California Government v. Department of Transportation (1997) 15 Cal.4th 543, 547.)* This mandate finds its genesis in a seminal case involving the very agency whose practices concerning the contracting of legal services are challenged in this case. *(State Compensation Ins. Fund v. Riley (1937) 9 Cal.2d 126, 135 [employment of an outside attorney by SCIF violated the predecessor to Article VII of the California Constitution, establishing the principle requiring services to be performed under the civil service is mandatory if the services are of such a nature that they can be performed adequately by civil service employees]. See also Burum v. State Compensation Ins. Fund (1947) 30 Cal.2d 575, 582 [SCIF must establish legal services*
could not be performed adequately, competently, or satisfactorily by attorneys selected under civil service]. The SPB has likewise repeatedly made it clear that SCIF is bound by the requirements set forth in statutory and case law when it seeks to contract out legal services. *(State Compensation Insurance Fund (2001) PSC No. 00-03 [SCIF’s contracts for personal services are subject to SPB review, disapproving contract for legal services related to employment discrimination claim]; State Compensation Insurance Fund (2016) PSC No. 16-01 [disapproving contract for legal services related to claims mishandling litigation].)

Government Code section 19130 codifies the exceptions to the civil service mandate recognized in various court decisions. The purpose of SPB’s review of contracts under Government Code section 19130 is to determine whether, consistent with Article VII and its implied civil service mandate, state work may legally be contracted to private entities or whether it must be performed by state employees. To justify a personal services contract pursuant to section 19130, a department must provide specific and detailed factual information, supported by documentary evidence or declarations, demonstrating that one or more of the statutory exceptions within the subdivisions of section 19130 apply. *(2 Cal. Code Reg., § 547.62, subd. (b).) The agency seeking the personal services contract bears the burden of establishing applicability of the exception. *(State Compensation Ins. Fund v. Riley, supra, 9 Cal.2d at pp. 134-135.)*

The law also requires an agency proposing to execute a personal services contract to notify all organizations that represent state employees who perform the type of work to be contracted, except under extenuating circumstances. *(Gov. Code, §*
19132, subd. (b)(1). In addition, all agencies seeking to employ outside legal counsel must provide written notice to the designated bargaining representative of State Employees Bargaining Unit 2 of any proposed contract for outside legal counsel. (Gov. Code, § 11045, subd. (a).)\(^8\) The notice requirements applicable to all personal services contracts under section 19132 do not change this requirement, nor do they require an additional notification. (Gov. Code, § 19132, subd. (b)(4).)

The Board's regulations set forth a clear and comprehensive process for reviewing personal services for compliance with Government Code section 19130, subdivision (b). Initially, when it submits the contract for approval by the Department of General Services (DGS), the contracting agency is required to submit written justification including specific and detailed factual information that demonstrates how the contract meets one or more of the conditions specified in Government Code section 19130, subdivision (b). (2 Cal. Code Reg., § 547.60.)\(^9\)

**Effect of the Parties' 2008 Settlement Agreement**

SCIF contends that, pursuant to the terms of the 2001 and 2008 settlement agreements, CASE waived the requirement that SCIF comply with the provisions of Government Code section 19130. The Board disagrees. The merit-based civil service system does not exist solely for the benefit of state civil service employees, but also serves the strong interest of the public in general in ensuring that partisanship plays no

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\(^8\) The notice requirements of Government Code section 11045, subdivision (a), apply to both state agencies that are required to request the consent of the Attorney General to employ outside counsel as well as agencies, such as SCIF, that are not required to require the consent of the Attorney General. (Gov. Code, § 11045, subd. (a)(1), (a)(2).)

\(^9\) In this case, there is no evidence that SCIF submitted any documentation to DGS concerning the contracts at issue.
role in selection and advancement within the civil service. (State Personnel Board v. Dept. of Personnel Admin. (2005) 37 Cal.4th 512, 527.) The mandate against contracting out work that the state itself can perform adequately and competently derives from the underlying purpose of Article VII of the California Constitution to promote efficiency and economy in state government and to eliminate the "spoils system" of political patronage, and "assure[s] that the state civil service is not neglected, diminished, or destroyed through routine appointments to 'independent contractors' made solely on the basis of political considerations or cronyism." (Professional Engineers in California Government v. Department of Transportation, supra, 15 Cal.4th at p. 564, quoting California State Employees' Assn. v. State of California (1988) 199 Cal.App.3d 840, 846-847; State Compensation Insurance Fund v. Riley, supra, 9 Cal.2d at p. 135.) Thus, the restriction on contracting out does not simply protect the individual interests of state civil service employees, but "emanates from an implicit necessity for protecting the policy of the organic civil service mandate against dissolution and destruction." (Professional Engineers at p. 548.)

The SPB is constitutionally required to enforce the provisions of Government Code section 19130 upon request by an employee organization. (State Compensation Insurance Fund, supra, PSC No. 00-13, pp. 6-7.) Because those provisions protect the integrity of the civil service itself, as mandated by the California Constitution, parties are not free to waive the requirement that all contracts for personal services meet one or more of the statutorily or judicially recognized exceptions to the civil service mandate. Accordingly, the Board's authority to review contracts for compliance with the constitutional merit principle cannot be waived by the parties. (State Personnel Board v.
Moreover, even if such a waiver were permissible, the evidence before us does not establish that the parties agreed that SCIF would be permitted to contract out legal services without ensuring that such contracts were justified under Government Code section 19130. The 2008 settlement agreement recites that it is "intended to settle, fully and finally, any and all claims that CASE has asserted or could have asserted against SCIF" in Sacramento County Superior Court Case No. 07AS04047 "arising out of or related to SCIF's use of outside counsel," up to and including the effective date of the agreement,¹⁰ and provides, in relevant part:

6. Challenges to SCIF's Use of Outside Counsel. During the term of the Agreement, CASE agrees not to challenge, directly or indirectly, SCIF's use of outside counsel in any forum, including but not limited to the State Personnel Board ("SPB") and the Superior Courts of the State of California. CASE further agrees that during the term of this Agreement, it will take no action in any forum to require SCIF to report any use of outside counsel to SPB, or to CASE except as provided in Paragraph 7 herein.

7. Meetings. CASE and SCIF will meet and discuss, at least once per calendar year, methods to cooperatively enhance the ability of SCIF's in-house legal workforce to handle matters without resort to outside counsel while allowing SCIF the needed flexibility to utilize outside counsel when necessary. Within a reasonable time prior to each annual meeting, SCIF will provide to CASE a list of all pending matters in which outside legal counsel is being utilized, and a list of all such matters that were closed within the preceding 12 months. Such lists shall be deemed confidential and shall not be disseminated outside of CASE's Officers, Directors, staff and counsel without prior approval of SCIF.

¹⁰ The agreement states that it was to become effective as of the date it was signed by both parties. The agreement was signed by CASE on November 15, 2008, and by SCIF on November 18, 2008.
The agreement further specified that the term of the agreement would be five years from the effective date.

Nothing in the settlement agreement purported to waive SCIF's obligation to comply with the requirements of section 19130 before contracting out legal services. Instead, the agreement provided only that, during the term of the agreement, which expired in November 2013, CASE would not challenge SCIF's use of outside counsel or require SCIF to report such use to the SPB, which CASE did not do. Therefore, SCIF's argument that it was not required to comply with section 19130 is rejected. Likewise, the Board rejects SCIF's contention that CASE waived the notice requirements of Government Code section 11045 and 19132, as nothing in the settlement agreement addressed SCIF's obligation to comply with those requirements.

SCIF's Compliance with Notice Requirements

CASE contends that all of the contracts should be disapproved because SCIF failed to provide it with notice of the proposed contracts as required under both Government Code section 11045 and Government Code section 19132. In support of its position, CASE argues that section 11045 is simply a more specific version of the notice requirements applicable to all personal services contracts under section 19132, which specifically references and incorporates the notice requirements of section 11045. Thus, CASE contends, the Legislature conferred jurisdiction on the SPB when it incorporated and linked the two related notice provisions, such that a failure to comply with section 11045 is also a failure to comply with section 19132, which is within SPB's enforcement authority.
It is undisputed that SCIF failed to comply with the notice requirements of section 11045. That section provides, in relevant part:

(a)(2) All state agencies, other than the office of the Attorney General, that are not required to obtain the consent required by subdivision (c) of Section 11040, shall provide written notice of any proposed contract for outside legal counsel to the designated representative of State Employees Bargaining Unit 2 five business days prior to execution of the contract by the state agency. The notice shall include the items required by subdivision (d). In the event of an emergency that requires the immediate employment of outside counsel, the state agency shall provide the written notice no later than five business days after the contract with outside counsel is signed.

(d) "Written notice" within the meaning of this section shall include, but not be limited to, all of the following:
1. A copy of the complaint or other pleadings, if any, that gave rise to the litigation or matter for which a contract is being sought, or other identifying information.
2. The justification for the contract, pursuant to subdivision (b) of Section 19130.
3. The nature of the legal services to be performed.
4. The estimated hourly wage to be paid under the contract.
5. The estimated length of the contract.
6. The identity of the person or entity that is entering into the contract with the state.

The Board agrees with the Executive Officer, however, that, because SPB's authority to disapprove a personal services contract stems from Government Code section 19130, the Board lacks jurisdiction to disapprove a contract based solely upon a state agency's violation of section 11045. Nonetheless, as discussed below, the provisions of section 11045 have largely been incorporated into Government Code section 19132, subdivision (b)(1).

Government Code section 19132, subdivision (b), as amended effective January 1, 2014, provides, in relevant part:
(1) Unless a personal services contract pursuant to subdivision (b) of Section 19130 is necessary due to a sudden and unexpected occurrence that poses a clear and imminent danger, requiring immediate action to prevent or mitigate the loss or impairment of life, health, property, or essential public services, the contract shall not be executed until the state agency proposing to execute the contract has notified all organizations that represent state employees who perform the type of work to be contracted. At a minimum, the notice shall include a full copy of the proposed contract. The notifying agency may redact specific confidential or proprietary information from the notice.

(2) The Department of General Services shall establish a process to certify the notification in paragraph (1).

(3) The notification and certification of notice requirements of this subdivision do not change the requirements for contracts under Section 11045 or require an additional notification.

Assuming section 19132, subdivision (b), applied, it is clear that SCIF also failed to comply with this provision. SCIF contends, however, that it was not obligated to comply with section 19132, subdivision (b), because all but one of the legal matters at issue were commenced prior to the effective date of this provision. The express language of the statute states that "the contract shall not be executed" until the state agency provides the requisite notification. Therefore, it appears to apply only prospectively to contracts that have not yet been executed, and does not apply to contracts already executed prior to January 1, 2014.

Other than a summary declaration that all but one matter (the Riley matter, which has since concluded) "commenced" prior to January 1, 2014, SCIF has provided no evidence as to when any of the contracts for specific matters were executed. Therefore, the Board is unable to determine whether the provisions of section 19132, subdivision (b) applied to any of these matters. The Board concludes, however, that it has jurisdiction to enforce compliance with this provision with respect to any contract for
legal services executed on or after January 1, 2014, but that the notice requirements of this provision did not apply to any matter for which a contract was executed prior to January 1, 2014. In the absence of any evidence showing that any of the contracts for the legal matters at issue herein were executed on or after that date and therefore subject to the requirements of section 19132, subdivision (b), the Board declines to consider whether to disapprove the contracts on that basis alone.

SCIF's Request to Provide Justification for the Contracts Disapproved by the Executive Officer

SCIF has not challenged the Executive Officer's findings that, with two exceptions, it failed to provide sufficient evidence to the Executive Officer that the contracted matters at issue in this case are justified under any provision of Government Code section 19130. Moreover, in its appeal to the Board, SCIF has not articulated any facts showing that, at the time the work was contracted, any justification for the remaining matters existed under any provision of Government Code section 19130, subdivision (b). Instead, SCIF requests the opportunity to now provide evidence to establish a justification under Government Code section 19130 for each of the matters it previously identified as having been contracted out.

Before turning to SCIF's request, we first address a contracting agency's burden to establish a justification for contracting out for legal services. Contracting out may be justified under Government Code section 19130, subdivision (b)(3), when the services contracted are not available within the civil service, cannot be performed satisfactorily by civil service employees, or are of such a highly specialized or technical nature that the necessary expert knowledge, experience, and ability are not available through the
Civil service system. In order to establish such a justification, the contracting agency must establish that either: (1) no civil service job classifications exist to which the department could appoint employees with the requisite expertise needed to perform the required work; or (2) the department was unable to successfully hire suitable candidates for any of the applicable classifications. (Service Employees International Union, Local 1000, PSC No. 05-03, at p. 8; Department of Pesticide Regulation, supra, PSC No. 01-09, at pp. 12-13.) The exception does not apply when the services could be performed through the civil service system, but not enough civil service employees are currently employed to perform those services. (Department of Pesticide Regulation, at p. 13.)

The fact that an agency’s in-house counsel may not possess the necessary knowledge, skill, or ability to perform the services is not determinative of whether contracting out legal services is justified under Government Code section 19130, subdivision (b)(3). Instead, the agency must show that the services are not available anywhere within the civil service, including within the Attorney General’s office, even though the agency may not be required to obtain the consent of the Attorney General to employ counsel other than the Attorney General. (State Compensation Fund, PSC No. 00-03, at pp. 11-12.)

There is no question that Government Code sections 11040 and 11041 exempt SCIF from the provisions of section 11042 that require most state agencies to obtain the consent of the Attorney General to employ legal counsel other than the Attorney General in judicial and other proceedings. While these provisions authorize exempt agencies such as SCIF to utilize in-house counsel to represent themselves in legal proceedings, they do not authorize SCIF or any other agency to contract out legal
services, nor do they exempt any agency from the state civil service mandate. (See Secretary of State (2005) PSC No. 04-04, at p. 5, at note 6 [applying same principle to exemption under Government Code section 10411, subdivision (b), for the continuation of attorney's services on a matter he or she was involved in prior to leaving state service from the 12-month prohibition of former civil service employee from contracting with the state].) As noted by the Board, “[e]ven though, under Government Code §§ 11040 and 11041, SCIF may not be required to obtain prior Attorney General consent before retaining its own in-house or outside legal counsel to represent it in litigation, nothing in those statutes precludes SCIF from seeking Attorney General representation when SCIF is sued in an action that SCIF's in-house lawyers are not qualified to defend.” (PSC No. 00-03, pp. 12-13.) Thus, the provisions of Government Code sections 11040 and 11041 do not exempt SCIF from complying with the provisions of Government Code section 19130 when retaining outside counsel. (Id. at p. 13.)

As further determined correctly by the Executive Officer, SCIF failed, with one exception, to demonstrate that the contracted legal services are not available in the civil service, cannot be satisfactorily performed by civil service employees, or are of such a highly specialized or technical nature that the necessary expert knowledge, experience, and ability are not available through the civil service system. In its submissions to the Executive Officer, SCIF failed to present any evidence that it even attempted to obtain legal representation for these matters within the civil service system, contending instead that it lacked sufficient in-house attorneys to perform the work, the matters were complex or unusual, and/or the private firms had particular expertise in the subject matter. Therefore, the Executive Officer properly concluded that SCIF had failed to
meet its burden of justifying the contracts under Government Code section 19130, subdivision (b)(3).11

Contracting out may also be justified under Government Code section 19130, subdivision (b)(10), when the services are of such an urgent, temporary, or occasional nature that the delay incumbent in their implementation under civil service would frustrate their very purpose. In order to establish this justification, a state agency must provide sufficient information to show: (1) the urgent, temporary, or occasional nature of the services; and (2) the reasons why a delay in implementation under the civil service would frustrate the very purpose of those services. (California Attorneys, Administrative Law Judges and Hearing Officers in State Employment (2005) PSC No. 05-04.) Contracting out may not be justified under Government Code section 19130, subdivision (b)(10), however, where the urgency is self-created and arises as a result of a lack of planning on the part of an agency. (California Department of Corrections and Rehabilitation (2012) PSC No. 12-01; Service Employees International Union, Local 1000 (2008) PSC No. 08-10.) Moreover, any “urgency” cannot arise out of factors that are within the State’s control, such as the failure to hire sufficient numbers of civil service employees to perform the required functions. (Professional Engineers in California Government v. Department of Transportation, supra, 15 Cal.4th at pp. 571-572; Department of Transportation (2008) PSC No. 07-05.)

11 While finding that SCIF failed to provide sufficient justification under Government Code section 19130, subdivision (b)(3), for the contract with the Sheppard firm for the EWL matter, the Executive Officer’s Decision allowed the contract to continue for a period of six months to enable SCIF to transition the work back to the civil service. That six-month period expired on February 17, 2016. Accordingly, the contract with the Sheppard firm for the EWL matter is hereby disapproved with respect to all work performed after February 17, 2016.
The Board agrees that SCIF provided sufficient evidence to the Executive Officer to establish a justification under Government Code, subdivision (b)(10), for contracting one specific matter to the Meckler firm, based upon SCIF's contention that the matter was a unique dispute that was unlikely to recur.12 The Board further affirms the Executive Officer's determination to allow the two RICO litigation matters contracted to the Hueston firm (Drobot matter) and the Manatt firm (Khan matter) to continue for a limited period of time due to the existence of urgent circumstances at the time the matters were presented to the Executive Officer. Those circumstances included a trial date set for August 2015, in the Drobot matter and a discovery cut-off date of October 2, 2015, in the Khan matter. As set forth in the Executive Officer's Decision, SCIF was directed to develop and implement a plan to transition the contracted work to civil service attorneys if and when the trial date in the Drobot matter was continued to a later date or other urgent circumstances no longer existed. SCIF has not disputed CASE's assertion that the Drobot trial was continued to February 9, 2016, nor has it provided any evidence to show a continuing urgency with respect to these matters or any efforts to transition the work to the civil service.13 Therefore, the Board concludes that any

12 Although CASE asserts that it was not afforded the opportunity to respond to the Executive Officer on the issue of whether the contract for this matter was justified under subdivision (b)(10), the Board finds that CASE was able to, and did, present its arguments on this issue to the Board. Having considered CASE's arguments, the Board concludes that CASE has not presented any evidence to contradict SCIF's evidence that the particular type of insurance policy at issue in the case is unusual and that SCIF has not had this litigation over this type of insurance coverage dispute for over seven years. Accordingly, the Board concludes that SCIF established sufficient justification for this matter under subdivision (b)(10).

13 As noted above, by order of the United States District Court for the Central District of California, the Hueston firm has been disqualified from representing SCIF in the Drobot litigation matter. Although SCIF asserts that it lacks the capacity to perform the work in-house, it has provided no evidence to demonstrate any effort to transition the work to civil-service attorneys, including but not limited to attorneys employed by the Attorney General’s Office. In its response to CASE's Notice of Supplemental Authority, SCIF requests that the Board allow it to continue to utilize outside counsel in this matter. Any such contract for legal services performed by a firm other than the Hueston firm is not before the Board in
urgency that may have existed at the time of the Executive Officer's review no longer exists, and orders the contracts for these matters terminated immediately.¹⁴

As for the remaining matters, the Executive Officer afforded SCIF ample opportunity to provide the necessary justification under Government Code section 19130 for contracting out legal services, yet SCIF utterly failed to do so. SCIF's only defense is that it did not maintain "documentation" for its decisions to contract out the specific matters at issue here because it believed the terms of the settlement agreements it entered into with CASE in 2001 and 2008, did not require it do so. SCIF's argument misses the point. Government Code section 19130 does not merely require a state agency to "document" its reasons for contracting out. Rather, it prohibits an agency from contracting out personal services unless the agency can demonstrate affirmatively that the contract is exempt from the civil service mandate under one or more of the provisions of Government Code section 19130. SCIF was required to provide its justification to the Executive Officer. In reviewing the Executive Officer's Decision:

The board will decide the appeal upon the factual information, documentary evidence, and declarations submitted to the executive officer before he or she issued his or her decision. Upon the objection of a party, the board will not accept additional factual information, documentary evidence, or declarations that were not previously filed with the executive officer if the board finds that the submission of this additional factual information, documentary evidence, or declarations would be unduly prejudicial to the objecting party.

¹⁴ Because the Board orders these contracts terminated immediately, the Board does not address CASE's further argument that, because the litigation in these cases was initiated by SCIF after SCIF's investigation, they were not justified at the time the matters were presented to the Executive Officer.
CASE has objected to SCIF's request to submit additional evidence. In its submissions to the Board, SCIF has not identified any specific evidence that it wishes to present that would justify the contracts. In effect, having failed to provide evidence justifying the contracts to either the Executive Officer or the Board, SCIF seeks a third bite of the apple. Based upon SCIF's own admissions, however, it is apparent that SCIF did not conduct the appropriate inquiry into the availability of the services within the civil service prior to contracting and, therefore, no such evidence existed at the time it made the decision to contract out. Accordingly, the Board finds no good cause to allow SCIF to submit additional evidence to justify the contracts after the fact.

In reaching this decision, the Board makes no finding that would preclude SCIF from considering or entering into future legal services contracts, including contracts for work in connection with the litigated matters that are the subject of this challenge, in the event SCIF believes there are changed or new circumstances that necessitate the retention of outside counsel. The Board recognizes that some of the matters covered by the disapproved contracts involve complex legal issues and procedures that could conceivably fall within one of the statutory exemptions as they further develop. In this case, however, SCIF utterly failed to take the necessary steps to determine whether, in fact, the services are or are not available within the civil service, prior to making the decisions to contract out. SCIF is reminded, yet again, that it is not exempt from the requirements of section 19130. Hence, before entertaining the possible option of

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15 Any such contract must, of course, comply with Government Code section 19135, subdivision (a), which provides: "The state agency shall not circumvent or disregard the board's action by entering into another contract for the same or similar services or to continue the services that were the subject of the contract disapproved by the board or its delegate."
engaging non-civil-service attorneys to handle SCIF's legal matters, SCIF must fully consider the factors under section 19130 and promptly notify CASE of the intent to contract for legal services as required by Government Code sections 11045 and 19132, subdivision (b). In other words, SCIF must comply with the law.

SCIF's Request for Clarification of its Obligation to Attempt to Employ Civil Service Attorneys

SCIF's request for clarification as to what it should do if it identifies an attorney in state civil service who possesses the requisite skills and experience misapprehends the nature of its obligation under Government Code section 19130, subdivision (b)(3). The inquiry is not whether an individual attorney, employed somewhere in the state civil service, possesses the particular skills and expertise necessary to perform the work. Rather, SCIF's obligation is to determine whether there are any civil service classifications to which employees with the requisite expertise could be appointed and, if so, to demonstrate its efforts to either hire or obtain the services of such employees. (Service Employees International Union, supra, PSC No. 08-10.) As noted above, the fact that SCIF may not currently have sufficient attorneys with the necessary expertise does not establish the justification, as it must show that it "exhausted all reasonable avenues for procuring the necessary services through the civil service." (Department of Pesticide Regulation, supra, PSC No. 01-09, at pp. 13-14.) Nothing in this Board Decision and Order requires SCIF to utilize the Attorney General for legal representation. If, however, SCIF lacks or is unable to hire its own attorneys to perform work that can be performed by civil service attorneys, it must demonstrate its efforts to obtain attorneys elsewhere in the civil service, including requesting representation by
the Attorney General, before it seeks to contract out work that civil service attorneys are capable of performing and have traditionally performed. Such efforts may include, but are not limited to, hiring additional attorneys through the civil service examination process, use of limited-term employees, use of training and development assignments, or utilizing the services of other agencies, such as the California Department of Human Resources (CalHR), with expertise in the particular subject matter.

Scope of Disapproval

Both parties have raised issues concerning the scope of the Executive Officer's disapproval of the contracts at issue in this case. SCIF asserts that, since the Executive Officer determined that the panel counsel agreements were not themselves contracts, it is only required to terminate its agreements with outside counsel with respect to the specific legal matters assigned to the law firms at the time CASE filed its request for review, and that it remains free to assign new matters to those firms so long as it does so in compliance with section 19130. SCIF’s request appears limited to the non-litigation matters assigned to the Clarence firm, the Gibson firm, the Horvitz firm, the SNR Denton firm, and the Sedgwick firm. CASE, in turn, asserts that, because SCIF only sought to justify specific matters before the Executive Officer, any other matters handled by the identified law firms must be disapproved.

Upon receipt of CASE’s request for review of its contracts with the specified law firms, SCIF was obligated to provide CASE and the SPB with copies of all contracts for legal services with those firms that existed at the time of SCIF’s request. In response, SCIF provided the 13 “engagement letters” that, with the exception of the agreement with the Meckler firm, did not describe any specific legal matters to be performed under
the terms of those letters. SCIF also identified specific legal matters separately in its written response to the Executive Officer. It appears undisputed that, in January 2015, after CASE filed its challenge in this case, SCIF also provided to CASE an extensive list of matters that it had contracted out.

The Board agrees with the Executive Officer that a "contract" was only formed when SCIF assigned a specific legal matter to a firm. In its response to the Executive Officer, SCIF identified approximately 11 specific litigation matters, as well as an unknown number of non-litigation matters, assigned to the firms identified by CASE in its request for review. The Board is mindful, however, that, since the commencement of this proceeding, SCIF may have assigned other matters to the identified firms or to other firms. In addition, while SCIF has acknowledged that many matters handled under the engagement letters have already been completed, it is unknown how many other matters were previously assigned to these firms but concluded prior to the date CASE filed its request for review. Any such matters should have been disclosed to CASE pursuant to Government Code sections 19132 and 11045. Therefore, while the Board's Decision and Order is limited to the specific matters identified by SCIF in this proceeding, the Board expects SCIF to comply with its obligation to disclose fully to CASE any and all contracts for legal services so that CASE may evaluate whether to challenge such contracts. In the event it is determined that SCIF has assigned additional legal matters to outside counsel without disclosing such matters as required by law, the Board will view any effort to justify such contracts under Government Code section 19130 with extreme disfavor.
CONCLUSION

The civil service mandate established under Article VII of the California Constitution prohibits SCIF from contracting out work that civil service attorneys can perform adequately and competently. The evidence in this case demonstrates that, in nearly all cases, SCIF has failed completely in its obligation to consider carefully the availability of qualified civil service attorneys to perform specific legal services before contracting out those services to private firms. While private entities may have the freedom to select their attorneys at will, preservation of the constitutional merit principle requires all state agencies to demonstrate a justification for contracting out under one of the specific exemptions to the civil service mandate before utilizing private counsel. In the absence of such a justification, the contracts cannot be approved.

ORDER

Based upon the entire record in this matter, the foregoing findings of fact, and conclusions of law, it is hereby ORDERED that:

1. The contract for legal services performed by the firm of Holland & Knight in connection with the XL Re, Ltd. matter is hereby APPROVED.

2. The contract for legal services performed by the firm of Meckler Burger Tilson Marick & Pearson LLP in connection with the Insurance Company of the State of Pennsylvania (ISOP) v. Alta Vista Solutions, Inc. (Alta Vista), et al. matter is hereby APPROVED.

3. The contract for legal services performed by the firm of Hueston and Hannigan (formerly Irell & Manella) in connection with the State Fund v.
Michael D. Drobot, Sr., et al., matter is hereby **DISAPPROVED** for any work performed after March 22, 2016.

4. The contract for legal services performed by the firm of Manning and Kass in connection with two *Qui Tam* litigation matters is hereby **DISAPPROVED**.

5. The contract for legal services performed by the firm of Manatt, Phelps & Philips LLP in connection with the *Khan, Riley, and Tendulkar* matters is hereby **DISAPPROVED**.

6. The contract for legal services performed by the firm of Sheppard Mullin Richter & Hamilton LLP in connection with the *Habilan, Notis, and EWL* (for all work performed after February 17, 2016) matters is hereby **DISAPPROVED**.

7. The contract for legal services performed by the firm of Manning and Kass in connection with two *Qui Tam* litigation matters is hereby **DISAPPROVED**.

8. The contract for legal services performed by the firm of Clarence Dyer & Cohen in connection with non-litigation research, advice and counsel is hereby **DISAPPROVED**.

9. The contract for legal services performed by the firm of Gibson Dunn & Crutcher in connection with non-litigation research, advice and counsel is hereby **DISAPPROVED**.

10. The contract for legal services performed by the firm of Horvitz & Levy in connection with non-litigation research, advice and counsel is hereby **DISAPPROVED**.
11. The contract for legal services performed by the firm of SNR Denton in connection with non-litigation research, advice and counsel is hereby **DISAPPROVED**.

12. The contract for legal services performed by the firm of Sedgwick LLP in connection with non-litigation research, advice and counsel is hereby **DISAPPROVED**.

13. SCIF shall terminate all disapproved contracts immediately and shall provide notice of such termination to CASE within 10 days of the date of this Board Decision and Order.

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STATE PERSONNEL BOARD

Kimiko Burton, President
Lauri Shanahan, Vice President
Patricia Clarey, Member

* * * * *

I hereby certify that the State Personnel Board made and adopted the foregoing Board Decision and Order at its meeting on May 5, 2016.

Suzanne M. Ambrose
Executive Officer

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16 Member Costigan recused himself and did not participate in this Board Decision and Order. Member Maeley Tom did not participate in this Board Decision and Order.
PROOF OF SERVICE

Case Name: State Compensation Insurance Fund and The California Attorneys, Administrative Law Judges, and Hearing Officers in State Employment

Case No.: 14-0032(b)

PSC Case No.: 16-02

I am over the age of 18 years and not a party to this action. I declare that I am employed by the California State Personnel Board, located at 801 Capitol Mall, Sacramento, CA 95814.

On May 11, 2016, I served the following document(s) on the below mentioned addressee(s):

BOARD DECISION AND ORDER

I served the above document(s) by enclosing them in an envelope and placing the envelope for collection and mailing following our ordinary business practices. I am readily familiar with the State Personnel Board’s practice for collecting and processing correspondence for mailing. On the same day that the correspondence is placed for collection and mailing, it is deposited in the ordinary course of business, in the United States Postal Service in a sealed envelope with postage fully prepaid.

Judith D. Sapper, Corporate Legal State Compensation Insurance Fund 5880 Owens Drive, Third Floor, Building B Pleasanton, CA 94588-3900 Attorney for SCIF

Patrick J. Whalen, Esq. The Law Office of Brooks Ellison 1725 Capitol Avenue Sacramento, CA 95814 Attorney for CASE

I declare under penalty of perjury that the foregoing is true and correct, and that this declaration was executed on May 11, 2016, at Sacramento, California.

Legal Department