

STATE OF WEST VIRGINIA

SPECIAL REPORT

ATTORNEY GENERAL'S OFFICE

**Unclear Whether the Attorney General
Had Authority to Contract with Private Attorneys
on a Fee Basis and to Bring an Action Against
Tobacco Product Manufacturers**

**Antitrust Enforcement Funds in Excess of
\$300,000 Have Not Reverted to the General
Revenue Fund**

**The Tobacco Case Settlement Was Structured
in a Manner to Maximize the Funds Received by the
Attorney General for Attorney Fees and Expenses**

**State Comparisons Suggests Appropriate
Staffing Levels**

**Examination of Billing Practices and
Outside Bank Accounts Revealed No Material Exceptions**

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January 2002

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John Sylvia
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January 7, 2002

The Honorable Edwin J. Bowman
State Senate
129 West Circle Drive
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The Honorable Vicki V. Douglas
House of Delegates
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1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0470

Dear Chairs:

We are transmitting a Special Report of the Attorney General's Office, which will be presented to the Joint Committee on Government Operations on Monday, January 7, 2002. The issue covered herein is "It Is Unclear Whether the Attorney General Had Authority to Contract with Private Attorneys on a Fee Basis Not in Accordance with W. Va. Code §5-3-3 to Bring an Action Against Tobacco Product Manufacturers in McGraw v. The American Tobacco Co., et al., Civil Action No. 94-C1707, Circuit Court of Kanawha County," "*Antitrust Enforcement Funds in Excess of \$300,000 Have Not Been Reverted to the General Revenue Fund as Mandated by the Code,*" "*The Tobacco Case Settlement Was Structured in a Manner to Maximize the Funds Received by the Attorney General for Attorney Fees and Expenses While Circumventing the West Virginia Code,*" "*State Comparisons Suggests Appropriate Staffing Levels,*" and "*Examination of Billing Practices and Outside Bank Accounts Revealed No Material Exceptions.*"

We transmitted a draft copy to the Attorney General's Office on December 21, 2001. We received the agency response on January 3, 2002.

Let me know if you have any questions.

Sincerely,

Handwritten signature of John Sylvia in cursive script.
John Sylvia

JS/aml

Joint Committee on Government and Finance

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Executive Summary

Issue 1: Unclear Whether the Attorney General Had Authority to Contract with Private Attorneys on a Fee Basis and to Bring an Action Against Tobacco Product Manufacturers.

The legal action, *McGraw v. The American Tobacco Co., et al*, initiated in the Circuit Court of Kanawha County in 1994 by outside legal counsel appointed by the Attorney General, brought welcome revenue to the State, but exposed a need to clarify how the Attorney General may compensate appointed attorneys and to address procedures by which the Legislature may wish to have comparable litigation prosecuted or settled in the future.

Recommendation 1:

The Legislature should consider amending the W. Va. Code, including §5-3-3, specifically to allow or disallow any future fee arrangement for private attorneys representing State agencies, which are, or are similar to, a contingency fee arrangement, and to define that term.

Recommendation 2:

If the Legislature should decide to allow the Attorney General and or other State agencies to continue to use fee arrangements for private attorneys which are, or are similar to, a contingency fee arrangement, the Legislature should consider amending the W. Va. Code to specify that all such fees received by a private attorney or private law firm are public information and are to be reported by the contracting State agency to the Legislature's Joint Committee on Government and Finance.

Recommendation 3:

The Legislature should consider enacting a general provision allowing the State to recoup attorneys fees in cases in which it initiates and prevails in its attempt to enforce a specific State law or in its attempt to right a wrong a person has inflicted on the State. The Legislature should make it clear that all attorneys fees are required to be deposited to the credit of the State's General Revenue Fund, unless it specifically provides otherwise by statute.

Issue 2: Antitrust Enforcement Funds in Excess of \$300,000 Have Not Reverted to the General Revenue Fund as Required By Law.

The State of West Virginia created the West Virginia Antitrust Act under the W. Va. Code in an effort to place statutory constraints on contracts, combinations in the form of trusts or otherwise, or conspiracies in restraint of trade or commerce. W. Va. Code establishes an Antitrust Enforcement Fund whereby all money received as a result of actions by the Attorney General shall be placed in this fund. W. Va. Code also states all sums in excess of \$250,000 (FY 2000) and

\$300,000 as amended (FY 2001) shall expire at the end of the year and shall revert to State general revenue. *The Digest of Revenue Sources in West Virginia* (the Digest) reports an ending balance for fiscal year 2000 of \$343,770.23 and 2001 of \$601,539.23. These Antitrust Enforcement Funds in excess of \$250,000 in FY 2000 or \$300,000 in FY 2001 have not reverted to the State's general revenue fund as required by W. Va. Code.

Recommendation 4:

In accordance with W. Va. Code §47-18-19, the Legislative Auditor recommends the current balance exceeding \$300,000 in the Antitrust Enforcement Fund be immediately transferred to the State General Fund by the Attorney General's Office. Also, the Legislature may want to consider receiving previous amounts not swept in the General Revenue Fund retroactively.

Recommendation 5:

The Legislature should consider revising the W. Va. Code to clearly provide the State Treasurer's Office with the statutory authority to sweep the funds that exceed any statutory limits, such as those set for the Antitrust Enforcement Fund, at the end of each fiscal year.

Issue 3: The Tobacco Case Settlement Was Structured in a Manner to Maximize the Funds Received by the Attorney General for Attorney Fees and Expenses While Circumventing the Intention of the W. Va. Code.

The Attorney General (AG) was awarded \$714,634.65 for the work performed by his staff in resolving the tobacco settlement lawsuit. However, the AG devised a plan whereby the \$714,634.65 would be received in three equal installments starting fiscal year ending 2001. The intention was to avoid having excess funds greater than \$250,000 (FY 2000) and \$300,000 (FY 2001) which would have to be transferred from the Antitrust Enforcement Fund to the State general revenue fund as provided in W. Va. Code. The AG has requested these payments be received after July 1 of each year with the first installment being received February 22, 2001. Clearly, the AG has structured the full installment to be paid over three years to circumvent the W. Va. Code. If the \$714,000 would have been received in a lump sum then \$475,000 would have been swept into the State General Revenue fund at the end of fiscal year 2001.

Recommendation 6:

The Legislative Auditor recommends the Attorney General request the final two installments immediately. These funds shall be deposited into the State General Fund upon receipt.

Issue 4: State Comparisons Suggests Appropriate Staffing Levels.

The Legislative Auditor performed a limited but suggestive analysis to determine if the current staffing level for the Attorney General’s Office is appropriate. An analysis revealed a high correlation between the state’s AG staffing levels, the state’s population and the number of state employees. West Virginia’s population and the number of state employees rank 37th in the nation, while the state’s AG staff ranks 38th. While this analysis is limited, it suggests that the State’s Attorney General’s Office is appropriately staffed when compared nationally. Given the high correlation between state Attorney General Office’s staffing levels, state population and state employees, West Virginia’s AG staff appears to be appropriate.

Issue 5: Examination of Billing Practices and Outside Bank Accounts Revealed No Material Exceptions.

The Attorney General’s Office is authorized by the State Budget Bill to employ attorneys to represent State agencies. Attorneys represent State agencies either as “billers” or “fully reimbursed.” The Legislative Auditor examined if fully reimbursed attorneys also provide services for other agencies and bill for the work. This examination noted no material instances where the AG’s office subsidized its revenue by permitting fully reimbursed staff to perform work for agencies other than those who are reimbursing their salary 100%.

State agencies are permitted to maintain outside bank accounts if they do not consist of State funds and the agency’s need is fully justified. The Legislative Auditor’s Office has concluded that the Office of the Attorney General does not have any outside bank accounts in its name at this time.

Review Objective, Scope and Methodology

The Special Report of the Attorney General (AG) was completed at the request of the Legislative Auditor as provided for in W. Va. Code §4-2-5.

Objective

The objective of this review was to determine the following:

- Is the contingency fee payment made on behalf of the American Tobacco Co. case legal?
- Is the AG in compliance with key areas of the W. Va. Code?
- Does the AG efficiently use State resources?
- Are unauthorized outside bank accounts present?
- Does the AG practice prudent billing practices?
- Are the Antitrust and Consumer Protection Funds properly expended?

Scope

The scope of this report examined AG issues for the time period from 1994 to present.

Methodology

This report was developed from reviewing various documents as it relates to the tobacco settlement, reviewing the W. Va. Code, comparing staffing levels to other states, reviewing various documents to confirm outside bank accounts do not exist, reviewing billing practices as well as various personal interviews. This performance evaluation complied with **Generally Accepted Government Auditing Standards**.

Issue 1: It Is Unclear Whether the Attorney General Had Authority to Contract with Private Attorneys on a Fee Basis Not in Accordance with W. Va. Code §5-3-3 to Bring an Action Against Tobacco Product Manufacturers in *McGraw v. The American Tobacco Co., et al.*, Civil Action No. 94-C1707, Circuit Court of Kanawha County.

Settlement of the Case Left the Legality of Paying Contingent Fee Undecided.

In 1994 the Attorney General, through private attorneys appointed by him, brought action against various tobacco product manufacturers in the Circuit Court of Kanawha County, Judge Irene Berger presiding, to recover damages for expenses incurred by the State as a result of injury to the health of medicaid recipients or employees arising from the use of tobacco. A letter dated July 21, 1994, appointing the attorneys and signed by the Attorney General, explained that it was “contemplated” that the attorneys would receive a proper, reasonable and customary fee, subject to approval of the court, and not to exceed one-third of recovery. The attorneys were to advance all expenses of maintaining the action.

Lawyers representing the tobacco companies launched a vigorous attack on the State’s prosecution of the action by the appointed counsel to be paid on a contingent fee basis. Judge Berger, in her order entered November 29, 1995, wrote that the challenged retention arrangement was a contingent fee arrangement and that the Attorney General had no statutory or constitutional authority to retain private counsel under the proposed arrangement. The Court also ruled that neither the Attorney General nor the Court had constitutional or statutory authority to authorize payment to private counsel as contemplated under the Attorney General’s appointment letter. The court’s order precluded further prosecution of the action under the contingent fee arrangement.

While an appeal in the case was pending before the West Virginia Supreme Court of Appeals, Judge Berger entered a Consent Decree and Final Order December 11, 1998, which incorporated a Master Settlement Agreement. Pursuant to provisions of the Master Settlement Agreement, the Attorney General’s appointed outside counsel were to be paid directly by the tobacco companies instead of from money the tobacco companies paid to the State. The State subsequently began receiving and appropriating money recovered under the settlement agreement. In a letter dated November 7, 2001, prompted by this evaluation, Frances A. Hughes, Managing Deputy Attorney General, denied that the July 21, 1994, appointment letter established a contingent fee arrangement, and stated that the one-third percentage was to serve as a cap. Of interest in this ongoing debate is W. Va. Code §30-9-2(12), which defines “contingency fee” as it relates to fees licensed accountants are permitted to charge, as follows:

"Contingent fee" means a fee established for the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent upon the finding or result of the service. A fee fixed by a court, taxing authority or other public authority is not a contingent fee.

Because the case was settled without a decision by the West Virginia Supreme Court of Appeals as to whether it was unlawful for the Attorney General to appoint outside counsel as he did in the case, the issue is still open to debate.

The Attorney General Has No Express Constitutional or Statutory Authority to Appoint Private Counsel to be Paid on a Contingent Fee Basis.

The West Virginia Supreme Court of Appeals has ruled that the powers and duties of the State's Attorney General are narrowly circumscribed. The Attorney General's powers and duties are limited to those specified by the constitution and by rules of law prescribed pursuant thereto. *Manchin v. Browning*, 170 W. Va. 779, 296 S.E.2d 909 (1982). The Attorney General's powers are limited to those specifically conferred by statute. *State ex rel. McGraw v. Scott Runyan Pontiac-Buick, Inc.*, 194 W. Va. 770, 461 S.E.2d 516, 523 (1995).

W. Va. Code §5-3-3 authorizes the Attorney General to appoint assistant attorneys general as necessary to perform the duties of his office and limits their compensation to amounts appropriated.

§5-3-3: Assistants to Attorney General

The attorney general may appoint such assistant attorneys general as may be necessary to properly perform the duties of his office. The total compensation of all such assistants shall be within the limits of the amounts appropriated by the Legislature for personal services. All assistant attorneys general so appointed shall serve at the pleasure of the attorney general and shall perform such duties as he may require of them.

All laws or parts of laws inconsistent with the provisions hereof are hereby amended to be in harmony with the provisions of this section.

No code section authorizes the attorney general to hire counsel on a contingent fee basis.

The Legislature Has Authorized Negotiated Settlements that Provide for Payment of Attorneys by Defendants or Respondents Above and Beyond the Amount Recovered.

The Legislature has authorized the Commissioner of the Bureau of Employment Programs to appoint attorneys to be paid on a contingent fee basis under limited circumstances. The Commissioner may retain counsel to administer the unemployment compensation program or to collect amounts due from employers to the Bureau or its divisions. The Commissioner, pursuant to W. Va. Code §21A-2-6(17), is required to solicit proposals from interested counsel. Selection of attorneys is made by the Compensation Programs Performance Council. §21A-2-6(17)(A) provides that a contingency fee payable from the amount recovered by judgment or settlement is permitted only in the event the assets of a defendant or respondent are depleted so that a full recovery plus attorneys fees is not possible. §21A-2-6(17)(B) provides that attorney fees to be paid from recovery

by either judgment or settlement shall be determined by the court or administrative law judge, in an amount no less than twenty per cent of the recovery.

However, notwithstanding the previous provision, §21A-2-6(17)(C) provides that if the Commissioner, Bureau or its divisions settle the action, the parties may negotiate a separate settlement of attorney fees to be paid by defendants or respondents above and beyond the recovered amount. The settlement must be approved by the court or administrative law judge. One of the arguments against permitting payment of outside counsel directly by the tobacco companies was that it would, in essence, reduce the amount of settlement money received by the State.

The Attorney General's Office Could Not Inform the Legislative Auditor How Much Individual Law Firms Representing the State of West Virginia in the Tobacco Settlement Agreement Received From the Settlement.

Pursuant to Amendment 14 to the Master [Tobacco] Settlement Agreement each "Original Participating Manufacturer" was required to pay its "Relative Market Share" of 150 million dollars to National Association of Attorneys General (NAAG). The payment to be made by each Original Participating Manufacturer was to be paid apart from any other amounts due pursuant to the Agreement. It was to be paid to the "Costs and Fees Account" previously established by NAAG. The amounts paid were to be used by the Attorneys General of the Settling States, pursuant to procedures and guidelines established by the Attorneys General through NAAG .

The fund was to be used, in the case of West Virginia, to reimburse the Office of the Attorney General for reasonable costs and expenses incurred in connection with the litigation or resolution of claims in the Tobacco Litigation; to pay the Office of the Attorney General an amount sufficient to compensate it for time reasonably expended by attorneys and paralegals employed in the A.G.'s office; and as otherwise directed by the Attorneys General of the Settling States, acting through NAAG.

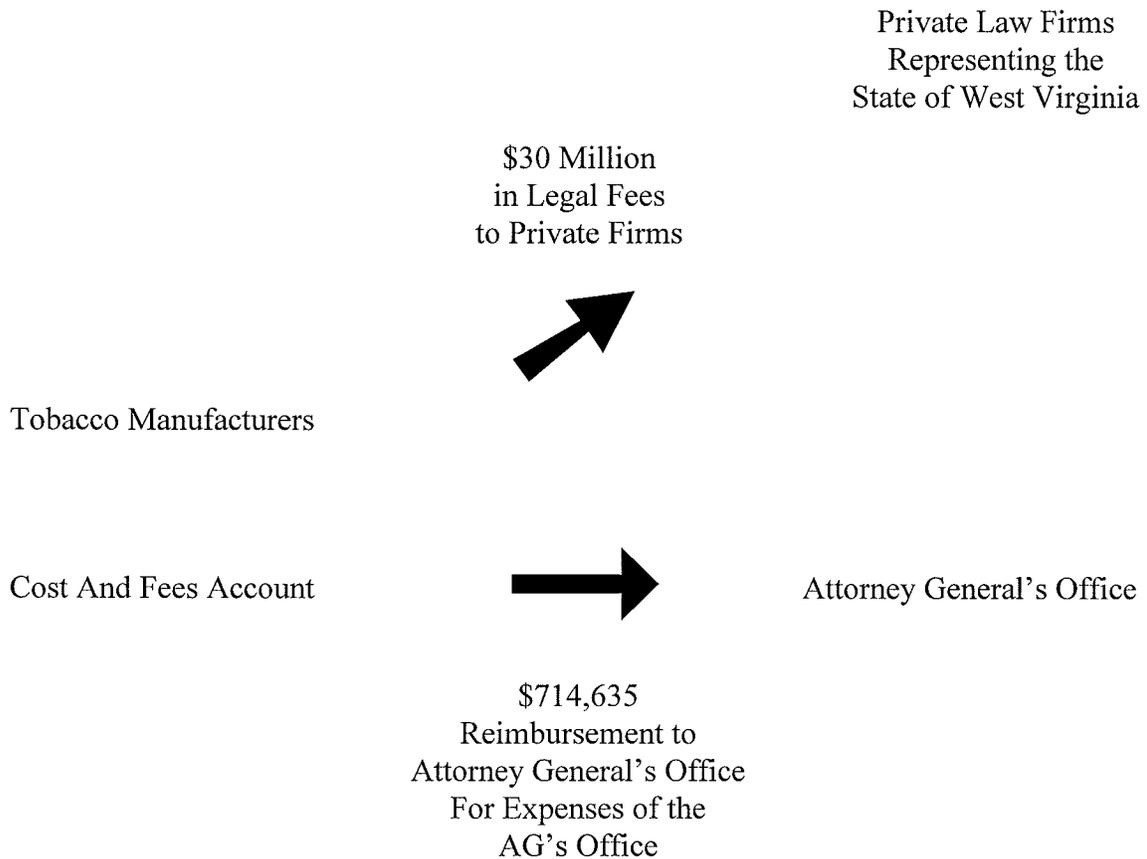
In addition to funds paid to the Attorney General's Office for their work, the tobacco manufacturers directly paid the private law firms involved in representing the states. In a letter dated November 13, 2001, to the Attorney General, the Legislative Auditor asked for the amounts paid to each of the appointed attorneys pursuant to the provisions of the Tobacco Master Settlement Agreement. The reply letter dated November 14, 2001, addressed to the Legislative Auditor, stated:

No bills or invoices were ever submitted to the Attorney General's office. Instead, as contemplated under the terms of the Master Settlement Agreement, such information was provided to a national board. Our office did not expend any money in payment to outside counsel.

As shown by the following flow chart, the \$30 million paid to the private law firms representing the State of West Virginia in the tobacco lawsuit did not pass through the Attorney General's Office. After discussions with members of the Attorney General's Office staff, it is the Legislative Auditor's understanding that, even though the private law firms received these funds for

representing the State of West Virginia, the Attorney General's position is that since the \$30 million did not pass through the State they were never "State funds."

Flow Chart of Funds Transfer For Legal Expenses



Because the amount of work performed by each outside attorney and the amount of fees realized by each attorney for that work is not available, no analysis can be undertaken to evaluate the efficiency or effectiveness of the appointment of outside legal counsel under the contingent fee arrangement. Thus, the Legislative Auditor cannot offer an opinion as to whether the \$714,635 the Attorney General's Office is to receive from the Master Settlement Agreement for its legal work is fair in comparison to the \$30 million the private law firms are to receive for their work. However, during the audit exit process, the Attorney General's Office did volunteer to assist the Legislative Auditor's Office in obtaining information on the fees received by outside counsel.

According to the Deputy Managing Attorney General all private law firms which applied to represent the State in this matter were hired. However, in the future, such an arrangement could

allow an Attorney General to financially reward political backers, without any outside review or knowledge if the settlement agreement required all payments to be kept private. Perhaps even more importantly, such arrangements, without statutory authority, directly removes from the Legislature its constitutional authority to be the appropriating agency of the State as set forth by Article VI, §50 of the Constitution of West Virginia.

The Attorney General's Office Is Not Always Authorized To Collect Attorney Fees.

In syllabus point 15 of *Hechler v. Casey*, 175 W.Va. 434, 333 S.E.2d 799, (W.Va. 1985) the Supreme Court of Appeals found:

The State or an agency or an officer thereof which was represented by the Attorney General in proceedings to dissolve an injunction may not, under W.Va.Code, §53-5-9 [1931], recover reasonable attorney fees incurred in such proceedings because the State has not been "damaged" by payment of the salaries of the regular staff of the Attorney General.

The Court also stated:

...to allow the State to recover reasonable attorney fees would ordinarily have a "chilling effect" upon a person's constitutional rights to apply to government for redress of grievances and to have the courts of this State open to him.

In that case the Court was addressing an instance in which an injunction was sought against the State. The State was in a defensive posture. There are other instances however when the State is pursuing an action against a party, as in the litigation pursued by the Attorney General against the tobacco manufacturers. In these types of cases it may be appropriate for the Legislature to provide for the collection of attorneys fees on behalf of the State when the State prevails. There is ample justification to require a party to restore resources used by the State to right a wrong the party has inflicted on the State, including the legal resources it takes to obtain relief.

The Legislature has specifically allowed for the recovery of attorneys fees by State agencies in many instances. Below is a non-exhaustive list of these instances.

1. In certain collection actions initiated by the Bureau of Employment Programs for collection of Workers compensation Premiums and unemployment Compensation taxes (§21A-2-6, §21A-5-16, §23-2-5a);
2. In certain antitrust actions initiated by the Attorney General (§47-18-9);
3. In certain telemarketing enforcement actions (§46A-6F-701); and
4. In certain environmental actions (§22-4-24, §22-5-7, §22-14-15, §22-15-15).

Concerns of the Legislative Auditor

The Attorney General and his staff have been successful in obtaining a large settlement from tobacco manufacturers for the benefit of West Virginia. **In fact, due to the early actions of the Attorney General, the State of West Virginia is scheduled to receive an additional \$196 million in 2008.** This \$196 million was awarded for the West Virginia Attorney General's Office's "unique contribution to the lawsuit." In fact, West Virginia is one of only five states, including Mississippi, Massachusetts, Minnesota and Florida which will receive funds from the Tobacco Settlement's Strategic Contribution Fund.

However, although the early actions of the Attorney General will bring a enormous additional financial benefit to the State of West Virginia in 2008, the Legislative Auditor has the following concerns:

- The Attorney General had no clear authority to appoint attorneys to be paid on a contingent fee basis, but he may not have had resources available to initiate and pursue the action within the limits of appropriated funds.
- The attorneys were appointed to do important, potentially highly lucrative work on behalf of the State without any provision in place to guarantee fair and equal access to the work or competitive access on merit.
- The Attorney General had no clear authority to enter into the settlement which permitted payment of the State's outside legal counsel by the defendant tobacco companies.
- Any future fee arrangement, which is or is similar to a contingency fee arrangement, may subvert the West Virginia Constitution's requirement that the Legislature is the governmental branch responsible for appropriating State funds.

Conclusion

The legal action, *McGraw v. The American Tobacco Co., et al*, initiated in the Circuit Court of Kanawha County in 1994 by outside legal counsel appointed by the Attorney General, brought welcome revenue to the State, but exposed a need to clarify how the Attorney General may compensate appointed attorneys and to address procedures by which the Legislature may wish to have comparable litigation prosecuted or settled in the future.

Recommendation 1:

The Legislature should consider amending the W. Va. Code, including §5-3-3, specifically to allow or disallow any future fee arrangement for private attorneys representing State agencies, which are, or are similar to, a contingency fee arrangement, and to define that term.

Recommendation 2:

If the Legislature should decide to allow the Attorney General and or other State agencies to continue to use fee arrangements for private attorneys which are, or are similar to, a contingency fee arrangement, the Legislature should consider amending the W. Va. Code to specify that all such fees received by a private attorney or private law firm are public information and are to be reported by the contracting State agency to the Legislature's Joint Committee on Government and Finance.

Recommendation 3:

The Legislature should consider enacting a general provision allowing the State to recoup attorneys fees in cases in which it initiates and prevails in its attempt to enforce a specific State law or in its attempt to right a wrong a person has inflicted on the State. The Legislature should make it clear that all attorneys fees are required to be deposited to the credit of the State's General Revenue Fund, unless it specifically provides otherwise by statute.

Issue 2: Antitrust Enforcement Funds in Excess of \$300,000 Have Not Reverted to the General Revenue Fund as Required by Law.

The State of West Virginia created the West Virginia Antitrust Act under the W. Va. Code §§47-18-1 et seq. in an effort to place statutory constraints on contracts, combinations in the form of trusts or otherwise, or conspiracies in restraint of trade or commerce. W. Va. Code §§47-18-6 and §47-18-7 outline the powers and duties of the Attorney General to enforce the Act. W. Va. Code §47-18-19 establishes an Antitrust Enforcement Fund whereby all money received as a result of actions by the Attorney General shall be placed in this fund. According to the Revenue Digest for fiscal year 2001, the Antitrust Enforcement Fund shows an ending cash balance as of June 30, 2001 of \$601,539.23.

The specific instructions in W. Va. Code §47-18-19 as amended are shown below:

*All money received by the state as a result of actions by the attorney general pursuant to this article or to the federal antitrust laws shall be placed in a separate fund by the state treasurer, to be known as the antitrust fund, and shall be used solely for the payment of fees, costs and expenses incurred by the attorney general in connection with antitrust enforcement activities and the first three hundred thousand dollars in this fund shall not expire at the end of each fiscal year but shall, by operation of law, be automatically reappropriated from year to year and **all sums in excess of three hundred thousand dollars remaining in such fund shall expire at the end of each fiscal year and shall revert to the general revenue fund.***
[Emphasis added]

Funds Have Not Reverted to General Revenue Fund

The *Digest of Revenue Sources in West Virginia* (the Digest) provided by the Legislative Auditor's Office shows all special revenue funds under the State's responsibility. Special revenue funds are accounts dedicated by statute for specific purposes. The Digest reports an ending balance for fiscal year 2001 of \$601,539.23 (See Table 1). The Digest reveals an ending balance for fiscal year 2000 of \$343,770.23. Additionally, the cash balance (i.e., Cash with Treasurer) for the Antitrust Enforcement Fund according to the West Virginia Financial Information Management System (FIMS) shows a December 20, 2001 balance of \$493,644.16. **In conclusion, these Antitrust Enforcement Funds in excess of \$250,000 in FY 2000 or \$300,000, as amended July 1, 2001, totaling \$300,000 have not reverted to the State's general revenue fund.**

Table 1		
Antitrust Enforcement Fund		
Fiscal Year Ending	Ending Balance	Excess Over W. Va. Code Cap
1999	\$95,900	\$0
2000	\$343,770	\$93,770
2001	\$601,539	\$301,359
Source : Digest of Revenue Sources in West Virginia		

Recommendation 4:

In accordance with W. Va. Code §47-18-19, the Legislative Auditor recommends the current balance exceeding \$300,000 in the Antitrust Enforcement Fund be immediately transferred to the State General Fund by the Attorney General's Office. Also, the Legislature may want to consider receiving previous amounts not swept in the General Revenue Fund retroactively.

Recommendation 5:

The Legislature should consider revising the W. Va. Code to provide the State Treasurer's Office with the clear statutory authority to sweep the funds that exceed any statutory limits, such as those set for the Antitrust Enforcement Fund, at the end of each fiscal year.

Issue 3: The Tobacco Case Settlement Was Structured in a Manner to Maximize the Funds Received by the Attorney General for Attorney Fees and Expenses While Circumventing the Intentions of the W. Va. Code.

The Attorney General (AG) was awarded \$714,634.65 for the work performed by his staff in resolving the tobacco settlement lawsuit. However, the AG devised a plan whereby the \$714,634.65 would be received in three equal installments starting fiscal year ending 2001. The intention was to avoid having excess funds that would have to be transferred from the Antitrust Enforcement Fund to the State General Revenue Fund as provided in §47-18-19. The AG has requested these payments be received after July 1 of each year with the first installment being received February 22, 2001. A letter from the AG's office, dated, June 24, 2000 states:

The Management Committee [AG's office] respectfully requests that the review committee pay West Virginia in-house fees and costs in equal one-third installments payable once a year over the next three years, with each installment being received after July 1 of each year, as soon as practicable.

A letter to the Legislative Auditor from the AG's office confirmed that the Master Settlement Agreement was negotiated to provide specifically that payment of \$714,634.65 for work performed by his staff would be spread over three years, to avoid the statutory limitation in §47-18-19:

The payments were spread out over three years because of the statutory limitation set forth in West Virginia Code §47-18-19, which only permits \$250,000 [amended to \$300,000 this year] to remain in the antitrust account at the end of the fiscal year. Consequently, a portion of the \$714,634.65 would have passed to the general revenue which was contrary to the intent of the Master Settlement Agreement, which was that the money was to be used to reimburse the Attorney General's Antitrust division for its work and expenses.

Clearly, the AG has structured the full installment to be paid over three years to circumvent the W. Va. Code. This also violates the intentions of W. Va. Code §12-2-2 which states:

All officials and employees of the state authorized by statute to accept moneys due the State of West Virginia shall keep a daily itemized record of moneys so received for deposit in the state treasury and shall deposit within twenty-four hours with the state treasurer all moneys received or collected by them for or on behalf of the state for any purpose whatsoever. [Emphasis added]

The first of three installments was received on February 22, 2001, for \$238,211.53. If the AG's office would have complied with W. Va. Code §12-2-2(a) by depositing the entire \$714,634.65 in the Antitrust Enforcement Fund the State of West Virginia would have earned \$15,745 of additional interest through November 30, 2001. However, if the AG receives the remaining two installments as planned on July 1, 2002 and 2003 then the State would lose an additional \$14,932 of interest at the current rate.

Recommendation 6:

The Legislative Auditor recommends the Attorney General request the final two installments immediately. These funds shall be deposited into the State General Fund upon receipt.

Issue 4: State Comparisons Suggests Appropriate Staffing Levels.

The Legislative Auditor performed a limited but suggestive analysis to determine if the current staffing level for the Attorney General's Office is appropriate. A correlation analysis was performed on the total staffing figures of the country's 50 state Attorney General Offices, each state's population, and each state's number of state employees. The purpose of this limited analysis was to first determine if there is a correlation between these three variables. One would expect that the number of employees of any state's AG office would be larger for state's with large populations and state employees than for states with small populations and state employees. If there is a correlation, then West Virginia's AG staffing level should be consistent with West Virginia's national ranking for population and state employees. For example, if the three variables are highly correlated and West Virginia has a ranking of 30th with respect to AG staffing, yet its population and number of state employees rank 45th then it would suggest that West Virginia's AG staffing levels are above appropriate national levels.

The correlation analysis revealed that there is a high correlation between state's AG staffing levels, the state's population and the number of state employees. The correlation coefficient between AG staffing levels and state populations was positive 0.875, and the correlation coefficient between AG staffing and state employees was positive 0.855. A correlation coefficient of 1.00 or -1.00 are the highest values depending on the direction of the correlation. The positive signs for the coefficients were appropriate and are relatively high suggesting a strong correlation. This suggests that the greater the state population and/or the number of state employees, the greater the number of AG staff.

Table 2 shows the national rankings of West Virginia's population, State employees and AG's staff. The table shows that West Virginia's population and the number of State employees ranks 37th in the nation, while the State's AG staff ranks 38th. While this analysis is limited, it suggests that the State's Attorney General's Office is appropriately staffed when compared to national ranking, with the national ranking a strong indicator because of the strong correlation between the three variables.

Table 2 2000 Attorney General Staff Ranking			
	WV Ranking	WV Totals	National Average
State Population	37	1,808,344	5,616,997
State Employees	37	32,034	81,654
Total AG Staff	38	161	596
Source: 2000 Census Data; National Association of Attorney Generals; and National Conference of State Legislatures.			

Conclusion

Given the high correlation between state Attorney General Office's staffing levels, state population and state employees, West Virginia's AG staff appears to be appropriate.

Issue 5: Examination of Billing Practices and Outside Bank Accounts Revealed No Material Exceptions.

The Office of the Attorney General does not Enhance its Revenue by Permitting Professional Staff to Bill Agencies in Addition to Receiving 100% Reimbursement from Another Agency.

The Attorney General's Office is authorized by the State Budget Bill to employ attorneys to represent State agencies. According to the Attorney General's Office attorneys represent State agencies either as "billers" or "fully reimbursed." Billers can represent more than one State agency and bill based on the respective amount of time the attorney worked for the agency. Fully reimbursed attorneys represent only one State agency and the attorney's salary is 100% reimbursed by that agency. The Legislative Auditor examined if fully reimbursed attorneys also provide services for other agencies and bill for the work. If this were occurring then agencies who pay 100% of an attorney's salaries would not be receiving 100% of the attorney's time. Therefore, those agencies would be paying more than they would be receiving.

As of December 2001 the AG's office employed 165 attorneys and support staff. Thirteen attorney's are considered billers whereas 37 perform work as reimbursable staff on behalf of the following 11 State agencies:

- Bureau of Employment Programs
- Department of Education
- Department of Health and Human Services
- Department of Motor Vehicles
- Department of Natural Resources
- Department of Tax and Revenue
- Division of Corrections
- Division of Juvenile Services
- Division of Rehabilitation Services
- Human Rights Commission
- West Virginia State Police

In Fiscal Year 2001, the AG generated 461 invoices for a total of \$597,019. The Legislative Auditor reviewed a sample of 67 invoices representing AG services performed for 24 agencies totaling \$75,000 from August 1999 to July 2001. This examination noted no material instances where the AG's office subsidized its revenue by permitting fully reimbursed staff to perform work for agencies other than those who are reimbursing their salary 100%. In the limited number of cases where fully reimbursable AG staff perform work for another agency, the AG's policy is to grant the reimbursable agency a credit for any work (hours) performed on behalf of another agency.

The Office of the Attorney General has Closed All Outside Bank Accounts.

State agencies are permitted to maintain outside bank accounts (i.e., accounts maintained with an individual bank and not through the Treasurer's Office) if the accounts do not consist of State funds and the agency's need is fully justified. The Legislative Auditor's Office has examined this issue specifically relating to the Office of the Attorney General and has reasonably concluded that the Office of the Attorney General does not have any outside bank accounts in its name at this time.

The Office of the Attorney General states expressly that it "does not utilize any outside bank accounts." A letter sent by Glenda Probst, Deputy Treasurer of Cash Management with the Office of the State Treasurer to the Legislative Auditor office, confirms the following:

We used several different processes to obtain and compare the outside bank account information. The West Virginia State Treasurer's Office maintains a database of accounts that is the basis for the report received by your office. We receive quarterly reports from all state banks that are used to analyze the collateral maintained for state accounts. These reports are compared to our database. We also requested a confirmation from each bank that they were reporting all accounts opened in the name of all state agencies.

In addition, we compare our records with those received by the Financial Accounting and Reporting Section (FARS) as part of their GAAP Closing Book reporting. FARS did a separate confirmation with the state's banks, which was also compared back to our database.

We required many agencies to fill out a positive confirmation and also requested supplemental information. We are in the process of following up this report with agency meetings.

While it is possible that an agency could have an outside bank account, I believe that it is unlikely. We continue to strengthen the process for establishing outside bank accounts and the reporting required by the banks.

Conclusion

The Legislative Auditor has concluded the Attorney General does not subsidize revenue by permitting AG professional staff to perform work for other agencies in addition to receiving 100% reimbursement from their assigned agency. The Legislative Auditor's Office also concludes with a reasonable degree of confidence that the Office of the Attorney General does not have any outside bank accounts at this point in time. Given the parameters stated by the Treasurer's Office, it should be reasonable—although not completely definitive—to conclude that outside bank accounts no longer exist in any depository under the name of the Office of Attorney General.

APPENDIX A

Transmittal Letter to Agency

WEST VIRGINIA LEGISLATURE
Performance Evaluation and Research Division

Building 1, Room W-314
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0610
(304) 347-4890
(304) 347-4939 FAX



John Sylvia
Director

December 21, 2001

Darrell V. McGraw, Jr., Attorney General
Attorney General's Office
Building 1, Room E-26
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0220

Dear Mr. McGraw:

This is to transmit a draft copy of the Special Report on the Attorney General's Office. We would like to schedule an Exit Conference on December 27, 2001 at 10:00 A.M., in your office. We would appreciate your written response by January 2, 2001 in order for it to be included in the final report.

Thank you for your cooperation.

Sincerely,

Handwritten signature of John Sylvia in cursive script.
John Sylvia

JS/wsc

Joint Committee on Government and Finance

APPENDIX B

Attorney General's Office Response



STATE OF WEST VIRGINIA
OFFICE OF THE ATTORNEY GENERAL
CHARLESTON 25305

DARRELL V. MCGRAW, JR.
ATTORNEY GENERAL

(304) 558-2021
FAX (304) 558-0140

January 3, 2002

Mr. John Sylvia, Director
West Virginia Legislature
Performance Evaluation and Research Division
State Capitol, Room W-314
Charleston, West Virginia 25305-0610

Dear Mr. Sylvia:

Enclosed please find the "Response of the Attorney General to the Draft 'Special Report: Attorney General's Office'."

Please do not hesitate to contact me if you have any further questions.

Very truly yours,

A handwritten signature in cursive script that reads "Frances A. Hughes".

FRANCES A. HUGHES
MANAGING DEPUTY ATTORNEY GENERAL

FAH/jkt

RESPONSE OF THE ATTORNEY GENERAL TO THE DRAFT "SPECIAL REPORT: ATTORNEY GENERAL'S OFFICE"

The Special Report does not Address its First "Objective:" Objective No. 1 asks whether "the contingency fee payment made on behalf of the American Tobacco Company is legal?" The answer to that question is clearly "yes" because the fee arrangement was approved by the Circuit Court of Kanawha County and thus its legality is *res judicata*. The Special Report does not address this question, but rather focuses on the legality of the "contract," if any, whereby the Attorney General initially appointed counsel to represent the State, in light of the Legislature's exclusive authority to appropriate State funds. Since that "contract," if any, was superseded by the Master Settlement, it has nothing to do with the legality of the fee payment arrangement.

Issue Area 1: **It Is Unclear Whether the Attorney General Had Authority to Contract with Private Attorneys on a Fee Basis Not in Accordance with W. Va. Code § 5-3-3 to Bring an Action Against Tobacco Product Manufacturers in *McGraw v. The American Tobacco Co., et al.*, Civil Action No. 94-C-1707.**

General Response: The underlying thesis of the draft report seems to be that the Attorney General has no authority to commit state funds beyond those appropriated to him. With this contention we have no disagreement, but fail to understand how it is implicated by the tobacco settlement.

The quoted "Issue" and the accompanying discussion are misleading insofar as they make it appear that the Attorney General "contracted" with private attorneys to pay them a "contingent fee" from funds recovered for the State. Actually, the appointment letters merely authorized certain attorneys to represent the State, made no commitment whatsoever regarding fees, made no commitment of state funds, and required that any fee eventually awarded be approved by the Court. Many attorneys turned down this opportunity because there was no contract.

The attorney fees actually awarded are to be paid by the tobacco companies, *will not deplete the funds payable to the State*, were computed *after* the amounts payable to the State had already been ascertained and committed, were awarded in accordance with a protocol approved by the Court which required that the amount of the fees be determined (if not agreed upon) by a panel which considered numerous factors, including hours worked and the "Lodestar" criteria used to set fees in civil rights cases. The report should reflect that the fee awarded to West Virginia's lawyers was the smallest of any of the States and constituted less than 2% of the damages awarded to the State (\$1.8 Billion) in the Master Settlement. These facts do not fit the usual understanding of "contingency fee contract," nor the definition used

by the auditors (on pp. 3-4), and did not operate to deprive the legislature of its exclusive power of appropriation.

Specific Responses:

Page 4 – As pointed out in the Special Report, West Virginia Code § 5-3-3 precludes the Attorney General from paying his employees salaries that, in the aggregate, exceed the amounts appropriated for personal services. It should not be construed to limit the Attorney General's authority to accept the services of volunteers, to appoint (at a client's request) outside counsel to be paid by the agency for whom counsel was appointed, or to appoint outside counsel to be paid by the opposing party (as in the tobacco litigation or civil rights cases). So construing the statute would defeat the substantive provisions defining the Attorney General's powers and duties. The legislature's power to limit the staff of an executive agency via appropriations extends only to staff funded by State funds. Substantive law, not appropriations, defines the scope of the Attorney General's powers and duties and thus the purposes to which his staff, volunteers, and outside counsel may be assigned.

Moreover, the restrictions of West Virginia Code § 5-3-3 do not apply to the Attorney General when he is acting as a party-litigant. Such restrictions pertain only to the Attorney General's services as legal counsel to the State officers; not to his use of outside counsel for the purposes of initiating and conducting litigation in his own name on behalf of the State.

As the Supreme Court of Appeals noted in *Manchin v. Browning*, 170 W. Va. 779, 296 S.E.2d 909 (1982), the Attorney General has broad discretionary powers when he initiates litigation in his own name.

When the Attorney general appears in a proceeding on behalf of the State his name, he exercises discretion as to the course and conduct of the litigation. He assumes the role of a litigant and he is entitled to represent what he perceived to be the interest of the State and the public at large.

... In some cases, such as in the areas of consumer protection and antitrust litigation, the Attorney General is statutorily charged as an Administrator of the law and appears in civil proceedings on his own motion as the agent and legal representative of the State and the citizens thereof.

170 W. Va. at 788-89, 296 S.E.2d at 918-19. Under both the Consumer Protection Act and the Anti-trust Act, the Attorney General has express statutory authority to litigate claims for damages sustained by the State. *See*, W. Va. Code § 46A-7-103(3) ("the Attorney General may prosecute any suit and take any proper action relating to the enforcement of any

consumer protection provision in this [Act]"). The consumer protection and antitrust courts were the only surviving claims remaining from the original complaint when the tobacco settlement was negotiated.

Page 5 – The auditors state that "one of the arguments against permitting payment of outside counsel directly by the tobacco companies was that it would, in essence, reduce the amount of settlement money received by the state." If this sentence remains in the report, it should be accompanied by a statement similar to the following: "However, there was no indication or evidence that the attorney fees in the tobacco litigation reduced the settlement money received by the state."

Page 5 -- If it remains in the final report, the title of the sub-section beginning on this page should be: "The Attorney General's Office Did Not Collect Information Regarding How Much Individual Law Firms Received From the Settlement." We have no disagreement with the auditor's recommendation that all fee arrangements and payments should be subject to public scrutiny, and we are unaware of anything in the tobacco settlement that would suggest that such fees are not public information. Although we do not have that information, we have volunteered to assist you in obtaining it.

Page 5 – The last sentence on page 5¹ implies that the Attorney General relied on the fact that no State funds were used to pay the attorneys as justification for failing to provide the auditors with information about those fees. That is not our recollection. Since our office was not involved in the determination of attorney fees, we simply don't have that information. Rather, the assertion that no state funds were used was made in the context of discussions of the Attorney General's authority to appoint outside counsel without circumventing the Legislature's appropriations power. Consequently, if this sentence remains in the report, it should be placed in a more appropriate subsection.

Page 6 – The auditors inaccurately state that "the amount of work performed by each outside attorney and the amount of fees realized by each attorney for that work is not available . . ." We believe that this information is available.

Page 6 – The flow chart should be eliminated or amended to show that the attorney fees were not paid from the Master Settlement funds.

Page 7 – The second "bullet" should mention that legal services are exempt from the

¹This sentence reads: "After discussions with members of the Attorney General's Office staff, . . . the Attorney General's position is that since the \$30 million did not pass through the State they were never 'state funds.'"

bidding requirements that normally apply to the State's purchase of services. More than 40 agencies hire attorneys "without any provisions in place to guarantee fair and equal access to the work or competitive access on merit." We hire on merit. The hiring of all outside counsel should be under the control of the Attorney General to insure that such agencies do not engage in political patronage. We have brought a lawsuit in the Supreme Court to vindicate this policy.

Page 8 – We believe that "Recommendation 2" is unnecessary. It appears to us that any records regarding fees paid to attorneys representing the State would be public records under existing statutory definitions.

Issue 2: The Office of the Attorney General Has Not Reverted Antitrust Enforcement Funds in Excess of \$300,000 to the General Revenue Fund as Mandated by the Code.

Issue 2 should be rephrased, but the Attorney General agrees that funds exceeding \$300,000 in the current balance of the Antitrust Account should be transferred to general revenue.

"Issue 2" should be rephrased to read: "Antitrust Enforcement Funds in Excess of \$300,000 Have not Reverted to General Revenue as Contemplated by the Code." As noted by the Special Report, West Virginia Code § 47-18-19 provides that "all sums in excess of three hundred thousand dollars remaining in such fund shall expire at the end of each fiscal year and shall revert to the general revenue fund." However, the phrasing of "Issue 2" makes it appear that the Attorney General was derelict in not effectuating a transfer of such funds to General Revenue. Since the statute imposes no responsibility on the Attorney General to do this, the issue should be rephrased.

Issue 3: The Office of the Attorney General Structured the Tobacco Case Settlement in a Manner to Maximize the Funds Received by the Attorney General for Attorney Fees and Expenses While Circumventing the West Virginia Code.

The title of this "issue" is stated as a legal conclusion that the Attorney General "Circumvented" the West Virginia Code. While that appears to be the opinion of the Auditors, the term "circumvent" carries an inappropriate negative connotation, given that no statutes were violated. Simply deleting the phrase, "While Circumventing the West Virginia Code" would solve this problem.

The auditor's recommendation that the final two installments be obtained immediately

and deposited in General Revenue defeats the intent of the Master Settlement Agreement that the funds paid to the Attorney General be used to defray his expenses, is not legally required, and would result in the laying off of staff who are currently engaged in antitrust and consumer enforcement efforts on behalf of the citizens of West Virginia.

As an aside, the Supreme Court of Appeals has not ruled that the Attorney General is not authorized to recover attorney fees under general statutes authorizing litigants to recover their fees in special circumstances. The Code should be amended to permit the State to recover reasonable attorney fees in those situations where a private litigant may do so.


FRANCES A. HUGHES
MANAGING DEPUTY ATTORNEY GENERAL

Dated: 01/03/02

APPENDIX C

State Treasurer's Response to Recommendation 5



JOHN D. PERDUE
STATE TREASURER

JERRY SIMPSON
ASSISTANT STATE TREASURER

State of West Virginia
OFFICE OF THE STATE TREASURER
CHARLESTON, WV 25305

January 4, 2002

1-800-422-7498
304-558-5000
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WWW.WVTREASURY.COM

Aaron Allred, Legislative Manager
Legislative Manager's Office
Building 1, Room E-132
State Capitol Complex
Charleston, West Virginia 25305

Dear Aaron:

I am in receipt of the recommendation your office will be making to the Joint Government Operations Committee on Monday, January 7, 2002. As I understand it, the recommendation would clearly provide the State Treasurer's Office with statutory authority to sweep funds that are in excess of any statutory limit. I fully support this recommendation and am eager to help your attorneys draft any proposed legislation.

If you have questions, or need additional information, please call me.

Sincerely yours,

A handwritten signature in cursive script that reads "John".

John D. Perdue
State Treasurer

JDP:jh

