



FORENSIC AUDIT REPORT

Legal Defense Billing Audit Opinion: Unsatisfactory

Date: May 31, 2014

Report Number: 2013-AUD-15

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Executive Summary

Background

Management of Citizens' Claims Legal Defense Billing Processes is divided between Claims Operations (specifically Citizens' Litigated and Disputed Claims Unit or LDCU) and Legal Services (Legal Compliance). LDCU manages the day to day claims litigation file while Legal Compliance focuses on the management of vendors from a contractual standpoint.

Chapter 624 of the Florida Statutes, (*Insurance Code: Administrative and General Provisions*) provides civil remedy to consumers by allowing civil action against an insurer when the consumer is damaged. The damages recoverable pursuant to this section include damages which are a reasonably foreseeable result of a specified violation of the section by the authorized insurer and may include an award or judgment in an amount that exceeds the policy limits. LDCU was established to manage the inventory of litigated and disputed claims, and work collaboratively with law firms that Citizens has contracted with to represent Citizens in its' defense against these civil actions.

LDCU resources are located in Jacksonville and Tampa and include 35 employees and 127 contracted staff. The Legal Compliance team is based in Jacksonville and consists of 1 employee who manages 8 contracted staff. Comparative data on litigation activity, as provided by claims management, for 2012 and 2013 follows:

Period	No. of Law Firms	Claims in Litigation	Total Litigation Fees
2012	68	13,587	\$59.4 million
2013	92	17,876	\$72.9 million

Management implemented the Acuity Management Solutions ("Acuity") system in May/June of 2013 to assist with daily claims' litigation management as well as legal defense firm billings. Prior to Acuity, legal defense billings were processed using the Visibility system. Historical data housed in Visibility for activity prior to May 2013 was transferred into Acuity.

The 2013 OIA fraud risk assessment identified Vendor Schemes and Cash Misuse/Larceny as two of the highest ranking fraud risks for Citizens. In conjunction with this risk, a representative from Claims Operations reported, to OIA, an instance where an attorney, contracted by LDCU, billed Citizens on multiple occasions for more than 18 hours of work on a single day. This information together with the volume of "cash" outflow and the number of vendors coupled with the complexity of managing litigated claims spend, led OIA to consider the need for a targeted forensic audit of the claims legal defense billing process.

OIA performed an analysis of data to determine if the instances were isolated (e.g. to one firm or employee) or were of a potentially systemic nature (e.g. multiple firms or attorneys). Our initial analysis highlighted numerous instances where multiple firms billed in excess of 18 hours on a single day. This analysis prompted a targeted forensic audit.

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Audit Objectives and Scope

The objective of this targeted audit was to assess processes and controls in place to manage attorney billings within the claims litigation process, as well as to analyze and assess billing data for indications of excessive or inappropriate billing. We specifically focused upon those controls mitigating the potential for excessive or inappropriate billings. When potentially excessive or inappropriate billings were noted, additional procedures were performed to understand the cause and effect of these billings and the subsequent payments.

The scope of the audit included the legal defense billings received and processed for the 70 firms (1,234 Attorneys) providing litigation services for the twelve month period from April 1, 2012 through March 31, 2013, herein referred to as the “audit period”.

Audit Procedures

Given the number of legal firms and attorneys utilized by Citizens during the audit period (70 total firms available, active and inactive), OIA performed procedures to understand the claims legal defense billing data and selected three firms and the corresponding four attorneys who were highlighted as submitting the most billings in excess of eighteen hours a day. In execution of the audit, OIA:

- Reviewed and documented the *Claims Legal Defense Billing Process* with the assistance of Citizens’ employees and a legal defense firm. This review provided understanding of the processes deployed by Citizens and helped to identify potential process improvement opportunities (specifically those opportunities that may mitigate the risk for fraud, waste and abuse);
- Identified the population of legal firms in the billings system and obtained relevant billing data (i.e. line item descriptions by firm and attorney, including corresponding documentation) processed during the audit period. Analyzed the data and selected three firms with the most instances of daily billings in excess of 18 hours a day. (Refer to graph on page 6).
- For the firms selected, performed further analysis and selected four individual attorneys whose billing practices (i.e. number of single day bills in excess of 18 hours as well as total hours billed during the audit period) far exceeded those of their colleagues (refer to Appendices 1, 2 & 3).
- For the four attorneys, performed a detailed analysis of a sample of billings submitted. OIA obtained related billing data and supporting documentation and contracted with independent LDCU Litigation Specialists to review and assess the accuracy and validity of transactions recorded.
- Performed in person interviews to understand the process(es) utilized, by the sample of attorneys for conducting work and submitting billings. OIA also presented and discussed preliminary audit results and findings with these attorneys individually.

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Summary of Results

Based on the results of the audit procedures performed, OIA noted the following:

1. The review of Claims' Legal Defense Billing Process confirmed that the former system, Visibility, did not have the capability of aggregating data of the same context from various sources and/or providing alerts for daily overbilling. Acuity was implemented in May/June 2013 and has the capability of aggregating and capturing the data on a daily basis to provide notification when submitted time exceeds 16 hours in a single day for an individual.
2. An analysis of the three firms indicated the following:
 - *Firm A:* Attorney *AI* billed Citizens a total of 101 days in excess of 18 hours. Approximately 4,500 hours were billed by Attorney *AI* during the audit period. A review of the billings submitted indicated a trend of value billing (i.e. billing the same amount per task regardless of actual time performed), double billing, billing for unnecessary or unneeded work, and inflating time per task.
 - *Firm B:* Attorney *BI* billed Citizens a total of 107 days in excess of 18 hours. Approximately 4,300 hours were billed by Attorney *BI* during the audit period. A review of the billings submitted indicated a trend of duplicate work, double billing and associates billing their time utilizing Attorney *BI*'s time codes; thus, inflating total hours at that attorney's higher billing rate.
 - *Firm C:* Attorney *CI* billed Citizens a total of 47 days in excess of 18 hours. Approximately 2,800 hours were billed by Attorney *CI* during the audit period. Attorney *C2* billed Citizens a total of 27 days in excess of 18 hours. Approximately 2,300 hours was billed by Attorney *C2* during the Audit Period. A review of the billings submitted indicated a trend of billing on cases after they were already closed and/or settled, billing for unnecessary or unneeded work, and billing for work not performed. Note: *CI* was an associate at *C2*'s firm during audit period.

Guidance suggests¹, "in determining which hours reported were reasonably expended and hence are billable to the adversary, the court should examine the total number of hours reported by each lawyer. While some private firm lawyers bill more than 2,000 hours per year, studies indicate that 1,400 to 1,600 billable hours per associate and 1,200 to 1,400 per partner represents the per annum norm that can actually be billed. These totals break down to six to seven billable hours per day for a five day week." This guidance includes the assumption that attorneys are providing 100% of their time and commitment to a single client. Through inquiry we discovered that the sample group, and most other firms, have additional clients; thus, not allowing them to provide 100% commitment to Citizens. Also, it is not unreasonable for an insurance defense firm who provides 100% commitment to bill approximately 2,000 hours per year.

Conclusion

Our work concluded that Citizens has a lack of management oversight and inadequate procedures over the management of claims litigation attorney spend on an individual and aggregate level. **As such we are of the opinion that processes deployed are unsatisfactory.** As

¹ Trial Diplomacy Journal, Vol. 18, 171 (1995), "Billing Guidelines and Fee Disputes: A Case Law Review", Schratz, James P. Note: Guidance refers to hours billable to an adversary. Nonetheless it is guidance of a very conservative prevailing standard.

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a result, Citizens failed to effectively manage and monitor litigator's spend which led to certain unethical and egregious litigator behaviors. Our results noted the following potentially unethical or improper billing practices that drove excessive billings:

- Value billing,
- Double billing,
- Billing for duplicating work,
- Billing for unnecessary or unneeded work or work never performed,
- Inflating time per task,
- Associates billing their time utilizing more expensive senior Attorney's higher billing rate, and
- Billing on cases that were already closed and/or settled.

The position the organization finds itself in is exacerbated by the influx of litigated claims over the years and the fact that internal processes have never been developed to manage such a large volume. This is a topic that was at the forefront of the KPMG assessment and proposal. In response management developed and implemented, in May of this year, a new organizational structure which will in essence address the management and oversight concerns raised in this report. Additionally, Legal Compliance advised that as of January 2014, utilizing data alert capabilities within Acuity system, they have bolstered their legal defense bill review process. Under the enhanced process, in addition to reviewing individual legal invoices for compliance with billing Guidelines, the Compliance Team now also reviews supporting documentation of legal bills to determine the reasonableness of fees on a case wide basis. As reported by management, the enhanced process has resulted in an increase of disallowed fees to approximately \$2.4 Mil from January 2014 to May 2014.

It is our opinion that Citizens should reassess its future relationship with the attorneys considered in this audit. Consideration should also be given to the organizations civil and criminal responsibility as well as the attorney's relationship with the Florida Bar.

In addition to the results above we noted the following process improvement opportunities:

- **The need for improved oversight.** Due to the increase in workload and the respective financial responsibilities, a dedicated team of professionals should be scoped into the budget and bill review process. Following the KPMG operational review results as well as other governance considerations, including the results of this report, management strengthened the LDCU organizational structure. Improved oversight can be achieved within the Legal Compliance billing review wherein a process is developed and implemented to track and record non-compliance and follow up with legal defense firms formally to mitigate any further non-compliance issues. This process should be considered not only by the Legal Compliance team, but throughout the entire legal defense billing process where at any point non-compliance or unacceptable bills or performance are found.
- **The need to develop meaningful reports.** Evidence suggests a lack of reports (periodic and ad-hoc) and management information to be used in the management of legal defense billing. Development and implementation of an array of reports detailing daily vendor billing, per case billing, and total spend by firm, attorney, and case would provide

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management with a holistic view of total litigation spend and an opportunity to manage potential waste, abuse or fraud.

- **The need for a formal case budget.** Implementing a formal budget process detailing projected costs by case type will strengthen financial control and oversight. The Acuity system has a budget tool which could be utilized for this purpose. To support the budget process a case type threshold could be developed as guidance in respect of reasonable spend.

Also, it is important to note that OIA's selected sample of billings reviewed represented only a small percentage of single day billings in excess of 18 hours and total hours billed during the period. Because of this, additional exposure may exist as it relates to excessive billings; thus, we recommend Citizens' conduct further analysis to determine the full extent of possible losses across the spectrum of attorney's used and seek counsel's advice on remedies and other legal action(s).

Note: As of the date of issuance of this report Management has begun taking the necessary steps to implement OIA's suggestions as well as enhance other existing processes and controls related to Legal Defense Billing. Specifically, Claims is in the process of suspending the three firms identified in this report, from work with Citizens, and is transferring their caseload to other firms. One of the mentioned attorneys is no longer with the identified firm; thus Claims is suspending this attorney as well as notifying their current employer. Additionally, work is being done to assess and understand the billing practices of twelve other attorneys, identified by OIA, who may have excessively billed Citizens. Management will continue to take appropriate steps as more information is obtained.

Appendix

Definitions

Audit Ratings

Satisfactory:

Critical internal control systems are functioning in an acceptable manner. There may be no or very few minor issues, but their number and severity relative to the size and scope of the operation, entity, or process audited indicate minimal concern. Corrective action to address the issues identified, although not serious, remains an area of focus.

Needs Improvement:

Internal control systems are not functioning in an acceptable manner and the control environment will require some enhancement before it can be considered as fully effective. The number and severity of issues relative to the size and scope of the operation, entity, or process being audited indicate some significant areas of weakness. Overall exposure (existing or potential) requires corrective action plan with priority.

Unsatisfactory:

One or more critical control deficiencies exist which would have a significant adverse effect on loss potential, customer satisfaction or management information. Or the number and severity of issues relative to the size and scope of the operation, entity, or process being audited indicate pervasive, systemic, or individually serious weaknesses. As a result the control environment is not considered to be appropriate, or the management of risks reviewed falls outside acceptable parameters, or both. Overall exposure (existing or potential) is unacceptable and requires immediate corrective action plan with highest priority.

Appendix

Issue Classifications

Control Category	High	Medium	Low
<i>Financial Controls (Reliability of financial reporting)</i>	<ul style="list-style-type: none"> Actual or potential financial statement misstatements >USD 5 million Control issue that could have a pervasive impact on control effectiveness in business or financial processes at the business unit level A control issue relating to any fraud committed by any member of senior management or any manager who plays a significant role in the financial reporting process 	<ul style="list-style-type: none"> Actual or potential financial statement misstatements between USD 2.5 million to 5 million Control issue that could have an important impact on control effectiveness in business or financial processes at the business unit level 	<ul style="list-style-type: none"> Actual or potential financial statement misstatements below USD 2.5 million Control issue that does not impact on control effectiveness in business or financial processes at the business unit level
<i>Operational Controls (Effectiveness and efficiency of operations)</i>	<ul style="list-style-type: none"> Actual or potential losses >USD 2.5 million Achievement of principal business objectives in jeopardy Customer service failure (e.g., excessive processing backlogs, unit pricing errors, call centre non responsiveness for more than a day) impacting 10,000 policyholders or more or negatively impacting a number of key corporate accounts Actual or potential prolonged IT service failure impacts one or more applications and/or one or more business units Actual or potential negative publicity related to an operational control issue An operational control issue relating to any fraud committed by any member of senior management or any manager who plays a significant role in operations 	<ul style="list-style-type: none"> Actual or potential losses between USD 0.5 to 2.5 million Achievement of principal business objectives may be affected Customer service failure (e.g., processing backlogs, unit pricing errors, call centre non responsiveness) impacting 1,000 policyholders to 10,000 or negatively impacting a key corporate account Actual or potential IT service failure impacts more than one application for a short period of time 	<ul style="list-style-type: none"> Actual or potential losses below USD 0.5 million Achievement of principal business objectives not in doubt Customer service failure (e.g., processing backlogs, unit pricing errors, call centre non responsiveness) impacting less than 1,000 policyholders Actual or potential IT service failure impacts one application for a short period of time
		<ul style="list-style-type: none"> Any operational issue 	

Appendix

Control Category	High	Medium	Low
	<ul style="list-style-type: none"> Any operational issue leading to death of an employee or customer 	<p>leading to injury of an employee or customer</p>	
<p><i>Compliance Controls (Compliance with applicable laws and regulations)</i></p>	<ul style="list-style-type: none"> Actual or potential for public censure, fines or enforcement action (including requirement to take corrective actions) by any regulatory body which could have a significant financial and/or reputational impact on the Group Any risk of loss of license or regulatory approval to do business Areas of non-compliance identified which could ultimately lead to the above outcomes A control issue relating to any fraud committed by any member of senior management which could have an important compliance or regulatory impact 	<ul style="list-style-type: none"> Actual or potential for public censure, fines or enforcement action (including requirement to take corrective action) by any regulatory body Areas of non-compliance identified which could ultimately lead to the above outcomes 	<ul style="list-style-type: none"> Actual or potential for non-public action (including routine fines) by any regulatory body Areas of noncompliance identified which could ultimately lead the above outcome
<p><i>Remediation timeline</i></p>	<p>Such an issue would be expected to receive immediate attention from senior management, but must not exceed 60 days to remedy.</p>	<p>Such an issue would be expected to receive corrective action from senior management within 1 month, but must be completed within 90 days of final Audit Report date.</p>	<p>Such an issue does not warrant immediate attention but there should be an agreed program for resolution. This would be expected to complete within 3 but in every case must not exceed 120 days.</p>

Appendix

Distribution

Addressees: Jay Adams, Vice President - Claims
Dan Sumner, Chief Legal Officer & General Counsel

Copies Tom Lynch, Citizens Audit Committee Chairman
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<i>Under the Direction of</i>	<i>Joe Martins Chief of Internal Audit</i>
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To: Joe Martins, Chief of Internal Audit
From: Dan Sumner, Chief Legal Officer and General Counsel
Jay Adams, Vice-President of Claims
Date: Thursday, June 12, 2014

SUBJECT: Management Response to Report 2013-AUD-15 (Legal Defense Billing)

We greatly appreciate the efforts of the Office of Internal Audit (OIA) to provide a comprehensive audit analysis of legal defense billing. Management concurs with the opinion rendered by OIA that the processes currently deployed are unsatisfactory. Management provides the following response to the audit findings:

Introduction

Oversight of Legal Defense Billing has been an ongoing concern of Management for a number of years, and culminated in a request by Management for this OIA Audit. Efforts to establish an oversight framework for legal defense billing began with implementation of Guidelines for Legal Services (Guidelines) in July 2008. The Guidelines provided standards to evaluate the accuracy, and necessity of charges, and required individual case budgets. In April 2011, the Legal Billing Compliance Review Program was created, comprised of a two-tiered review by the Legal Bill Review Team and the Claims Adjuster. The Legal Billing Compliance Review was principally comprised of manual review of individual legal invoices for compliance with the Guidelines. While significant amounts of billed fees were disallowed by the Legal Billing Review process, the manual review of individual invoices was essentially a clerical function rather than a forensic analysis. In an effort to educate defense firms on compliance with Guidelines, compliance summaries were provided to each defense firm on a monthly basis identifying: Total charges billed; Total charges disallowed; and Compliance issues identified. Clearly, this strategy for enforcing compliance with Guidelines was not adequate.

The OIA Audit Results highlight that a manual invoice-based bill review process was too limited in scope and did not identify compliance issues and billing abuses occurring on a matter-wide basis which could not be ascertained by manual review of an individual invoice.

The limited scope of the per-invoice bill review process was in large part the result of the lack of technology to compile billing information and produce reports and intelligence on a

matter-wide basis. In December 2011, Citizens issued a competitive solicitation to procure a new Litigation Matter Management System. The successful respondent was Acuity and the Acuity Matter Management system was introduced in June, 2013. The Acuity system has system-generated controls and alerts based on the Guidelines. However, the Acuity System is still under development and robust reporting capabilities and integration with the Claims Management System are scheduled for the first quarter, 2015. Nonetheless, from January 2014 to May 2014, as the Acuity technological resources have come online for a more forensic analysis of legal bills on a matter-wide basis, the Legal Billing Compliance Review Program has resulted in approximately \$2.4 million in disallowed fees for this period.

While the findings of the Audit focuses primarily on just four attorneys and three firms out of the 1,234 attorneys from the 70 firms covered in the scope of the audit this in no way reduces the significance of the findings and the positive impact of implementing far stronger controls. Managements' response to this Audit must be both backward looking and forward looking. Looking back, Legal Bill overbilling is no different than any other abuse of policyholder premiums. Management will seek redress with regard to recovery of bill overpayments. The attorneys responsible for overbilling must be held accountable under their Citizens contract, as well as referring these abuses to the appropriate professional and criminal authorities. Looking forward, Management must assure that there is a forensically sophisticated and technologically robust bill review process in place. The strategic and business decision is whether Citizens should continue to build the proper bill review process in-house or outsource legal billing review to a professional bill review entity. Further, legal billing whether in-house or outsourced, must be a component of a larger litigation strategy. Management's recognition of the need for strengthening the litigation strategy is, as reflected by the recent reorganization in Claims to create a stronger Litigation Management structure, and the expansion of in-house counsel to provide direct support to litigation teams. Also, the introduction of a Vendor Management process will provide for defense counsel oversight on broader areas of performance in addition to legal billing.

Finding 1: Reporting

Management concurs with this finding. The Audit highlights that robust technology to compile billing data and provide alerts and intelligence is fundamental to a forensically sound bill review process. Improvement must be made both in continued development of the Acuity system capabilities and the use of information provided by the Acuity system to create an effective holistic bill review process. Evaluation must be made as to whether the Acuity system has the capabilities to serve as the technological foundation for a forensic legal bill review process in the long term.

Finding 2: Budgeting and Oversight

Management concurs with this finding. Utilization of case budgets and technology to track compliance is an important component of legal billing management. The implementation of a billing threshold per case type and mandatory use of currently existing budget control capabilities within the Acuity system will enhance the oversight of billing and spend per case.

Proper staffing, whether in-house or outsourced is vital to a forensic legal bill review

process. The creation of a unit solely to the processing of billed items with a dedicated team of professionals to provide financial oversight would allow for greater time and attention to detail and thus mitigate the risk of being over or improperly billed.

Finding 3: Excessive Billings Legal Remedies

Management concurs with this finding. Legal Bill overbilling by defense counsel is no different than any other abuse of policyholder premiums. Management will pursue the remedies available to recover monies that were improperly billed. Further the attorneys responsible for the excessive billing must be held accountable under the Citizens contract, as well as referring evidence of overbilling abuse to the appropriate criminal and professional authorities. This process of accountability will begin with termination of the Defense Counsel contracts of the three firms whose actions were confirmed in the audit, as well as for an attorney involved in overbilling who moved to another firm. Referrals to the appropriate criminal and professional authorities will be made for these three firms. Also, demands for justification of hours billed will be sent to twelve firms with attorneys with annual billings in excess of 2,500 hours.