



U.S. Department of Energy
Office of Inspector General
Office of Audits and Inspections

Special Report

Inquiry into the Procurement of Law Firm Services and Management of Law Firm-Disclosed Organizational Conflicts of Interest by the Department of Energy's Loan Programs Office



OAS-RA-12-14

August 2012



Department of Energy

Washington, DC 20585

August 28, 2012

MEMORANDUM FOR THE SECRETARY

A handwritten signature in cursive script, appearing to read "Greg Friedman".

FROM: Gregory H. Friedman
Inspector General

SUBJECT: INFORMATION: Special Report on "Inquiry into the Procurement of Law Firm Services and Management of Law Firm-Disclosed Organizational Conflicts of Interest by the Department of Energy's Loan Programs Office"

BACKGROUND

The Department of Energy's Loan Programs Office was created to accelerate the domestic commercial deployment of innovative and advanced clean energy technologies by guaranteeing and providing loans to eligible recipients. The Loan Programs Office currently oversees over \$34 billion in loans to about 40 projects. From the outset of the loan programs, the Department concluded that it needed independent legal advisory services from private law firms to assist in its review of loan guarantee applications. In response to solicitations, the Department entered into Retainer Agreements with 10 firms. The Retainer Agreements and Federal regulations require law firms to disclose any actual or potential conflicts of interest. Recognizing that such conflicts were likely under the circumstances, the Department required law firms to complete a mitigation plan describing how actual or potential conflicts of interest would be avoided or mitigated. It also reserved the right to grant waivers when appropriate.

In prior audits, weaknesses were identified in the administration of loan programs. Our most recent review, *The Department of Energy's Loan Guarantee Program for Clean Energy Technologies* (DOE/IG-0849, March 2011), found that the Loan Programs Office had not developed and implemented a comprehensive records management system or documented how it had resolved or mitigated relevant risks. The U.S. Government Accountability Office's (GAO) report, *DOE LOAN GUARANTEES: Further Actions are Needed to Improve Tracking and Review of Applications* (GAO-12-157, March 2012), also found that the Loan Programs Office did not have consolidated data on application status and that review steps were omitted or poorly documented.

We received anonymous complaints alleging various improprieties in the Loan Programs Office related to the procurement of legal services and the management of law firm-disclosed conflicts of interest in the Innovative Technology Loan Guarantee Program (Program). In response, we initiated a special inquiry to review the circumstances surrounding the allegations.

RESULTS OF INQUIRY

Our inquiry did not substantiate the specific allegations outlined in the complaint. Absent additional information, we plan no further action regarding the original allegations.

We did, however, identify opportunities to improve transparency over the Program's management of organizational conflict of interest waiver requests. Specifically, we noted that the Program had not deployed a tracking system for managing law firm waiver requests and had not documented, in an organized system of records, the rationale for denying or approving waiver requests. The issues observed parallel the findings in prior Loan Guarantee Program reviews.

Review of Allegations

In response to the various complaints, we conducted a review of the Program's management of legal services procurement activities and potential conflicts of interest. To that end, we interviewed Program officials to determine the processes in place for law firm selection. We also reviewed the requirements set forth by the Retainer Agreements between the law firms and the Department regarding issues that could give rise to a conflict of interest. Additionally, we requested and reviewed 70 organizational conflict of interest waiver requests that had been approved. Finally, we requested all formal and informal communication, and documentation associated with a selected sample of 11 waiver requests submitted to the Program for approval.

Our examination revealed that the Program had established procedures for identifying and disclosing conflicts of interest. To mitigate the risk of such conflicts, the Program incorporated requirements in the solicitation and the Retainer Agreements between the law firms and the Department requiring firms to fully disclose any actual or potential conflicts of interest. If a firm identifies a potential conflict of interest it may submit, in accordance with Program procedure, a request to waive the conflict. The Program, in turn, can either approve or deny the request. The Program requires a request for a waiver be submitted anytime a law firm determines that its activities and relationships may hinder impartiality or objectivity in performing work for the Department. For example, a conflict could occur if a firm represented a client interested in obtaining a Department loan guarantee and, at the same time, wished to provide counsel to the Department regarding the selection of guarantee recipients.

As noted, we did not substantiate the specific allegations that were the predicate for this inquiry; however, we did identify opportunities for the Program to improve the management of conflict of interest waivers.

Tracking System

We found that the Program had not deployed a tracking system for the receipt, review and denial/approval of law firm waiver requests. Although the Program developed a standardized waiver request form, Program officials stated that the tracking of waivers was done only through emails. They also asserted that they believed their process complied with applicable procurement requirements and the Retainer Agreements. In our view, a waiver tracking system would provide information the Program would need to ensure consistency during the review, approval or denial of waiver requests involving multiple law firms, their numerous clients and their commitments to represent the Department. For example, Program officials stated that there had been numerous denials of waiver requests, both formally and informally. However, based on our review, denials had not been tracked, and information supporting the rationale for denial was not readily available for examination when reviewing the validity of subsequent requests.

The Program explained that this occurred in some cases because, after informal consultations with the Department, the law firm determined not to seek a waiver.

Documentation and Recordkeeping Concerns

Our inquiry also established that, in a number of cases, available records lacked sufficient information to permit an independent reviewer to understand the reasons for granting waivers of conflicts of interest. Prior to, or contemporaneous with, granting requested waivers, the Department had not always memorialized key decision points, and therefore could not demonstrate, through systematically organized records, that its justifications for granting waivers for actual or potential conflicts of interest were appropriate. In response to our request for information supporting the decision-making processes, the Program could only provide emails that were retained on a Program official's computer. These emails were neither included in the official agreement files nor added to an organized system of records. Additionally, the emails, in a number of cases, lacked sufficient detail to render the rationale for granting the waiver transparent, thus preventing an independent reviewer — based on a review of official records alone — from objectively evaluating the basis or justification for such action.

During our review, Program officials told us that their files contained signed modifications of the Retainer Agreements and approved organizational conflict of interest waivers. These same officials expressed their belief that the documentation they retained was sufficient. Even though they had not always documented information regarding the steps followed, Program officials were generally able to describe their rationale for granting particular waivers. We noted, however, that the official files contained the requested waivers and the actual Federal approval of the waivers, but no other supporting information. Also, no information regarding waivers that had been denied was maintained in official files.

The lack of supporting information limited the ability to carry out an objective examination of the decision process leading to the granting of conflict of interest waivers. In particular, without contemporaneously prepared documentation, management and/or reviewing officials are unable to readily understand the basis for approving the waivers. One particular case we examined, in our opinion, demonstrated the need to adequately document approval decisions. In this case, Program officials approved waiver requests in which a law firm covered by an existing mitigation plan proposed to provide general advice to private clients in connection with loan guarantees. Program officials told us they had approved the waiver requests because the firm explained that it was not representing clients on specific loan applications or projects. However, supporting documentation provided by the requesting law firm did not completely explain the types and extent of advice the law firm planned to provide to its clients. In another example, Program officials had not documented specific amplifying information provided by the requesting law firm in response to their requests.

The *Standards for Internal Controls in the Federal Government* published by GAO requires all transactions and other significant events to be clearly documented and that such documentation be readily available for examination. Additionally, all documentation and records are to be properly managed and maintained. Permitting individual employees to retain records relating to critical decision points on individual computer systems is inconsistent with these standards. Such a practice raises significant retention concerns, including employee departure or turnover.

General Procedures

The lack of a tracking system and documentation supporting the reasons for approving waiver requests in an organized system of records occurred, in large part, because the Program had not established formal documentation procedures. Program officials stated that they believed the agreement modifications complied with applicable procurement rules and the Retainer Agreements, and served as the evidence of the waiver request and its approval. While the Program had limited procedures for processing waiver requests, it had not established any guidance on document retention and information required to support approvals or denials.

RECOMMENDATIONS

We recognize that the notion of sufficiency in terms of documentary evidence supporting conflict of interest waiver decisions is subjective. However, given the taxpayer-provided funds at risk in the Loan Guarantee Program, the sensitivity of the Program and its reliance on outside law firm legal advice free from conflicts and impairments, we concluded that the Department should ensure that contemporaneous records clearly demonstrate the support and rationale for approving or denying conflict of interest waiver requests. Ultimately, greater transparency in the decision-making process could be of special value in the event of a default, bankruptcy or similar event.

To address the issues identified in our report, we recommend that the Acting Executive Director of the Loan Programs Office direct officials to:

1. Establish a formal tracking system to document the receipt, review and denial/approval of organizational conflict of interest waiver requests;
2. Develop and implement, in coordination with the Department's Office of Management and Office of the General Counsel, formal procedures on documentation requirements in agreement files associated with law firms selected for legal services; and,
3. Ensure that the measures outlined in Recommendations 1 and 2 lead to the development of an audit trail that adequately describes the factual basis, rationale, and thought process leading to the Department's approval of waivers for legal service organizational conflict of interest applications.

MANAGEMENT REACTION AND AUDITOR COMMENTS

The Loan Programs Office's management concurred with our recommendations and proposed corrective actions. Management noted that the benefit of implementing the recommendations will be to create a transparent audit trail that will facilitate third-party review of the basis for the approval or denial of conflict of interest waiver requests. In response to our recommendations, management stated that the Loan Programs Office is in the final stages of developing and implementing a state of the art records management system as well as an integrated information management system that will integrate the recommended tracking and document retention systems to allow waiver requests to be followed from receipt to final disposition. Regarding coordination on formal procedures for documentation, management stated that the Loan

Programs Office will seek input from the Department's Office of General Counsel and Office of Management. Additionally, management stated that the implementation of the records management and integrated information management systems will enable the Loan Programs Office to produce an audit trail that adequately describes the factual basis, rationale and thought process leading to the Department's approval of requests for waivers of potential conflicts of interest in connection with the provision of legal services.

Management's proposed actions are responsive to the recommendations. Management's comments are included in Attachment 2.

cc: Deputy Secretary
Associate Deputy Secretary
Acting Executive Director, Loan Programs Office
Chief of Staff

RELATED REPORTS

Office of Inspector General

- Audit Report on [*The Department of Energy's Loan Guarantee Program for Clean Energy Technologies*](#) (DOE/IG-0849, March 2011). The audit revealed that the Loan Guarantee Program could not always demonstrate, through systematically organized records, how it resolved or mitigated relevant risks prior to granting loan guarantees. Decision documents summarizing the process did not always describe the actions taken by officials to address, mitigate and/or resolve risks. We found that the loan origination files were not maintained in the Loan Guarantee Program's official electronic information repository, which according to Federal regulations is to contain key documentation to support actions as part of the loan guarantee process. Although the Loan Guarantee Program's website referenced requirements for loan documentation, the Loan Guarantee Program had not adopted a records management system that imposed structure, consistency and discipline in the development and retention of loan documentation.

U.S. Government Accountability Office

- Audit Report on [*DOE LOAN GUARANTEES: Further Actions Are Needed to Improve Tracking and Review of Applications*](#) (GAO-12-157, March 2012). The audit was initiated because of questions regarding inconsistent treatment of applications and the Department's review process. The U.S. Government Accountability Office (GAO) found that the Loan Guarantee Program had not maintained consolidated data, but had to assemble the information from various sources. The audit also revealed that the Loan Guarantee Program had not always adhered to its review process. In addition, GAO could not determine whether the Loan Guarantee Program had performed some established review steps because of poor documentation. GAO recommended that the Loan Programs Office: (1) Commit to a timetable to fully implement a consolidated system that enables the tracking of the status of applications and that measures overall program performance; (2) Ensure that the new records management system contains documents supporting past decisions, as well as those in the future; and, (3) Regularly update the Loan Guarantee Program's credit policies and procedures manual to reflect current program practices to help ensure consistent treatment for applications to the program.

MANAGEMENT COMMENTS

Department of Energy
Washington, DC 20585

AUG 24 2012

MEMORANDUM FOR:

Rickey R. Hass
Deputy Inspector General
for Audits and Inspections
Office of Inspector General

FROM:

David G. Frantz
Acting Executive Director
Loan Programs Office

Mary Wright

SUBJECT:

Office of Inspector General Draft Special Report
Inquiry on Procurement of Law Firm Services and
Management of Law Firm Disclosed Conflicts of Interest
by the Department of Energy's Loan Programs Office"
(Project Number A12HQ012)

Thank you for the opportunity to comment on the draft special report, "Inquiry on Procurement of Law Firm Services and Management of Law Firm Disclosed Conflicts of Interest by the Department of Energy's Loan Programs Office." The Office of Inspector General (IG) made an exhaustive review into the Loan Programs Office's (LPO) process for procuring law firm services and managing potential law firm organizational conflicts of interest.

The LPO notes that, after this exhaustive review, the IG did not identify any improprieties or other substantive concerns about the process, the law firm engagements or the organizational conflict of interest waivers that had been granted. In fact, the IG specifically stated that LPO "had established procedures for identifying and disclosing conflicts of interest," including standardized mitigation strategies for the risks associated with any such conflicts. The only issue identified by the IG is the opportunity to improve transparency in the LPO's management of organizational conflict of interest waiver requests.

With respect to the specific recommendations in the draft report:

LPO management concurs in the three specific recommendations contained in the report respecting the establishment of a tracking system to document receipt, review and denial/approval of law firm organizational conflict of interest waiver requests and the development and implementation of formal documentation requirements.

We note that the benefit of implementing the Report's recommendations will be to create a transparent audit trail that will facilitate third-party review of the basis for the approval or denial of conflict of interest waiver requests in connection with legal services provided to the LPO.

We do not, however, agree that this greater transparency "could be of special value in the event



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of a default, bankruptcy or similar event,” as we can discern no rational nexus between the basis for the grant or denial of a waiver requested by outside legal counsel and the substantive concerns at issue in an event of default, bankruptcy or similar event affecting a portfolio project.

Recommendation 1: *Establish a formal tracking system to document the receipt, review and denial/approval of law firm waiver requests.*

Management Response: Concur.

As we have indicated in other contexts, the LPO is in the final stages of developing and implementing a state of the art records management system as well as an integrated, information management system. The recommended tracking and document retention systems will be integrated into these systems and will allow an organizational conflict of interest waiver request to be followed from receipt to final disposition and key decision points to be documented and retained. The estimated completion date is March 31, 2013.

Recommendation 2: *Develop and implement, in coordination with the Offices of Management and the General Counsel, formal procedures on documentation requirements in agreement files associated with law firms selected for legal services.*

Management Response: Concur.

LPO will work with appropriate officials from the Department’s Office of General Counsel (GC) and Office of Management (MA) to seek input on the development of formal procedures on documentation requirements for agreement files associated with law firms selected for legal services. The estimated completion date is March 31, 2013.

Recommendation 3: *Ensure that the measures outlined in Recommendations 1 and 2 lead to the development of an audit trail that adequately describes the factual basis, rationale, and thought process leading to the Department’s approval of waivers for legal service conflict of interest applications.*

Management Response: Concur.

LPO believes that the implementation of its state-of-the-art records management and integrated information management systems will enable LPO to produce an audit trail that adequately describes the factual basis, rationale, and thought process leading to the Department’s approval of requests for waivers of potential conflicts of interest in connection with the provision of legal services. Further, consultation with GC and MA will ensure that LPO and MA maintain proper documentation in compliance with the Department’s regulations. The estimated completion date is March 31, 2013.

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