

DATE ISSUED: May 14, 2004 REPORT NO. 04-108

ATTENTION: Rules, Finance and Intergovernmental Relations Committee
Agenda of May 19, 2004

SUBJECT: San Diego Data Processing Corporation

REFERENCE: Manager's Report No. 04-090, dated April 29, 2004
San Diego Data Processing Corporation Ad Hoc Committee on Policies
and Procedures memorandum on "Adoption of a Risk Management Plan
in Response to City Manager's Report to Dissolve DPC"
Dr. Gloria Ma's letter to Rules, Finance & Intergovernmental Relations
Committee dated May 5, 2004
Andrea Johnson's letter to Honorable Mayor Dick Murphy and City
Council Members, dated May 7, 2004

SUMMARY

Issues

1. Should the Rules, Finance & Intergovernmental Relations Committee forward the resolution to the San Diego City Council for approval regarding the transfer of the Council's voting proxy and the delegation of the Council's duties to the City Manager related to the affairs of San Diego Data Processing Corporation (DPC)?
2. Should the City Manager reallocate funds allocated for technology services within the FY2004 through FY2006 budgets to fund the engagement of consultants to conduct transition activities?

Manager's Recommendation

1. Forward the resolution to City Council for approval.
2. Direct the City Manager to reallocate funds allocated for technology services within the FY2004 through FY2006 budgets to fund the engagement of consultants to (1) conduct a sourcing strategy assessment that will provide an objective evaluation of all options of sourcing information technology (IT) services including the complete dissolution of DPC; (2) engage specialized legal counsel to assist with developing and conducting a request for proposal (RFP) process, and to assist with any changes in the corporate entity; and (3) provide assistance with change management and organizational issues.

Other Recommendations – None.

Fiscal Impact.

One-time costs are estimated in the range of \$2 million to \$4 million based on preliminary research as well as discussions with organizations that have gone through a similar process as being contemplated. Technology initiatives which may have to be delayed in order to fund costs will be reprogrammed using projected cost savings.

A consultant will be required to conduct a sourcing strategy assessment that will provide an objective evaluation of all options of sourcing IT services including the complete dissolution of DPC. The consultant will then be required to assist in activities that will result in the approved model. These activities include creating implementation plans, and developing and conducting a competitive RFP process to identify qualified vendors to provide those IT services that are determined to be sourced externally.

Other transition costs include specialized legal counsel to assist in the RFP process as well as formalize any changes to DPC, up to and including dissolution. Specialized consulting expertise will also be required to assist the City with change management and organizational issues.

The above costs are estimates and costs to the City of San Diego will not be known until consultants and legal counsel are engaged. It is recommended that current funds allocated to technology services be reallocated within the FY2004 through FY2006 budgets to fund these transition activities. Any technology initiatives that are deferred or delayed to fund activities related to the study and implementation of an alternative IT service delivery model can be reprogrammed when implementation savings become available.

Long-term savings are anticipated to be generated through elimination of overhead and the injection of competition, taking advantage of the provider's economies of scale and best practices. Industry experience indicates cost savings in the range of 10% to 20% for those functions sourced externally. Determining the magnitude of savings to the City of San Diego will require additional analysis.

Staffing Impact

The assessment and implementation of this effort will require the dedication of staff. The City Manager, in his April 22, 2004 memorandum regarding organizational changes, indicated that the status of the Information Technology & Communications (IT&C) Department Director position was being assessed during this evaluation. Due to the need to dedicate a position to oversee the ongoing organizational assessment and RPF process, a Program Manager position will be responsible for these efforts and the organizational structure will be assessed at the conclusion of the implementation.

BACKGROUND

On May 5, 2004, the City Manager presented the recommendation to strategically dissolve DPC and competitively source selected functions to qualified IT service providers. The Rules Committee subsequently directed the City Manager to return with a resolution for the Committee's consideration.

DISCUSSION

City Manager Report 04-090 dated April 29, 2004 presented the following recommendations:

1. Direct the City Manager to develop an implementation plan within 180 days to strategically dissolve DPC and competitively source selected functions to qualified IT service providers. As part of the implementation plan, identify specific functions that should be transferred to the City and develop a preliminary cost analysis.
2. To establish a single point of accountability for IT service delivery, direct the City Attorney to prepare changes to DPC's governing documents to accomplish the following:
 - 2.1. Delegate voting proxy on matters related to DPC, including without limitation, authority to appoint the members of the Board of Directors from the City Council to the City Manager.
 - 2.2. Allow City staff to be eligible to serve as voting members of the Board of Directors. Change Board composition to include three staff as part of the seven member Board: the City's Chief Information Officer (CIO) and two additional staff at the Deputy City Manager or Department Director level.
 - 2.3. Direct the Board to confirm the CIO as Chair of the Board of Directors.
3. Direct DPC to provide City staff its full and timely cooperation in the City's efforts to develop and carry out the implementation plan.
4. Direct the City Manager to reallocate funds allocated for technology services within the FY2004 through FY2006 budgets to fund transition activities, including the

engagement of consultants and specialized legal counsel to develop and conduct a RFP process, and assist in dissolving the corporate entity.

After deliberation, the Rules Committee returned the below action items:

- A. Return to the Rules Committee May 19, 2004, with a resolution to:
 1. Transfer the Council's voting proxy and the Council's duties regarding DPC to the City Manager.
 2. Restructure DPC's Board of Directors such that City staff will be eligible to serve as voting members; and that the composition of the Board be changed to include 4 instead of 3 City staff. City staff will include the CIO and 3 additional City staff at the Deputy City Manager or Department Director level.
 3. Direct the Board to confirm the CIO as Chair of the Board.
- B. Direct the City Attorney to return with an analysis of the legal issues related to having three or four City staff members on the Board;
- C. Direct the City Manager to request that the consultant hired to develop the implementation plan conduct a truly objective evaluation that will look at other options in addition to complete dissolution of DPC;
- D. Direct the City Manager to provide the consultant with the written information provided on May 5, 2004 by Dr. Gloria Ma and DPC's Ad Hoc Committee on Policies and Procedures;
- E. Direct the City Manager and City Attorney to respond to the six-point action plan submitted by DPC's Ad Hoc Committee on Policies and Procedures; and
- F. Direct the City Manager to return with information on the experience of San Diego County and other local governments in outsourcing Information Technology services; and
- G. Direct the City's CIO to respond to the information heard on May 5, 2004.

In response to Rules Committee direction, a resolution has been prepared incorporating the direction provide at the May 5, 2004 meeting. With respect to the Rules Committee's direction to evaluate City representation on the Board and based on the advice of the City Attorney, the City Manager recommends changing the composition of the Board of Directors to include 3 City staff instead of 4 as described above.

In addition, staff will also provide Andrea Johnson's letter to Mayor Dick Murphy and City Council Members, dated May 7, 2004 to the consultant hired to conduct the sourcing strategy assessment.

The remainder of this report addresses items E, F, and G.

Upon City Council approval, staff will report status back to the Rules Committee within 90 days and quarterly thereafter. The table below describes the major steps and estimated time periods. This is only an estimate and would be refined as the City progresses through the assessment and RFP process. Note that the timeline differs from the one presented in City Manager’s Report 04-090 of April 29, 2004 in that it provides more detail in the first two steps.

Step	Period (months)
Engage consultant to assist with assessment and development of the outsourcing RFP; includes issuing an RFP, allowing for vendor response period, proposal evaluation, vendor selection and contract negotiation	5 – 6
Conduct an evaluation of all options of sourcing IT services including the complete dissolution of DPC; determine appropriate model to deliver IT services; baseline IT functions for performance comparison after end state is achieved; develop and issue RFP for functions to be sourced externally	7 – 8
Vendor response period	1 – 2
Proposal evaluation; vendor selection	1 – 2
Contract negotiation; vendor signature	3 – 4
Council approval	1 – 2
Total	18 – 24

DPC Risk Management Plan

The Rules Committee directed the City Manager to respond to the six-point action plan (the “Risk Management Plan”) submitted by DPC’s Ad Hoc Committee on Policies and Procedures (action item E).

After preliminary review, DPC’s proposed action plan appears to be prudent in order to minimize risk to the Corporation and the City. DPC’s action to conduct a security audit immediately is consistent with maintaining operational support for City applications. The City Manager concurs with and is actively maintaining communications with DPC’s senior team, and will continue to do so. A meeting was held on May 13, 2004 between the CIO and DPC management to begin discussions on actions which may be required in any potential change of service delivery model.

The remaining Phase I items in DPC’s plan should assist the City during any change in the IT service sourcing model. Data collection to establish baselines would be an integral part of the

sourcing strategy assessment and would be included in the RFP for those functions determined to be sourced externally. Consideration of existing litigation and employee matters are also part of any change. Phase II items support complete dissolution of DPC, should this action be approved.

Although not specifically identified in the Risk Management Plan, staff considers *change management as critical to the success of any change* in the IT sourcing model. Given the magnitude of change and the environment of uncertainty, the City will be engaging consultants with change management expertise in the technology field to provide the City and DPC with an outreach and communications plan that will mitigate risk and significantly improve the probability of a successful effort.

Experience of Other Local Governments with Outsourcing Initiatives

The Rules Committee directed the City Manager to provide information regarding outsourcing initiatives of San Diego County as well as other jurisdictions that have had successful efforts (action item F). Staff has arranged for the CIO of the County of San Diego, Mr. Michael Moore, to provide a briefing on their outsourcing initiative. Staff has also arranged for the CIO of the County of Orange, Dr. Daniel Hatton, to provide a briefing on their outsourcing initiative.

Public Technology, Inc. (PTI), a national non-profit technology research and development organization representing local governments, was also asked to provide other government outsourcing experiences and comment on the critical success factors. PTI cited case studies from Chicago, Illinois, the Commonwealth of Pennsylvania, and Minneapolis, Minnesota as examples relevant to the City of San Diego's situation.

Chicago, with a population of 2,896,016, outsourced their data center and distributed infrastructure, including the network, desktops and help desk, to two separate providers (Acxiom and Unisys) in 1999. Chicago's CIO reported that the city had seen a marked improvement in its IT services after outsourcing. A follow-up IT user satisfaction survey conducted by Gartner Measurement showed an unprecedented 29 percent increase in service-level and user satisfaction over the baseline survey from 1999.

The City of Chicago and Unisys also agreed to have a follow-up benchmark study conducted to provide quantitative measures of the deal's performance. The results of this benchmark, which compared performance metrics to peer group organizations, best-practice firms and outsourcing services, confirmed that the service providers' pricing was competitively priced. In fact, the benchmark study concluded that the pricing was less than the peer average group.

The Commonwealth of Pennsylvania outsourced their IT facility, which houses a mainframe, mid-range computers and other technologies, in August, 1999. The original seven-year contract with Unisys was valued at \$621 million. In October, 2002, the agreement was extended through 2009 at an additional value of \$252 million. The contract extension is expected to produce cost savings of \$31 million in addition to the estimated \$110 million in cost avoidance achieved during the first five years of the contract.

Minneapolis, Minnesota outsourced their IT infrastructure, consisting of the data center, server support, desktops, service desk and network management, to a single provider, Unisys, in 2002. Enhanced service delivery for customers requiring 24 by 7 support and savings in excess of \$20 million over the course of seven years are among the expected benefits reported by their CIO.

In reviewing the case studies, PTI offered the following summary points to guide an outsourcing strategy:

- Outsourcing is a marathon race, not a sprint. Organizations should appreciate the essential long term nature of the effort and ensure there is sustained support from top decision makers for the time it will take to implement a successful relationship and achieve strong outsourcing results.
- The human management dimension cannot be overstated. Transition committees need to identify implementation issues and suggest ways to turn problem into opportunity for improvement.
- Private industry is able to keep up with changes in the technology platforms, especially when the vendor has multiple clients offering them economies of scale not available to the government. Therefore the refresh rate of the equipment and hardware can be shortened from governmental levels, and training for employees provided in more direct and aggressive manner.
- Vendors are driven to excellence based on incentive agreements that may tie compensation to Service Level Agreement (SLA) achievement. Therefore, if the vendor is incentivized to excel, the outcome may be far better levels of service at acceptable cost levels.
- The operating agencies know the services that are required by in-house clients and the general public. Employees need to be involved in designing the basic needs assessment and system goal documents. Managing the outsource contract becomes the vehicle not only to ensure compliance with administrative terms and conditions, but more importantly to manage the human interactions and goal accomplishment progress.

Discussion Regarding Public Testimony of May 5

The following information is provided in response to Rules Committee direction for the CIO to respond to public testimony heard on May 5, 2004 (action item G). During the presentation of City Manager's Report 04-090, the Rules Committee heard a number of issues and concerns raised by DPC and from public testimony. These included staff issues (potential staff attrition, inability to duplicate DPC's expertise), cost savings (lack of benchmark data to back up the Manager's recommendations, questions of how a for profit company could be better than a non-profit), service level performance (DPC's performance metrics comparisons), and the negative experience of San Diego County's outsourcing initiative.

Staff understands and acknowledges these concerns, which will be addressed during the sourcing strategy assessment and with change management. The City Manager's recommendations are

intended to position the City with the potential to realize the maximum benefit. The current model does not address a number of issues, which include:

- The contractor/owner (i.e., DPC is the contractor, City is the owner) relationship between the City and DPC results in DPC being treated like a City department rather than a third-party IT service provider, making it difficult for both organizations to establish and enforce meaningful contractual obligations.
- Related to the above, service level agreements with DPC have no meaningful financial incentives/disincentives; therefore, they become merely objectives with no financial or contractual leverage.
- The City is at risk for service level agreements between DPC and other entities.
- The City underwrites entrepreneurial investments in competition with the private sector.
- The profit-loss bottom-line of private sector companies is absent, thus reducing incentives to stay lean.

The Manager's recommendations regarding DPC has had a significant impact on DPC employees' morale. Staff has opened a dialog with the employees through DPC senior staff and will continue to maintain communications through a focused change management effort. Regardless of the eventual sourcing model, staff considers it a priority to work with DPC to create an employee transition process that should mitigate adverse impact to the employees as well as to DPC operations in support of the City's applications.

SUMMARY

The actions proposed by this report are summarized below.

- Forward a resolution that incorporates Rules Committee direction except as recommended below:
 - Delegate voting proxy on matters related to DPC, including without limitation, authority to appoint the members of the Board of Directors from the City Council to the City Manager.
 - Allow City staff to be eligible to serve as voting members of the Board of Directors. Based on the advice of the City Attorney, the City Manager recommends changing Board composition to include three staff as part of the seven member Board: the City's CIO and two additional staff at the Deputy City Manager or Department Director level.
 - Confirm the CIO as Chair of the Board.
- Direct the City Manager to reallocate funds allocated for technology services within the FY2004 through FY2006 budgets to fund transition activities, including the engagement of consultants to conduct an objective evaluation that will look at other options in addition to complete dissolution of DPC.

- Direct the City Manager to request that the consultant hired to develop the implementation plan conduct an objective evaluation that will look at other options in addition to complete dissolution of DPC.
- The City Manager will engage consultants with change management expertise in the technology field to provide the City and DPC with an outreach and communications plan to mitigate risk in any transition process.
- The City Manager will provide the consultants with the written information provided on May 5, 2004 by Dr. Gloria Ma and DPC's Ad Hoc Committee on Policies and Procedures, and the written information provided in Andrea Johnson's letter to Mayor Dick Murphy and City Council Members, dated May 7, 2004.
- The City Manager will assign a Program Manager to be responsible for the transition and RFP process.
- Staff will meet with DPC on a regular basis to communicate the process and status of the sourcing strategy assessment, as well as the conduct of the entire initiative.
- Staff will report status back to the Rules Committee within 90 days and quarterly thereafter.

ALTERNATIVE

Do not approve the resolution.

Respectfully submitted,

Rey Arellano
Deputy City Manager & Chief Information Officer

Approved: P. Lamont Ewell
City Manager

Attachment

(R-2004-___)

RESOLUTION NUMBER R-_____

ADOPTED ON _____

WHEREAS, the San Diego Data Processing Corporation, Inc. [SDDPC] has been incorporated as a nonprofit corporation and the City of San Diego [City] is the sole member of said corporation; and

WHEREAS, on May 5, 2004, the City Manager appeared before the Committee on Rules, Finance and Intergovernmental Relations [Rules Committee] recommending that SDDPC be dissolved and specified functions merged with the City's Information Technology & Communications Department [IT&C], and remaining functions competitively sourced to qualified information technology [IT] service providers; and

WHEREAS, the City Manager also identified fundamental changes to resolve the underlying structural problems related to oversight and accountability of the delivery of IT services to the City; and

WHEREAS, the City Manager requires the authority and flexibility to implement change within SDDPC through an implementation plan; and

WHEREAS, the City Council, acting on behalf of the City of San Diego as the sole member of the SDDPC has the authority and ability to delegate voting proxy of the City to the City Manager, without limitation, over matters related to SDDPC.

NOW, THEREFORE, BE IT RESOLVED, by the Council of The City of San Diego, that the voting proxy of the City as the sole member [Member] of the SDDPC, be delegated to the City Manager, without limitation, over matters related to SDDPC.

BE IT FURTHER RESOLVED, that officers and employees of the City shall be eligible to serve as voting members of the Board of Directors [Board] for the SDDPC.

BE IT FURTHER RESOLVED, that the City Manager is hereby directed to change the Board's composition to include three (3) City staff as part of the seven member Board: the City's Chief Information Officer [CIO] and two (2) additional staff at the Deputy City Manager or Department Director level.

BE IT FURTHER RESOLVED, that the Board is hereby directed to confirm the CIO as Chair of the Board.

BE IT FURTHER RESOLVED, that SDDPC, its Board, officers and employees are hereby directed to fully and timely cooperate in all matters related to the City's efforts to develop an implementation plan.

BE IT FURTHER RESOLVED, the implementation plan should consider the following:

a. Engaging consultants and specialized legal counsel to develop an unbiased strategic sourcing and implementation plan that considers what is in the best interest of the City and specifically addresses: (1) whether SDDPC should be dissolved in its entirety and its functions transferred to IT&C; (2) whether SDDPC should be dissolved in its entirety and its functions transferred to outside IT service providers and IT&C; and (3) whether SDDPC should not be dissolved, but retained to assist in competitively outsourcing selected IT services.

b. That the six issues identified in SDDPC's Ad Hoc Committee on Policies and Procedures memorandum *Adoption of a Risk Management Plan in Response to City Manager's Report to Dissolve DPC*, dated May 5, 2004, and Dr. Gloria Ma's letter to the City of San Diego, Honorable Mayor Dick Murphy, Chair, and Rules Committee, dated May 5, 2004, be provided to the Consultant for consideration in the unbiased strategic sourcing and implementation plan.

BE IT FURTHER RESOLVED, that in the event of a conflict between this Resolution and the current SDDPC Bylaws or Operating Agreement between the City and SDDPC, this Resolution shall take precedence over any and all conflicting document(s).

APPROVED: CASEY GWINN, City Attorney

By _____
Paul G. Edmonson
Deputy City Attorney

PGE:sf
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Or.Dept: City Manager
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