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REPORT TO THE HONORABLE  
MAYOR AND CITY COUNCIL

PROVISION OF DEFENSE FOR FORMER EMPLOYEES IN CASE ENTITLED  
*SECURITIES AND EXCHANGE COMMISSION V. MICHAEL T. UBERUAGA, ET AL.*

### INTRODUCTION

In a complaint filed April 7, 2008, the Securities and Exchange Commission [SEC] filed a complaint for violations of the federal securities laws against Michael T. Uberuaga, Edward P. Ryan, Patricia Frazier, Teresa A. Webster, and Mary E. Vattimo. The complaint alleges that the defendants were involved in false and misleading disclosures relating to the City's municipal securities offerings in 2002 and 2003. (*See*, U.S.D.C. Case No. CV 0621 DMS LSP, a copy of which is attached hereto).

On January 31, 2005, and on other occasions since that date, the City Council has authorized the payment of attorneys' fees for the representation of past and present City employees related to their participation in interviews and proceedings, including compliance with subpoenas, and in responding to the SEC report, related to investigations by the SEC, United States Attorneys' Office, and the San Diego District Attorney's Office. The Council, acting pursuant to the discretion provided by Government Code section 995.8, had determined that it was in the best interests of the City to provide such independent representation to employees and staff members.

The scope of the previous authorization does not include providing a defense to a civil case filed against individual former or current employees. Accordingly, this report discusses the City's obligations under California law to provide these former employees a defense in the *SEC v. Uberuaga* case described above, and the exceptions thereto.

### DISCUSSION

#### **I. The Duty to Provide a Defense Pursuant to California Government Code Section 995.**

California Government Code section 995 requires that the City provide a defense to any civil action or proceeding brought against a former employee in his or her official or individual

capacity on account of an act or omission in the scope of employment by the City. California Government Code section 995 provides in relevant part:

Except as otherwise provided in Section 995.2 and 995.4, upon request of an employee or former employee, a public entity shall provide for the defense of any civil action or proceeding brought against him, in his official or individual capacity or both, on account of an act or omission in the scope of his employment as an employee of the public entity. . .

The defendants in the *SEC v. Uberuaga* case are all former City employees. Michael Uberuaga is a former City Manager; Edward Ryan, a former City Auditor and Comptroller; Patricia Frazier, a former Deputy City Manager; Teresa Webster, a former Deputy Auditor and Comptroller; and Mary Vattimo, a former City Treasurer. Accordingly, these former employees would be entitled to a defense by the City unless an exception under California Government section 995.2 or 995.4 is found to be applicable in this circumstance.<sup>1</sup>

California Government Code section 995.2(a) provides that a public entity may refuse to provide for the defense in an action brought against an employee or former employee if the public entity determines that:

- (1) the act or omission was not within the scope of employment;
- (2) the employee or former employee acted or failed to act because of actual fraud, corruption, or actual malice; or
- (3) the defense of the action by the public entity would create a conflict of interest between the public entity and the employee or former employee.

Upon an employee's request for a defense, the public entity must within 20 days, inform the employee or former employee whether it will or will not provide a defense, and the reason for the refusal to provide a defense. Cal. Gov't Code § 995.2(b).

The City Council has the discretion to make a determination regarding the existence, or lack thereof, of the factors set forth in section 995.2(a). If the City Council determines that these factors were present, then this exception to California Government Code section 995 allows the City Council to refrain from providing a defense to a former employee.

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<sup>1</sup> California Government Code section 995.4 provides that a public entity may, but is not required to, provide for the defense of: (a) an action brought by the public entity to remove, suspend, or otherwise penalize its own employee or former employee; or (b) an action or proceeding brought by the public entity against its own employee or former employee as an individual and not in his official capacity. Section 995.4 is not relevant to this analysis because the action is not brought by the City.

**II. The Complaint Alleges that Defendants Engaged in False and Misleading Disclosures Relating to the City's 2002 and 2003 Bond Offerings.**

The complaint alleges that the defendants committed federal securities violations in connection with the City's 2002 and 2003 municipal securities offerings by engaging in conduct, in the offer or sale of securities:

- a. with scienter, employed devices, schemes, or artifices to defraud;
- b. obtained money or property by means of untrue statements of a material fact or by omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
- c. engaged in transactions, practices, or courses of business which operated or would operate as a fraud or deceit upon the purchaser.

(See, paragraphs 44 and 47 of the SEC complaint).

In addition to the allegations in the SEC complaint, the Report of the Audit Committee of the City of San Diego [Kroll Report] concluded:

With regard to the City's unlawful financial disclosures, we believe the evidence supports the determination that the following City representatives acted with wrongful intent, i.e., scienter as defined pursuant to Section 10(b) of the Securities Exchange Act of 1934:

Deputy City Manager Patricia Frazier  
City Treasurer Mary Vattimo  
Auditor and Comptroller Ed Ryan  
Deputy Auditor and Comptroller Terri Webster  
[balance of names omitted]

(See Kroll Report, p. 238)

With respect to City Manager Michael Uberuaga, the Kroll Report concluded that, as to the financial disclosures, he was negligent in the fulfillment of his responsibilities to the City. (See Kroll Report, p. 238).

Accordingly, with the exception of Mr. Uberuaga, the SEC complaint and the Kroll Report both allege that the former employees intentionally made false and misleading disclosures. The City may refuse to provide a defense to the former employees under the exception in California Government Code section 995.2(a)(2) if it believes that they acted or failed to act because of actual fraud, corruption, or actual malice.<sup>2</sup>

### **III. Refusal to Provide a Defense.**

“If a public entity fails or refuses to comply with its duty to provide a defense--for example, because it erroneously believes that one of the exceptions applies--and the employee retains his or her own counsel to defend the action, the employee is entitled to recover from the public entity the reasonable attorney’s fees and other expenses incurred in presenting the defense.” *City of Huntington Beach v. Petersen Law Firm*, 95 Cal. App. 4th 562, 566-67 (2002). This conclusion is based on Government Code section 996.4, which states in relevant part:

If after request a public entity fails or refuses to provide an employee or former employee with a defense against a civil action or proceeding brought against him and the employee retains his own counsel to defend the action or proceeding, he is entitled to recover from the public entity such reasonable attorney's fees, costs and expenses as are necessarily incurred by him in defending the action or proceeding if the action or proceeding arose out of an act or omission in the scope of his employment as an employee of the public entity, but he is not entitled to such reimbursement if the public entity establishes (a) that he acted or failed to act because of actual fraud, corruption or actual malice, or (b) that the action or proceeding is one described in Section 995.4.

Under this provision, should the City Council decide not to provide a defense to these former employees based on the allegations in the complaint or other relevant facts, the former employees could seek reimbursement of all of their legal defense costs. However, they would not be entitled to reimbursement if the City establishes that the employee’s actions were outside the scope of employment or were done with actual fraud, corruption, or malice. Any decision to reimburse them for their attorneys’ fees, costs, and expenses would be subject to the discretion of the City Council.

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<sup>2</sup> Contrary to statements made by some officials, there is no presumption of innocence in a civil case.

**CONCLUSION**

In general, the City must provide a defense to its employees for actions occurring within the scope of their employment. However, California Government Code section 995.2 provides an exception to the general rule. If the City Council determines that the former employees acted because of actual fraud or corruption, then the City is not required to provide a defense.

In this case, the SEC alleges that defendants made false and misleading disclosures relating to the City's 2002 and 2003 municipal securities offerings. This allegation also was made in the Kroll Report as to all the former employees, except former City Manager Michael Uberuaga who was found to be negligent. Accordingly, there appears to be a sufficient factual basis for the City Council to refuse to provide a defense to Mr. Ryan, Ms. Frazier, Ms. Webster, and Ms. Vattimo. However, because the allegations as to Mr. Uberuaga are not confirmed by the findings in the Kroll Report, additional time is necessary to review these allegations.

Respectfully submitted,



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