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REPORT TO THE HONORABLE  
MAYOR AND CITY COUNCIL

LEGAL ISSUES ASSOCIATED WITH INTERIM EMERGENCY MEDICAL SERVICES  
AGREEMENT WITH RURAL/METRO CORPORATION

### INTRODUCTION

In response to legal concerns raised by this Office and findings set forth in the Independent City Auditor's April 2011 report entitled, "Performance Audit of Fire-Rescue's Emergency Medical Services,"<sup>1</sup> the City of San Diego (City) has chosen to sell its fifty percent interest in San Diego Medical Services Enterprise, LLC (SDMSE) to Rural/Metro Corporation (Rural/Metro). From 1997 to the present, SDMSE has been co-owned and operated by its two members: the City and a subsidiary of Rural/Metro. As a condition of the proposed sale, the City will no longer contract with SDMSE for Emergency Medical Services (EMS). Instead, the City will contract directly with Rural/Metro on an interim, sole source basis while the City conducts a Request for Proposals (RFP) process for a new EMS provider.

An interim, sole source contract with Rural/Metro is legally appropriate while an RFP process is underway. In light of the fact that the City has operated under the prior structure for over 13 years, this Office recommends that the City take this opportunity to conduct a comprehensive and careful review of alternative delivery models that have proven successful in similarly-situated communities. This type of in-depth analysis will enable the City to put its best ideas forward in the next RFP to ensure that ambulance service is provided to the citizens of San Diego in the lowest cost, most efficient, and highest quality manner possible. We provide an overview of associated legal issues below.

### QUESTIONS PRESENTED

1. May the City legally sell its interest in SDMSE, and enter into an interim, sole source EMS agreement with Rural/Metro?
2. Is Proposition 26, requiring voter action for certain fee increases, implicated?

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<sup>1</sup> The complete title of the City Auditor's April 2011 report is "Performance Audit of Fire-Rescue's Emergency Medical Services: Significant Opportunities for Improvement Exist to Strengthen Oversight, Recover Costs, and Enhance Response Time Reporting."

### BRIEF ANSWERS

1. Yes. The City may legally sell its interest in SDMSE, and contract with Rural/Metro on an interim, sole source basis while an RFP process is underway. In the meantime, the City can and should utilize the two-year sole source period to consider alternative delivery models to achieve best results in the next RFP.
2. Probably not. It is unclear whether Proposition 26 applies to patient rates under these circumstances. Even if it does, the "government services" exception permits local governments to charge fees on a per-service basis, provided the fees do not exceed the reasonable costs of the local agency.

### BACKGROUND

#### I. RECENT LEGAL ACTION

Since its inception in 1997 to the present, SDMSE has provided EMS to the City. The City conducted an RFP for EMS in 1996, which resulted in a ten-year contract award to SDMSE. After certain delays, the City issued another RFP for EMS in 2009. SDMSE was the only proposer, and was once again chosen to provide EMS to the City. In July 2009, the City Council authorized the Mayor or his designee to negotiate and execute a contract with SDMSE in accordance with the terms and conditions of the RFP. *See* San Diego Resolution R-30579 (July 21, 2009). The parties subsequently entered into an EMS agreement commencing July 1, 2010 (2010 EMS Agreement).

In a series of confidential memos commencing in November 2009, this Office advised the Mayor and Council of certain legal and financial issues regarding the City's relationship with Rural/Metro and the structure of SDMSE. Shortly after the Independent City Auditor had commenced an audit of SDMSE operations, on September 20, 2010, the City received notice that a whistle-blower action had been filed against Rural/Metro on the City's behalf (the Qui Tam Action). The qui tam plaintiff, a former employee of Rural/Metro, alleged that Rural/Metro improperly failed to deposit certain funds in SDMSE's account.

By April 2011, the City, Rural/Metro and the qui tam plaintiff entered into a settlement agreement, whereby the Qui Tam Action would be dismissed without prejudice in exchange for Rural/Metro agreeing to: (1) voluntarily submit to a full forensic accounting of SDMSE overseen by an independent referee, at Rural/Metro's own expense; and (2) submit a surety bond to the City in the amount of \$7.5 million to secure the City's potential claims.<sup>2</sup>

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<sup>2</sup> Pursuant to the settlement agreements between the parties, Rural/Metro may be entitled to gradual early releases of the bond amount under certain conditions and subject to the City's written authorization.

As of the date of this report, the independent referee has appointed a qualified accounting firm to conduct the full forensic accounting of SDMSE and the parties are in the process of collecting relevant documents.

**II. OPTIONS FOR AN INTERIM EMS AGREEMENT WITH RURAL/METRO**

Under the terms of the parties' settlement, Rural/Metro will purchase the City's fifty percent interest in SDMSE. Depending on the option chosen, the buy-out price will range between \$5 million and \$6 million. The buy-out price is intended to compensate the City for its interest in the assets of SDMSE (valued at approximately \$3.7 million for the City's share), as well as residual profit value, the company name, and good will. While SDMSE will no longer contract directly with the City, it may continue to contract with the County<sup>3</sup> and other third-parties. The City may legally sell its interest to Rural/Metro, and thereby terminate its rights and liabilities in SDMSE as of the buy-out date. The terms and conditions of the buy-out are set forth in detail in the Membership Purchase Agreement.

The parties also agreed to negotiate in good faith to enter into a new EMS agreement by June 15, 2011 or another date as mutually agreed to by the parties. The purpose of the new EMS agreement was to provide for the continuation of critical services on an interim basis while the City conducted an RFP process. The following four options are now presented to the City Council for consideration:

	<b>Buy-out Price</b>	<b>City Operational Fee (Per Year)</b>	<b>Average Patient Charge</b>
<b>Option 1</b>	\$6 million	\$ 10 million	\$1,761
<b>Option 2</b>	\$5 million	\$ 8 million	\$1,304.51
<b>Option 3</b>	\$5.5 million	\$ 9 million Yr. 1 \$ 10 million Yr. 2	\$1,533 Yr. 1 \$1,761 Yr. 2
<b>Option 4</b>	\$5 million	\$ 9 million	\$1,533

This Office notes that only Option 2 will avoid a substantial increase in patient rates. Therefore, this Office recommends Option 2. However, this is ultimately a policy decision for the Mayor and City Council.

<sup>3</sup> SDMSE provides ambulance service to Petco Park and "County Service Area No. 17," also known as the San Dieguito Ambulance District, which includes Encinitas, Del Mar, Solana Beach, Rancho Santa Fe, and other areas within San Diego County. Both the Petco and County Service Area No. 17 contracts permit SDMSE to assign its obligations with the other party's prior written consent.

**A. Legal Basis for Sole Source**

For reasons mentioned above, the City has chosen to restructure its EMS system, and prepare and issue a new RFP. The Mayor's Office has indicated that this will be a two-year process, which will include an overall system review. In the meantime, the City may legally enter into an interim, sole source agreement with Rural/Metro to ensure continuation of uninterrupted ambulance service. The San Diego Municipal Code provides for an exception to competitive bidding for "sole source" contracts. SDMC §§ 22.3037 and 22.3212(e). Sole source contracts are justified where "strict compliance with competitive selection or bidding requirements would be unavailing, or would not produce an advantage, or would be undesirable, impractical, or impossible." SDMC § 22.3037; *see also Graydon v. Pasadena Redevelopment Agency*, 104 Cal. App. 3d 631, 636-37 (1980).

A sole source contract may be justified on an emergency basis if there is insufficient time to conduct a competitive process. *Taylor Bus Service, Inc. v. San Diego Board of Education*, 195 Cal. App. 3d 1331, 1345 (1987) (upholding sole source award to various bus companies after low bidder failed to provide necessary insurance; competitive process was excused due to proximity to start of the school year). Courts generally permit a sole source contract with the vendor of a city's choosing, pending resolution of an RFP process. *See, e.g. San Joaquin Helicopters v. Department of Forestry*, 110 Cal. App. 4th 1549, 1554-55, 1565 (2003) (upholding interim sole source contract to helicopter maintenance company while protest from rival company was being resolved).

In this case, Rural/Metro is best-situated to provide EMS to the City on short notice and without an interruption in service. Due to the City's prior contract with SDMSE, Rural/Metro is able to immediately provide the personnel, vehicles, and the equipment necessary to continue ambulance service throughout the City at current response times. For these public safety reasons, the selection of Rural/Metro as a sole source provider is legally defensible.<sup>4</sup>

For the past thirteen years, the City has contracted with SDMSE, a limited liability company in which the City and Rural/Metro have shared an ownership interest. No other ambulance company or joint venture has attempted to compete for the City's EMS contract since 1997. Therefore, this Office strongly recommends that the City take the opportunity during this two-year period to conduct an in-depth, meaningful review of alternative EMS systems and

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<sup>4</sup> Under the terms of 2010 EMS Agreement, Rural/Metro arguably would have been entitled to two years' notice of termination. While this Office will not opine here on whether this provision of the 2010 EMS agreement is legally enforceable, the City did take this into consideration when determining the term length of the interim agreement. Due to the complexity of EMS systems and the requirement for capital outlay such as ambulances, medical equipment, and insurance, prior RFPs have contemplated 10-year terms (e.g. a five year original term, plus one five-year renewal option). State law requires that EMS agreements be subject to "a competitive process held at period intervals" (Cal. Health & Saf. Code §1797.224), which state officials have historically interpreted to mean at least every 10 years. Per San Diego City Charter section 99, future EMS agreements with a term longer than five years must be presented to the City Council for two-thirds' approval by ordinance.

innovative delivery models. Since it has chosen to discontinue its participation in the limited liability company model, the City is in a unique position to reassess its EMS system as whole, conduct market-research, incorporate the City Auditor's findings, consider business alternatives, encourage competition, and improve the cost-efficiency and quality of ambulance service on a going forward basis. In short, the City can utilize this two-year period to develop a new and improved EMS system, and pursue that system in the next RFP.

### **B. Applicability of Proposition 26**

Due to the recent passage of Proposition 26<sup>5</sup> requiring voter action for certain government-imposed fee increases, we briefly address its applicability to ambulance patient rates. While this is a novel issue, one could make the argument that the City is "imposing" a fee by specifying an Average Patient Charge in the contract with Rural/Metro. The counter-argument would be that the City is not requiring Rural/Metro to charge this amount; the City is only setting a maximum over which Rural/Metro cannot charge and therefore, Proposition 26 would not apply at all. Even if Proposition 26 applies, the patient rates likely fall within the "government services" exception to Proposition 26. Under this exception, a fee "imposed for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of providing the service or product" is not a tax. Cal. Const. art. XIII C § (e)(2).

In this case, only people who receive ambulance service are charged. Therefore, the City, or its vendor, may charge a fee for ambulance service so long as it does not exceed reasonable costs. The Mayor's Office and the City's Fire Department have indicated that the City's costs in providing 911 services would far exceed revenue that is indirectly recovered from patient rates. Therefore, even if Proposition 26 is found to apply to patient rates, the fees proposed are most likely defensible.

### **CONCLUSION**

By choosing to sell its interest in SDMSE and conduct an RFP for a new EMS provider, the City is uniquely positioned to review its EMS system as a whole. We strongly recommend that the City take this opportunity to consider alternative delivery models, and put its best ideas forward in an open and competitive RFP process. In the meantime, an interim, sole source

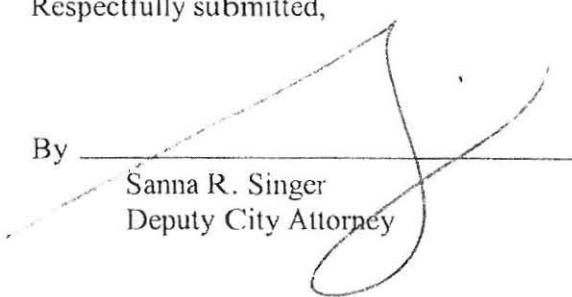
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<sup>5</sup> On November 2, 2010, California voters approved this ballot initiative, which amended articles XIII A and XIII C of the California Constitution. Under Proposition 26, "any levy, charge or exaction of any kind" imposed, increased, or extended by local government agencies on or after November 3, 2010, is considered a tax requiring two-thirds' voter approval with certain exceptions.

contract with Rural/Metro is legally defensible to ensure continuation of critical public safety services. While it is arguable whether Proposition 26 applies, patient rates likely fall within the "government services" exception, which permits fees on a per-service basis, provided the fees do not exceed the reasonable costs of the local agency.

Respectfully submitted,

By



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SRS:aml  
Attachment  
RC-2011-25