Office of
The City Attorney
City of San Diego

MEMORANDUM

DATE: July 6, 2006

TO: Patrick Kelleher, Principal Procurement Specialist

FROM: Michael Calabrese, Deputy City Attorney

SUBJECT: Council Approval of Revenue Contracts

Per your request, I have researched the question of whether the City's award of a contract for towing services, on a district by district basis in sixteen towing districts throughout the City, pursuant to which the City will receive a minimum of $10,000 in revenue per quarter per district, and under which the City will pay a small amount for the towing of its own vehicles, requires the approval of the City Council. My analysis follows.

BACKGROUND

Since the release of an RFP in August of 2005, the Purchasing Division has been seeking to enter a new contract for towing services to be provided throughout the City. As with previous towing contracts, this contract is expected to be mainly a revenue generating deal, although it will also involve some expenditures. The main source of revenue is from the contract's referral fees. That is, the towing contractor pays the City a fee for each vehicle that the City requests that the contractor tow. Because the vehicle owner, rather than the City, pays for the towing itself, there is no direct expenditure to the City expect in the relatively rare cases where the City itself owns the vehicle (for example, when a City vehicle breaks down). Revenue under this contract is guaranteed to be at least $640,000 annually, and can be higher if the volume of towing exceeds what is necessary to meet this guarantee. For the purposes of this memo, I will assume that revenues may exceed $1,000,000 annually. City expenditures under such a contract are typically in the range of $50,000. The contract will have a one-year initial term with up to four one-year renewal options.

You have asked our advice as to whether the contract award must be approved by the City Council.

QUESTION PRESENTED

Does a City towing contract require City Council approval, where it will have a one-year duration with four one-year renewal options, and will likely involve annual expenditures of approximately $50,000 and generate revenues that could exceed $1,000,000?

SUMMARY CONCLUSION

A contract that provides mainly for the City to receive revenue from the provision of towing services by a private party whenever the City requests a tow, and which will involve expenditures in an undetermined amount that will certainly not approach $1,000,000, and that will not have a duration exceeding five years, does not require the approval of the City Council.

There is no default assumption under applicable law that requires contracts to be approved by the City Council. Rather, the default provision of law appears to be SDMC §22.3202, which gives the Purchasing Agent authority to enter contracts when City departments so request. This authority is subject to varying levels of scrutiny when certain factors are present, and these are set forth in various provisions of the Municipal Code and City Charter. Provisions calling for Council approval include, *inter alia*, City Charter § 99 (contracts exceeding five years' duration); City Charter §103 (franchises); and SDMC §22.3211(d) (contracts involving expenditures of $1,000,000 or more). However, none of these provisions, nor any applicable rule in this area of law, would require the towing contract described here to receive City Council approval.

It might well be argued that the proposed towing contract, which involves revenues to the City that could conceivably reach $1,000,000, implicates the same policy considerations that motivated the various provisions discussed– i.e. the need for heightened scrutiny of contracts which have larger financial implications for the City. However, there is no evidence in either the text of the various provisions cited or in their history to suggest that they were intended to apply to revenue contracts. Thus, it appears that where other features of a contract – e.g. its duration or level of expenditures – do not bring it within the requirements for City Council approval, a high revenue level will not trigger such a legal requirement.

However, we would recommend, as a matter of policy, that City Council approval be sought even though it is not required by law. This contract has been approved by the Council in the past, and a deviation from this practice may be seen as an attempt to avoid public scrutiny. This may be particularly problematic in the case of a contract that could be perceived by the public as a means by which the City makes money through a sweetheart deal with towing providers, financed at the expense of ordinary citizens. To reduce the degree of publicly accessible review of this contract from what has previously been allowed could heighten public dissatisfaction in this area. Because this office always favors greater openness in government actions, we believe the better policy would be to seek Council approval of this contract.

LEGAL ANALYSIS

As a general matter, the question of whether a contract to be awarded by the City's Purchasing Agent must receive the prior approval of the City Council is the subject of Chapter 2, Article 2, Division 32 of the San Diego Municipal Code, SDMC §§ 22.3201-22.3224 ("Division 32"). However, Division 32 does not directly address the question of how to treat a contract that

is mainly a revenue producer, instead focusing mainly on expenditure contracts. Therefore, other sources must be consulted, including the legislative history of Division 32, the City Charter, case law, and memoranda and opinions of this office.

A. Sources of the Purchasing Agent's Authority to Enter Contracts for Services

The duties of the Purchasing Agent generally are laid out in §35 of the City Charter. Those duties as explicitly stated mainly involve the purchasing of "supplies, materials, equipment, and insurance." Contracts for services are not mentioned. However, §35 does provide for the Purchasing Agent to assume "such other duties as may be prescribed by general law or ordinance or by the Manager." Thus, if an ordinance authorizes the Purchasing Agent to contract for services, then that power exists and may be exercised in a manner consistent with the grant in the authorizing ordinance.

There is an ordinance that provides for the Purchasing Agent to contract for services. SDMC §22.3202 provides that "The Purchasing Agent is authorized to enter into contracts upon the request of City departments." The term "contracts" is explicitly defined at SDMC §22.3003 to include a "contract for services," which would include towing services. When the Purchasing Agent enters contracts under SDMC §22.3202, with certain exceptions, the award must be pursuant to a "competitive process in accordance with Section 22.3211." SDMC §22.3202. SDMC §22.3211, subsections (a) through (d), in turn, provides for increasing levels of scrutiny of any contract as the level of "expenditure" increases. Contracts involving expenditures from $5,000 to $9,999 require the Purchasing Agent to seek "competitive prices," but this may be done informally. SDMC §22.3211(a). Expenditures from $10,000 to $49,999 require "written price quotations from at least five potential sources." SDMC §22.3211(b). Expenditures from $50,000 to $999,999 additionally require advertisement in the City's Official Newspaper. SDMC §22.3211(c). Finally, contracts involving expenditures of $1,000,000 or greater require advertisement for sealed bids, and, unlike any other expenditure level under SDMC §22.3211, the Purchasing Agent "shall obtain the City Council's approval to award the contract." SDMC §22.3211(d).[1]

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[1] Division 32 also provides that certain kinds of contracts may be awarded, "without Council action," by the City Manager [now the Mayor]." This process applies to contracts for Inmate Services (SDMC §22.3221) and contracts with governmental agencies and non-profit organizations (SDMC §22.3222). The expenditure limit for contracts under these provisions is $500,000. It may seem incongruous that the threshold for a requirement of Council approval is lower for these contracts than for those entered by the Purchasing Agent, and this might suggest that a requirement of Council approval is to be assumed in the absence of an express provision to the contrary. However, as to service contracts, such an expression exists in SDMC §22.3202. The apparent incongruity between the provisions of Division 32 may not be as severe as it may appear at first glance. None of the requirements for public advertising or competitive bidding, which are otherwise found applicable under SDMC §22.3211, apply to contracts under SDMC §§22.3221 and 22.3222. Indeed, this removal of the normal bidding requirements was seen as the main substantive thrust of these sections, according to the legislative history of those provisions, which included a "Committee Action Sheet" stating that the Rules Committee had voted "to amend the Municipal Code as proposed *to waive bidding requirements* for personal service contracts performed by prisoners, probationers, and parolees, and nonprofit organizations that further a social purpose…" (Emphasis supplied). Thus, the overall level of formality for such contracts is generally much lower, even when considering the lower threshold to require Council action.

Thus, the question presented is whether, in the absence of any explicit statement of legislative intent to apply the same standards to revenue contracts as apply to expenditure contracts,[2] such an intent may be either found in Division 32 by implication, or found in some other source of law.

B. Possible Sources of a Requirement for Council Approval of Revenue Contracts

1. Is There an Implied Requirement of Council Approval of Revenue Contracts in Division 32?

First, it might be asked whether, despite the lack of an explicit requirement for Council approval of a large revenue contract in Division 32, one might be implied. In this vein, the legislative history of that ordinance, as well as prior pronouncements of the courts and of this office on similar topics, shed some light. On the whole, they tend to preclude any finding of an implied requirement.

a. There is Precedent in Our Opinions for Treating Revenue Contracts Differently from Expenditure Contracts of Similar Magnitude, Even where that Different Treatment is not Explicitly Codified.

First, while this office has not specifically opined on the question of whether a revenue contract requires Council approval under Division 32, it has addressed the similar question of whether a revenue contract exceeding five years' duration must, per City Charter §99, be approved by ordinance (as opposed to resolution). The last sentence of §99 requires any "contract, agreement, or obligation extending for a period of more than five years" to be adopted by ordinance. However, the balance of §99 addresses only transactions in which the City takes on indebtedness or other financial obligations. Thus, the question arose whether the last sentence, requiring approval by ordinance, applies to *revenue* contracts that exceed five years' duration.

In 1993, this office created a private memorandum, in light of then-pending litigation on the topic, in which we concluded that §99 requires approval by ordinance of *all* contracts exceeding five years' length. That memo did not, however, specifically address revenue contracts, instead focusing on the difference between present expenditures and long-term indebtedness. However, it later came to be interpreted to mean that revenue contracts exceeding

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[2] For the purpose of this discussion, the proposed towing contract will be treated purely as a revenue contract, despite the fact that it does involve some level of expenditures. The expenditures are relatively small, and the Purchasing Division has complied with the requirements of SDMC §22.3211 applicable to such expenditures. If any more rigid process is to be imposed, it will be because of the contract's revenue generating potential. And, for the purpose of this discussion, that potential will be assumed to be $1,000,000 or higher, though in fact the Purchasing Division doubts that expenditures will actually reach that level.

five years' length required approval by ordinance. This was viewed with disfavor by some in City government, and thus a clarifying Memorandum of Law was requested. Thus, an MOL was issued in 1998, limiting the scope of the earlier memo, by concluding that revenue contracts were not subject to the restrictions in §99.

Thus, there is precedent for this office approving different treatment for revenue contracts as opposed to expenditure contracts, even where the governing law does not explicitly provide for such different treatment. The 1998 MOL was based primarily on the legislative history of §99 (in particular Sec. 99's focus on public indebtedness and the need for public scrutiny thereof), and thus was peculiar to that provision and is likely of limited direct value in addressing a question where §99 is clearly inapplicable. Nonetheless, since there is precedent for finding more leniency in the standards for approving revenue contracts than expenditure contracts, even where the governing law does not clearly so provide, this seems to support more lenient treatment in the Division 32 context, where the applicable ordinance seems to explicitly provide for different treatment.

b. The Legislative History of Division 32 Suggests No Justification for Implying a Requirement of Council Approval Where None is Explicitly Stated.

Prior to 1998, the Municipal Code contained provisions relating to the awarding and approval of contracts that were very different from what appears there today. Previously, such questions as the one now under consideration were governed by Chapter 2, Article 2, Division 5. Division 5 still exists, but most of the provisions on this topic have been repealed and replaced by substantively different provisions now appearing in Division 32.

Under the old Division 5, the California Court of Appeals addressed a question specific to the requirements for an award of a towing contract by the City of San Diego. *See, Mike Moore's 24-Hour Towing v. City*, 45 Cal. App. 4th 1294 (1996). In 1994, a dispute arose when the City awarded towing contracts for three districts to one entity, SDPTO, over others including Mike Moore's Towing.[3] Moore sued, claiming that the City's findings regarding the bids were improper. Although the specific facts of the dispute (which related to whether various bids met the RFP requirements) are not relevant here, the decision-maker was clearly the City Council. Because the question of the need for Council approval was not before the court, it was not discussed, but the Court of Appeals did refer to the approval process as having been governed by "SDMC section 22.0512." *Moore*, 45 Cal. App. 4th at 1306. Bids were "evaluated by a screening committee, which made a recommendation to the City Council." *Moore*, 45 Cal. App. 4th at 1300.

As noted, the approval process proceeded under the old Division 5. Division 5 still

[3] As with the presently proposed contract, the contract in *Moore's* was principally a revenue contract, with the revenue coming in the form of referral fees paid to the City by the towing company for each City-requested tow. *Moore's*, 45 Cal. App. at 1300.

exists, but many of the sections that were formerly included were repealed in 1998 by Ordinance O-18532. This was the same ordinance that created what is now Division 32, "Contracts for Personal Services, Goods, and Consultants," whose relevant provisions are described above. The Council thus appears to have consciously decided to amend the Municipal Code to replace the former with the latter.

In addition to SDMC §22.0512, the repealed sections also included the former SDMC §22.0504, which required the Purchasing Agent to obtain Council approval for contracts involving a "cost…in excess of $50,000." Though the Court did not explain why Council approval was sought in the *Moore's* case, the likely explanation is that, although the contract's revenues would have dwarfed expenditures, expenditures still would have exceeded the threshold for Council approval, which was only $50,000 at the time, per former SDMC §22.0504.[4] By contrast, the current threshold under SDMC §22.3211 is $1,000,000, and such towing fees will not approach this threshold.

Division 32 provides a detailed and specific set of rules for determining what kinds of contracts require what kinds of approval. Council must be assumed to have intended to enact exactly these rules when it chose the specific language of Division 32 to replace the substantively different provisions of Division 5. The general rule is that "The Purchasing Agent is authorized to enter contracts upon request of City departments." SCMC §22.3202. The specific process for entering these contracts is, unless §§22.3212, 22.3221, or 22.3222 apply (and in this case, they do not), "a competitive process in accordance with Section 22.3211." Section 22.3211 lays out specific *expenditure* amounts, beginning at $5,000, and sets the rules for how such contracts may be awarded – i.e. whether competitive bids must be sought, how formally, and ultimately, in the most extreme cases (where expenditures reach $1,000,000), whether Council approval is required. The ordinance's explicit language only speaks of thresholds for expenditures. I have reviewed the legislative history that was generated when the ordinance was adopted in 1998 (City Manager's Memo, drafts, 1472, and other documentation), but there is no suggestion of how the Council intended to treat revenue contracts, or that they considered the issue at all.

Given that the overall effect of Division 32 is to provide a rather detailed set of rules for exactly what kinds of approvals are needed for City contracts, that the ordinance explicitly requires Council approval where the Council thought it appropriate, that there is precedent for requiring less scrutiny for revenue contracts than for expenditure contracts of the same magnitude, and that the legislative history of Division 32 gives no indication that the Council intended anything other than what the ordinance explicitly says, I believe the better reading is that Division 32 does not require Council approval for the proposed towing contract.

2. Is the Towing Contract a Franchise?

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[4] It has also been suggested that this contract was viewed as a "consultant" contract, though this view would certainly appear to be erroneous, as towing is clearly not an "expert or professional" service. SDMC §22.3003.

Finally, it has been suggested that because the proposed towing contract includes a certain measure of exclusivity, and because it involves City rights-of-way, that it might be considered a "franchise." If so, it would require Council approval. Under §103 of the City Charter, franchises "for the use of public property" may only be awarded "by ordinance adopted by vote of two-thirds (2/3) of the members of the Council." Under §105, the City reserves "plenary control over all primary and secondary uses of its streets and other public places." The term "franchise is not defined in the Charter and is not easily defined." *Copt-Air, Inc. v. City of San Diego*, 15 Cal. App. 3d 984, 987 (1971). The language quoted from §§103 and 105 clearly indicates that the term "franchise" denotes some grant of a right to use streets or other public property. Thus, the issue is whether a towing contract involves sufficient use of streets to constitute a franchise, requiring Council approval by a 2/3 vote.

The issue of what is a "franchise" is a difficult one that has given rise to extensive discussion by the California courts. From the 19th Century, it was recognized that "The term 'franchise' has several significations, and there is some confusion in its use." *Spring Valley Water Works v. Schottler*, 62 Cal. 69, 106 (1882). In the sense under consideration here, "franchise" means "a certain privilege of a public nature, conferred by a grant from the Government, and vested in individuals. It is a sovereign prerogative, and vests in an individual only by virtue of a legislative grant." *The Truckee and Tahoe Turnpike Road Company v. Campbell*, 44 Cal. 89, 91 (1872). It generally involves "the use of a sovereign body's property." *City of Santa Cruz v. Pacific Gas & Electric Co.*, 82 Cal. App. 4th 1167, 1171, n. 2 (2000). Though some franchises may be awarded by the State itself, "the power to grant franchises to use the highways for secondary purposes, (such as pipelines under those highways), is generally delegated to the local subdivisions of the state." *Southern Pacific Pipelines, Inc. v. City of Long Beach*, 204 Cal. App. 3d 660, 666 (1988). The status of a franchise as such depends in part on the fact that the right given must be affirmatively granted by the government: "If the privilege is one that any individual may enjoy without a permit from the government…it is not a franchise." *Oakland v. Hogan*, 41 Cal. App. 2d 333, 346 (1940). Further, a franchise necessarily is granted "to enable an entity to provide vital public services with some degree of permanence and stability, as in the case of franchises for utilities." *Santa Barbara County Taxpayers Ass'n v Santa Barbara County*, 209 Cal. App. 3d 940, 949 (1989). And it is not enough that there is mere use of the right-of-way. Rather, a franchise grants, *inter alia*, "a possessory interest in public real property, similar to an easement." *Id.*

Thus the law regarding the definition of franchises has evolved over more than a hundred years. And it was against this backdrop that the Court of Appeals, in 1995, decided *Saathoff v. City of San Diego*, 35 Cal. App. 4th 697, which decision likely would control the question of whether a towing contract is a franchise requiring approval by the Council on a 2/3 vote. In *Saathoff*, the Court of Appeals considered a challenge by a losing bidder to a City contract for ambulance services. The plaintiff contended that the contract was invalidly entered because it

was actually a franchise, and thus required an ordinance passed by a 2/3 vote of the Council, which had not occurred, the contract instead being awarded by a resolution passed by a vote of 5-4.

Applying many of the standards noted above, the Court found that the contract for ambulance services did not constitute a franchise. The contract did involve a public grant of authority, and the provision of an important public service. *Saathoff*, 35 Cal. App. 4th at 706. However, the Court found that there was insufficient use of public property.[5] *Id.* The use of real property that the Court referenced in *Saathoff* was the placement of ambulance dispatchers in City buildings, which the Court observed did "not involve a permanent intrusion into public property comparable to the installation of poles, wires, pipes, etc. utilized for the provision of other public services." *Id*. Of even greater import was the relatively short duration of the contract, four years, which "need not be viewed as creating a long-term interest." *Id.*

These same factors counsel even more strongly against finding a franchise in the case of the proposed towing contract. While towing might be deemed an essential public service, it is less likely to be so viewed than ambulance services. There is nothing in the proposed towing contract that could be viewed as involving a possessory use of public real property. And the proposed contract is of even shorter duration in this case than the four year deal in *Saathoff*, being for a one-year term with options for up to four one-year renewals. *Cf. Copt-Air, supra*, 15 Cal. App. 3d at 989 (A permit to conduct helicopter operations, revocable without cause on ten days' notice, was not sufficiently permanent to constitute a franchise.)

Because the towing contract does not involve a possessory right in public real property, and does not involve the "degree of permanence and stability" normally associated with a franchise, it is not a franchise. Thus, Charter §103 does not apply, and Council approval by a 2/3 vote on an ordinance is not required.

CONCLUSION

The awarding of a towing contract that will have a one year duration with up to four one-year renewals, and will involve total expenditures of far less than $1,000,000 and annual revenues of at least $640,000 annually, does not require the approval of the City Council.

It appears clear in this case that neither the public (in adopting the City Charter) nor the Council has required that the contract at issue be brought before the Council. The Purchasing Agent is empowered to enter into "contracts for services" under SDMC §22.3202, which is in turn authorized by §35 of the City Charter, giving the Purchasing Agent such powers as the City Council may prescribe by ordinance. Other provisions of Chapter 2, Article 2, Division 32 of the

[5] The Court did not even consider, in drawing this conclusion, the fact that the contractor would use the roads for vehicular travel – the only such use that will take place in the towing contract. This seems sensible, since that use, whether by ambulances or by tow trucks, is no different from the use of the roads that is made by thousands of motorists every day, and such use needs no special permit that could be equated with a franchise.

Municipal Code place constraints on the Purchasing Agent's authority as stated in §22.3202. However, the only such provision that is applicable here is SDMC §22.3211. This section requires Council approval only when a contract involves "expenditures" of $1,000,000 or more. This is not the case here. There is nothing in either the text or the legislative history of Division 32 to suggest that the requirement of Council approval that explicitly extends to contracts with "expenditures" of $1,000,000 or more was intended to also apply to "revenue contracts" of a similar magnitude.

The proposed towing contract is not a "franchise" as that term is used in §103 of the City Charter. According to case law, a franchise must involve a right to possessory use of public real property of a relatively permanent nature. This is not the case here, because the towing contractor's only use of public real property will be its use of roads for vehicular travel, which is the same right as every other motorist has, and thus does not derive from an affirmative government grant and is not a possessory right. Further, the contract's relatively short duration would preclude a finding of sufficient permanence to support a franchise. Thus, §103, with its requirement of franchise approval by a 2/3 vote of council, does not apply.

As to the specific features of this contract and possible public perception of them, we would caution against creating the possibility that the public would perceive this contract as a deal between the City and a towing contractor that, without adequate public scrutiny, brings revenue to both parties at the expense of ordinary citizens. The possibility that the public would be dissatisfied with the level of openness in this process could be heightened if the process is viewed as less open than what was employed in the past, when Council approval was obtained. Thus, as a policy matter we would advise seeking Council approval, but it is not a legal requirement.

MICHAEL J. AGUIRRE, City Attorney

By

Michael P. Calabrese
Deputy City Attorney

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