

MEMORANDUM OF LAW

DATE: October 29, 1991

TO: Honorable Mayor and City Council

FROM: City Attorney

SUBJECT: Management Audit - San Diego Data Processing Corporation -
Southeast Economic Development Corporation - Center City
Development Corporation -
San Diego Convention Center Corporation

The Housing Authority recently determined to review the performance of the executive director of the Housing Authority and Housing Commission. In connection with the Housing Authority's discussion, a motion was made that this office report to the City Council with regard to any legal issues which would arise should the City Council decide to conduct a management review of the San Diego Data Processing Corporation (SDDPC), the Southeast Economic Development Corporation (SEDC), Center City Development Corporation (CCDC) and the San Diego Convention Center Corporation (SDCCC).

BACKGROUND INFORMATION

The above corporations are all California nonprofit corporations which were created at the request of the City Council. The purpose behind the creation of the four corporations was in each case to allow for certain public benefit services to be performed by a legal entity separate from the City.

The corporations are governed by the California Corporations Law and are not bound by the City's Charter or by general laws applicable to municipal corporations. The officers and employees of the corporations are not protected under the City's Civil Service rules and are not members of the City's retirement system.

In the case of each corporation, the City, under the Articles of Incorporation is the sole member of the corporation. The Articles of Incorporation specify that the member, i.e., the City Council, appoints the directors of each corporation. The articles and bylaws of each corporation provide that the directors appoint the officers of each corporation.

Each of the four corporations is largely, if not exclusively, supported financially by the City or the City's Redevelopment Agency. The City has entered into operating agreements with each of the four corporations which agreements require the submission of an annual budget for approval by the City. Once the annual budget is approved, each

corporation is allowed to operate without necessity of additional City Council approval so long as it operates within the parameters of its budget and in accordance with its operating agreement with the City.

The bylaws of each of the four corporations were approved by the City Council acting as the sole member of each corporation and the bylaws are subject to amendment by the member (the City). In each instance the bylaws provide in part as follows:

Section 10. Participation of City Officials. The City Manager and members of the City Council of The City of San Diego shall be entitled to make recommendations to the Board of Directors or any committee thereof with respect to any matter at any meeting thereof. The City Manager and each member of the City Council or their authorized representatives shall have the right to attend any meeting of the Board of Directors or any committee thereof with the right of debate, but he shall not be entitled to vote on any matter considered by the Board of Directors or any committee thereof.

Each corporation has appointed an executive director or executive vice president to manage the day-to-day activities of the corporation. In the case of CCDC and the Convention Center Corporation, there are separate employment agreements for the executive directors which run from year-to-year and month-to-month respectively, whereas, in the case of the other two corporations the appointment of the executive director was handled less formally by action of the board of directors and the executive director's position is held "at will" and included in the annual budget submitted to the City together with statement of proposed compensation. (In the case of the Convention Center, the directors are presently in the process of choosing a new executive director.)

ANALYSIS

The question posed, once again, is what legal issues may arise should the City determine to perform management audits? By report to the Mayor and Council dated June 20, 1991, Cristie McGuire of this office answered the following question:

May the City require a management audit of one of its wholly owned nonprofit, public benefit corporations, SDDPC, without unlawfully interfering in the management of the corporation's affairs?

Ms. McGuire concluded that there is no legal prohibition to conducting or requesting that the corporation conduct such an audit. Ms. McGuire's conclusion was based, in part, upon the following provision which is contained in the operating agreement with SDDPC:

10. AUDIT AND REPORTING PROCEDURES.

Corporation agrees to allow City officials complete access to all personnel, operational and financial records and data pertaining to the services provided pursuant to this agreement. Corporation further agrees to submit to City in the form requested by the City Council or City Manager any reports deemed necessary by

City in connection with the services to be provided pursuant to this agreement.

While the operating agreements for the other three corporations discussed herein have differing provisions regarding auditing and records, all of the operating agreements provide for City access to the corporations' records.

As noted in the above background information, the City has significant powers with regard to each corporation in that it appoints the directors and approves an annual budget. While the City may properly conduct a management audit in order to ascertain that the public moneys being transferred to the corporations are being utilized efficiently and productively and in full compliance with the operating agreements, it is important that the City maintain its independence from the corporations and allow each corporation to maintain its separate legal entity status.

The only significant potential legal problem to conducting management audits, therefore, would be a requirement that the City conduct such audits in a manner consistent with the proposition that each corporation is separate and distinct from the City; that the officers and employees of each corporation are not City employees; and that the corporations are not merely "agents" of the City but are separate, legal entities responsible for their own acts and capable of entering into contracts on their own behalf, without City approval and without creating a City obligation.

While the legal concept of "piercing the corporate veil" is generally involved in for-profit corporation situations, the concept has also been applied to a nonprofit corporation. *Macaluso v. Jenkins*, 420 N.E.2d 251, Ill. (1981). Substantial financial issues would be involved in the event the various nonprofit corporations were held to be mere conduits and agents of the City. Any such possibility should therefore be avoided.

In the context of maintaining the separation between the City and the corporation it is, therefore, recommended that either the City conduct or contract for any management audits which are deemed to be desirable by the City Council, or that the City request rather than attempt to direct such a management audit to be performed by the corporations with their own budgeted funds.

In addition, if, as a result of any management audit, the City Council determines that any changes in management are desirable, the City Council should request the corporations to take appropriate action and deal with any continuing problems through the rights vested in the Council as the sole member of each corporation, and, if necessary, through the budget process.

JOHN W. WITT, City Attorney

By

Harold O. Valderhaug

Deputy City Attorney

HOV:ps:010(x043.2)
ML-91-89