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**MEMORANDUM**

TO: Billie K. Wimmer, Executive Director  
Michigan Association of Charter School Authorizers

FROM: Bryan T. Newland

RE: Implications of Educational Service Providers Appointing Chief Administrative  
Officers

DATE: May 29, 2009

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**INTRODUCTION**

You have indicated that public school academies (“PSAs”) have been engaging in a practice whereby they appoint an employee of their educational service provider (“ESP”) to serve as Chief Administrative Officer (“CAO”) of the PSA. You have requested information regarding the legal implications of employees of ESP employees serving as the CAO of a PSA.

**SUMMARY**

The appointment of an ESP employee as the CAO of a PSA raises serious questions about the relationships between those parties. As public officers, CAOs owe a fiduciary duty to the public to faithfully carry out their duties prescribed by law. Michigan law prohibits contracts between public officers and other parties that interfere with this fiduciary obligation. Therefore, it is imperative that ESPs, PSAs, and their counsel understand the obligations of CAOs, as public officers and under the Budget Act, before agreeing to the appointment of an ESP employee as the CAO for a PSA.

Michigan law defines the duties of both a PSA board of directors and its CAO. CAOs must have a complete understanding of the school's operations, including facts necessary to create and oversee the school's budget, to fulfill the duties imposed by Michigan law. It would be very difficult for a passive CAO to satisfactorily fulfill these duties. In addition, PSA boards of directors must also ensure that they do not improperly delegate authority and responsibilities to their CAOs.

## **BACKGROUND**

It has become a common practice for ESP's to recommend that client-PSAs appoint ESP employees to serve as the academy's CAO. There are three common examples of this practice:

1. The CAO is the owner of the ESP;
2. The CAO is a "corporate" employee of the ESP (i.e., a person who is typically not present at the school); or
3. The CAO is an employee of the ESP, but is required to be present at the school on a day-to-day basis (e.g., the Superintendent or School Principal).

This practice has significant implications for PSAs, their ESPs, and the individuals designated as CAOs. First, designation as a CAO requires the execution of certain public functions that implicates some of the duties and restrictions placed upon public officers. Second, Michigan law imposes a number of statutory obligations on both PSA boards of directors and CAOs. Therefore, it is critically important for ESPs, PSA boards of directors, and their counsel to understand the statutory duties of a CAO.

## **DISCUSSION**

First, it is important to understand the primary consequence of designation as the CAO of a PSA. An individual designated as the CAO of a PSA becomes a "public officer" under Michigan law. This status raises serious concerns, with respect to the relationship between the CAO, the PSA, and the ESP that employs the CAO in the situation described above. Second, it is important to understand the duties, obligations, and responsibilities of both the PSA's board of directors and its CAO. Michigan law sets forth the responsibilities of each, as well as where those responsibilities can and cannot be delegated or shared.

### **1. Implications of Designation as a CAO.**

When an individual is designated by the board of a PSA as its CAO, he or she becomes responsible for performing a number of public functions on behalf of the PSA. Given that PSAs are "public entities," individuals appointed by the PSA board of directors would likely be

deemed public officers for purposes of state law. See, e.g., the Michigan Incompatible Public Offices Act, 566 PA 1978, MCL 15.181 et seq. (“Incompatible Public Office Act”); and, the Contracts of Public Servants With Public Entities Act, 317 PA 1968, MCL 15.321 to 15.330 (“Conflicts of Interest Act”).

Under the Incompatible Public Office Act, a “public officer” is an individual “who is elected or appointed to...[a] school district, intermediate school district, special district, or other public entity of this state...” MCL 15.181(e). Under the Conflicts of Interest Act, “all persons serving any public entity” are classified as “public servants.” MCL 15.321.

The Michigan Supreme Court has further clarified who constitutes a “public official” in *Council of Organizations and Others for Educ About Parochiaid, Inc v Governor*, 455 Mich 557; 566 NW2d 208 (1997). In *Parochiaid*, the Michigan Supreme Court set forth a list of five key factors that make a particular office a “public office.” Those factors are:

- (1) It must be created by the Constitution or by the legislature or created by a municipality or other body through authority conferred by the legislature;
- (2) it must possess a delegation of a portion of the sovereign power of government, to be exercised for the benefit of the public;
- (3) the powers conferred, and the duties to be discharged, must be defined, directly or impliedly, by the legislature or through legislative authority;
- (4) the duties must be performed independently and without control of a superior power other than the law, unless they be those of an inferior or subordinate office, created or authorized by the legislature, and by it placed under the general control of a superior officer or body;
- (5) it must have some permanency and continuity, and not be only temporary or occasional. *Id.* at 585, fn 22 (citing *Bandfield v Wood*, 104 Mich App 279, 282; 304 NW2d 551 (1981) (emphasis added).

It is likely that a PSA’s CAO would constitute a “public officer” under both the statutory definition contained in the Incompatible Public Office Act and the expanded definition provided by the Court in *Parochiaid*, because: (1) the CAO position was created by the PSA board of directors in accordance with the Budget Act; (2) the CAO performs functions that benefit the public by providing knowledge of board activities and overseeing the budget (3) the CAO’s powers are defined by law; (4) the CAO’s duties are performed independently with some oversight from other board members; and, (5) the CAO’s position is permanent and not occasional.

As public officers, the CAOs of PSAs would be subject to other Michigan laws that address the duties of, or impose restrictions upon, public officers.

The Conflicts of Interest Act prohibits public servants from being “a party, directly or indirectly, to any contract between himself or herself and the public entity of which he or she is an officer or employee.” MCL 15.322(1). Moreover, the Conflicts of Interest Act states that “a public servant shall not directly or indirectly solicit any contract between the public entity of which he or she is an officer or employee and...[a]ny private corporation in which he or she is a stockholder owning more than 1% of the total outstanding stock...” MCL 15.322(2). There are certain narrow exceptions to the Conflicts of Interest Act, as set forth in sections 3, 3a, and 4. Nevertheless, contracts in violation of the Conflicts of Interest Act are voidable, and persons who violate the Conflicts of Interest Act may be guilty of a misdemeanor. MCL 15.325; and 15.327.

The Incompatible Public Office Act prohibits a public officer from breaching the duty of public office. MCL 15.181(b)(iii). As the Michigan Supreme Court has noted, “All public officers are agents, and their official powers are fiduciary. They are trusted with public functions of the good of the public; to protect, advance and promote its interests...” *Macomb County Prosecutor v Murphy*, 464 Mich 149, 164; 627 NW2d 247 (2001) (citation omitted).

The fiduciary status of a public officer could impact the relationship between the CAO, the PSA, and its ESP. In a case regarding the validity of a public officer’s private contract, the Michigan Supreme Court stated the rule:

A contract made by a public officer is against public policy and void, if it interferes with the unbiased discharge of his duty to the public in the exercise of his office, or if it places him in a position inconsistent with his duty to the public, or even if it has a tendency to induce him to violate such duty; and the question of the validity of such a contract does not depend on the circumstances whether it can be shown that the public has actually suffered any detriment or loss.

*Sellars v Lamb*, 303 Mich 604, 608; 6 NW2d 911 (1942).

In light of this rule, an ESP employee serving as the CAO for a PSA may face the prospect of a void or voidable contract if it violates the Conflicts of Interest Act, the Incompatible Public Office Act, or the CAOs fiduciary obligations. With respect to the Conflicts of Interest Act, the CAO may also be subject to misdemeanor criminal liability for being party to a contract in violation of that act’s provisions. In other words, ESP employees who are appointed to serve as the CAO of a PSA may be faced with an inherent and incurable conflict of interest.

## **2. Statutory Duties of PSA Boards of Directors and Chief Administrative Officers**

Aware of the fact that the CAO of a PSA is a public officer, it is important to then understand the duties of both the CAO and the PSA board of directors under Michigan law. The Uniform Budgeting and Accounting Act, 2 PA 1968, MCL 141.421 *et seq.* (“Budget Act”) defines PSAs as “local units,” and the board of a public school academy as a “legislative body.”<sup>1</sup> See MCL 141.422d(4)(h) and MCL 141.422d(2)(h). The Budget Act also permits the PSA board to appoint a “chief administrative officer,” who is “a person granted administrative control<sup>2</sup> of the public school academy by the board of directors . . . or other person designated by the board of directors. . . .” MCL 141.422b(3)(h).

The duties and functions performed by the PSA board of directors, as a legislative body for a local unit, are different from those responsibilities that can be delegated by the board of directors to a CAO or other authorized person. To ensure separation of functions, the Budget Act dictates that “[n]o duties shall be delegated to the chief administrative officer that diminish any charter or statutory responsibilities of an elected or appointed official.” MCL 141.438 (emphasis added). Thus, any function that the Budget Act requires the CAO to perform must be analyzed in terms of whether that function delegated by the PSA board to the CAO “diminishes any statutory responsibility” of the PSA board.

### **A. Role of the PSA Board of Directors**

To assess whether a delegation of authority is proper, it is important to identify the roles and functions of both the PSA board of directors and the CAO. Under the Budget Act, the PSA board of directors may or is required to do the following:

1. Employ or otherwise engaged individuals to supervise a budgetary center [MCL 141.422a(1)];
2. Authorize an appropriation to incur obligations and expend public funds for a stated purpose [MCL 141.422a(3)];
3. Adopt a general appropriations act [MCL 141.422a(4); 141.422c(2)];

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<sup>1</sup> Section 502(1) of the Revised School Code, MCL 380.502(1), requires that each public school academy be “organized and administered under the direction of a board of directors in accordance with this part and with bylaws adopted by the board of directors.”

<sup>2</sup> The Budget Act does not define “administrative control,” but does include a definition for an “administrative officer” which is an “[i]ndividual employed or otherwise engaged by a local unit to supervise a budgetary center.” MCL 141.422a(1). “Budgetary center” means “a general operating department of a local unit [public school academy] . . . to which money is appropriated by the local unit.” MCL 141.422b(1).

4. Establish a budgetary center and appropriate money for its operation [MCL 141.422b(1)];
5. Appoint a CAO or designate a person to perform functions of a CAO [MCL 141.422b(3)(h)].
6. Obtain and retain a copy of annual financial report submitted under the Budget Act; make annual financial report available for public inspection through Freedom of Information Act, MCL 15.231 et seq. [MCL 141.424b(3)];
7. Obtain an annual audit of its financial records, accounts and procedures [MCL 141.425(2)];
8. Retain certified public accountant to perform annual audit of its financial records, accounts and procedures [MCL 141.426];
9. File copy of audit report and audit procedures with State Treasurer [MCL 141.427(3)];
10. Adopt time schedule for annual budget process (schedule must allow adequate time for review and adoption of budget before commencement of ensuing budget year) [MCL 141.434(3)];
11. Consider recommended budget transmitted by CAO [MCL 141.434(4)];
12. Before final passage of general appropriations act, hold public budget hearing in accordance with MCL 141.411 et seq. [MCL 141.434(4)];
13. Request additional information needed to consider recommended budget transmitted by the CAO [MCL 141.434(5)];
14. Pass general appropriations act [MCL 141.436(1)];
15. Amend general appropriations act to prevent deviation from originally passed general appropriations act [MCL 141.437(1)];
16. Require the CAO to provide periodic reports of the financial condition of the public school academy [MCL 141.437(1)]; and
17. Cannot create a debt or incur a financial obligation on behalf of the public school academy that is not permitted by law [MCL 141.438(1)]; and
18. Cannot authorize or participate in the expenditure of funds unless they are authorized by a general appropriations act approved by the board of directors [MCL 141.439(1)].

## **B. Role of the Chief Administrative Officer.**

The Budget Act specifically identifies certain functions to be performed by the CAO and, in some cases, permits the PSA board to delegate or assign certain responsibilities to the CAO. Under the Budget Act, the CAO is required or permitted to do all of the following:

1. Make an annual financial report (local unit fiscal report) in accordance with section 4 [MCL 141.424(1) and (2)];
2. Submit annual financial report to State Treasurer; Request an extension for filing annual financial report [MCL 141.424(3)];
3. Request an extension for filing annual audit report and copy of the report of auditing procedures; if extension is requested, CAO must inform the board of directors of the requested extension within 10 days of the request [MCL 141.427(4)];
4. Retain final responsibility for budget preparation, presentation of budget to public school academy board, and control of expenditures under the budget and general appropriations act [MCL 141.434(1)];
5. Prepare recommended annual budget for ensuing fiscal year in accordance with sections 15 through 20a of the Budget Act [MCL 141.434(2)];
6. Transmit recommended budget, along with suggested general appropriations act to implement budget, to public school academy board of directors in accordance with board's time schedule [MCL 141.434(3)];
7. If requested, furnish information that the public school academy board requires for proper consideration of recommended budget. [MCL 141.434(5)];
8. If requested, furnish periodic reports on the financial condition of the public school academy [MCL 141.437(2)];
9. Monitor whether expenditures exceeds available revenue for current fiscal year [MCL 141.437(2)];
10. Recommend to public school academy board amendments to general appropriations act to ensure expenditures do not exceed available revenue in current fiscal year [MCL 141.437(2)];
11. Cannot create a debt or incur a financial obligation on behalf of the public school academy that is not permitted by law [MCL 141.438(1)];

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12. Cannot authorize or participate in the expenditure of funds unless they are authorized by a general appropriations act approved by the board of directors [MCL 141.439(1)]; and
13. If prior approval is given by the public school academy board of directors, may transfer within limits stated in the general appropriations act between appropriations.

### **CONCLUSION**

The appointment of an ESP employee as the CAO of a PSA raises serious questions about the relationships between those parties. As public officers, CAOs owe a fiduciary duty to the public to faithfully carry out their duties prescribed by law. Michigan law prohibits contracts between public officers and other parties that interfere with this fiduciary obligation. Therefore, it is imperative that ESPs, PSAs, and their counsel understand the obligations of CAOs, as public officers, before agreeing to the appointment of an ESP employee as the CAO for a PSA.

Michigan law defines the duties of both a PSA board of directors and its CAO. CAOs must have a complete understanding of the school's operations, including facts necessary to create and oversee the school's budget, to fulfill the duties imposed by Michigan law. It would be very difficult for a passive CAO to satisfactorily fulfill these duties. In addition, PSA boards of directors must also ensure that they do not improperly delegate authority and responsibilities to their CAOs.

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I trust that this information is responsive to your request. Please do not hesitate to contact me if you have any questions or concerns. Thank you.

**BTN**

cc: Leonard C. Wolfe

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