

Date of Hearing: June 19, 2024

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT

Juan Carrillo, Chair

SB 1209 (Cortese) – As Amended June 11, 2024

SENATE VOTE: 39-0

SUBJECT: Local agency formation commission: indemnification.

SUMMARY: Authorizes a Local Agency Formation Commission (LAFCO) to require an applicant to indemnify the LAFCO, its agents, officers, and employees from and against any claim, action, or proceeding that may stem from a LAFCO decision to approve an application. Specifically, **this bill:**

- 1) Provides that a LAFCO may require, as a condition for processing a change of organization or reorganization, a sphere amendment or sphere update, or any other action or determination requested from the LAFCO, that the applicant agrees to defend, indemnify, and hold harmless the LAFCO, its agents, officers, and employees from any claim, action, or proceeding against the LAFCO, its agents, officers, or employees to attack, set aside, void, or annul an approval by the LAFCO.
- 2) Specifies that an agreement to defend, indemnify, and hold harmless entered into pursuant to 1) above, shall require the LAFCO to promptly notify the applicant of any claim, action, or proceeding to attack, set aside, void, or annul an approval by the LAFCO and shall require the LAFCO to cooperate fully in the defense.
- 3) Provides that an applicant who is party to an agreement to defend, indemnify, and hold harmless entered into pursuant to 1) above, shall not be responsible to defend, indemnify, or hold harmless if the LAFCO fails to notify the applicant or cooperate fully in the defense pursuant to 2) above.
- 4) Specifies that an applicant who is a party to an agreement to defend, indemnify, and hold harmless entered into pursuant to 1) above, shall not be required to pay or perform any settlement relating to the agreement, unless the applicant approves the settlement.
- 5) Provides that nothing in this bill shall be construed to prohibit a LAFCO from participating in the defense of any claim, action, or proceeding to attack, set aside, void or annul an approval by the LAFCO if both of the following conditions are met:
 - a) The LAFCO bears its own attorney's fees and costs of the claim, action, or proceeding.
 - b) The LAFCO defends the claim, action, or proceeding in good faith.

FISCAL EFFECT: None.

COMMENTS:

- 1) **Local Government Boundaries.** The Legislature has the authority to create, dissolve, or otherwise modify the boundaries and services of local governments. Beginning in 1963, the Legislature delegated the ongoing responsibility to control the boundaries of cities, county

service areas, and most special districts to LAFCOs in each county. The responsibilities and authority of LAFCOs have been modified in subsequent legislation, including a major revision of the LAFCO statutes in the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 [AB 2838 (Hertzberg), Chapter 761, Statutes of 2000]. The courts often refer to LAFCOs as the Legislature's watchdog over boundary changes.

Local governments can only exercise their powers and provide services where LAFCO allows them to. LAFCOs' boundary decisions must be consistent with spheres of influence (SOIs) that LAFCOs adopt to show the future boundaries and service areas of the cities and special districts. Before LAFCOs can adopt their SOIs, they must prepare Municipal Service Reviews (MSRs) which analyze population growth, public facilities, and service demands. LAFCOs may also conduct special studies of local governments.

Most boundary changes begin when a city or special district applies to a LAFCO, or when registered voters or landowners file petitions with a LAFCO. In limited circumstances, LAFCOs can initiate some special district boundary changes: consolidations, dissolutions, mergers, subsidiary districts, or reorganizations. Boundary changes generally require four (sometimes five) steps:

- a) First, there must be a completed application to LAFCO, including a petition or resolution, an environmental review document, an agreement on how property taxes will be transferred, and a plan for services that describes what services will be provided at what level and how those services will be financed.
 - b) Second, LAFCO must hold a noticed public hearing, take testimony, and may approve the proposed reorganization. The LAFCO may impose terms and conditions that spell out what happens to the assets and liabilities of affected local agencies. If LAFCO disapproves, the proposed reorganization stops.
 - c) Third, LAFCO must hold another public hearing to count written protests in order to determine whether an election is needed. Although there are many exceptions, in most cases an election is required if 25% of the voters in a district, or voters representing 25% of the assessed value of land, submit written protests. In nearly all cases, if a majority of voters or landowners protest, the reorganization also stops.
 - d) Fourth, if an election is required, it occurs among the affected voters, requiring majority voter approval.
 - e) Finally, LAFCO's staff files formal documents to complete the reorganization.
- 2) **LAFCO Funding.** Under state law, any local agency whose council or board members are eligible to be LAFCO commissioners must help pay to fund the county LAFCO. Each LAFCO is required to annually adopt a proposed budget by May 1 and a final budget by June 15. At a minimum, the proposed and final budget is required to be equal to the budget adopted for the previous fiscal year unless the LAFCO finds that reduced staffing or program costs will nevertheless allow the LAFCO to fulfill the purposes and programs of LAFCO law. After the adoption of the final budget, the county auditor generally must apportion the net operating expenses of a LAFCO in the following manner:

- a) In counties where there is city, county, and independent special district representation on the LAFCO, each must provide one-third share of the LAFCO's operating costs.
 - i) The cities' share must be apportioned to each city's total revenues as a percentage of the combined city revenues within a county, as specified.
 - ii) The independent special districts' share shall be apportioned in proportion to each district's total revenues as a percentage of the combined total district revenues within a county, as specified.
 - iii) Alternative methods for apportionment can take place if a majority of cities or independent special approve an agreement.
 - b) In counties where there is no independent special district representation, the county and the cities within that county each provide one-half of the LAFCO's operational costs.
 - c) In counties where there are no cities, the county and its independent special districts each provide one-half of the LAFCO's operational costs.
 - d) Any alternative method of apportionment of the net operating expenses of the LAFCO may be used if approved by a majority vote of each of the following: the board of supervisors; a majority of the cities representing a majority of the total population of cities in the county; and the independent special districts representing a majority of the combined total population of independent special districts in the county.
- 3) **Indemnification.** When a private entity or a governmental agency brings a proposal before a LAFCO for review and approval, many LAFCOs have often required the applicant to sign an indemnity agreement. Such an agreement essentially requires the applicant to indemnify the LAFCO against any lawsuits that may stem from its decision and cover the LAFCO's legal expenses should any be incurred in the process of defending its decision. However, recent court cases have ruled that LAFCO's do not have the authority to require such indemnity agreements.

In the 2021 appellate court case *San Luis Obispo Local Agency Formation Commission v. City of Pismo Beach*, a dispute arose over attorney fees and costs. The Central Coast Development Company (Central Coast) owned a 154-acre parcel of property within the sphere of influence of the City of Pismo Beach (Pismo Beach). Central Coast wanted to construct 252 single family residences and 60 senior housing units on the parcel. Pismo Beach approved Central Coast's application for a development permit for the property. Pismo Beach and Central Coast applied to the LAFCO for Pismo Beach to annex the property. The LAFCO application contained the following indemnity agreement:

“As part of this application, Applicant agrees to defend, indemnify, hold harmless and release the San Luis Obispo Local Agency Formation Commission (LAFCO), its officers, employees, attorneys, or agents from any claim, action or proceeding brought against any of them, the purpose of which is to attack, set aside, void, or annul, in whole or in part, LAFCO's action on the proposal or on the environmental documents submitted to or prepared by LAFCO in connection with the proposal. This indemnification obligation shall include, but not be limited to, damages, costs, expenses, attorneys' fees, and expert witness

fees that may be asserted by any person or entity, including the Applicant, arising out of or in connection with the application. In the event of such indemnification, LAFCO expressly reserves the right to provide its own defense at the reasonable expense of the Applicant.”

The LAFCO ended up denying the annexation application, and Pismo Beach and Central Coast sued the LAFCO. The LAFCO prevailed and presented Pismo Beach and Central Coast with a bill for more than \$400,000 in attorney fees and costs. Pismo Beach and Central Coast ultimately refused to pay. According to the Court, the Special District Risk Management Authority (SDRMA), a public entity insurance pool, paid the LAFCO’s fees and costs, and the LAFCO and SDRMA subsequently sued Pismo Beach and Central Coast to recover the expenses based on the indemnity provision of the annexation application. The Trial Court ruled in favor of Pismo Beach and Central Coast because the LAFCO had no authority to require such fees. The Appellate Court affirmed the Trial Court’s decision.

Government Code Section 56383 allows a LAFCO to establish a schedule of fees and service charges for the following:

- a) Filing and processing applications filed with the LAFCO.
- b) Proceedings undertaken by the LAFCO and any reorganization committee.
- c) Amending or updating a sphere of influence.
- d) Reconsidering a resolution making determinations.

However, the Appellate Court stated that, “Moreover, section 56383 contemplates that fees charged thereunder will be limited to those necessary to the administrative process, not to post-decision court proceedings...Nothing in section 56383, no matter how broadly construed authorizes the indemnity agreement.”

In *San Luis Obispo Local Agency Formation Commission v. Central Coast Development Company*, a subsequent 2022 appellate court case also regarding the awarding of attorney fees, the Court stated, “We affirmed in *San Luis Obispo Local Agency Formation Com. v. City of Pismo Beach* (2021) 61 Cal.App.5th 595 [275Cal.Rptr.3d 837] (*LAFCO I*). We determined that the indemnity agreement was not supported by consideration and that LAFCO has no statutory authority to impose an indemnity agreement as a condition of LAFCO’s statutory duty to consider Central Coast’s application.” The Court also stated, “Government Code section 56383 does not include a provision for attorney fees incurred in the collection of such processing fees and charges. In *LAFCO I*, we expressly rejected the argument that the authority to provide for attorney fees could be implied from statutes.”

- 4) **Other Indemnity Authority.** LAFCOs are seeking the ability to enter into indemnity agreements with applicants, which is not unique as other governmental entities have this authority. For example, Government Code section 66474.9(b) of the Subdivision Map Act allows local agencies to require a subdivider to indemnify the local agency for lawsuits challenging the local agency’s approval of a subdivision. Such an agreement requires the subdivider to defend, indemnify, and hold harmless the local agency from any claim, action, or proceeding against the local agency to attack, set aside, void, or annul, an approval of the local agency concerning a subdivision. Like this bill, the Subdivision Map Act requires the

local agency to promptly notify the subdivider of any claim and that the local agency cooperate fully in the defense. If the local agency fails to promptly notify the subdivider of any claim, or if the local agency fails to cooperate fully in the defense, the subdivider is not responsible to defend, indemnify, or hold harmless the local agency.

- 5) **Bill Summary.** This bill allows a LAFCO to require, as a condition for processing a change of organization or reorganization, a sphere amendment or sphere update, or any other action or determination requested from the LAFCO, that the applicant agrees to defend, indemnify, and hold harmless the LAFCO, its agents, officers, and employees from any claim, action, or proceeding against the LAFCO. This bill applies only to a decision by a LAFCO to approve any of these actions. This bill is sponsored by the California Association of LAFCOs.
- 6) **Author's Statement.** According to the author, "SB 1209 would authorize LAFCOs to be indemnified by an applicant when a commission approves their application. For most applications to public agencies, such as those for land-use, private parties indemnify the involved city or county. Similarly, LAFCOs have normally required an indemnification provision in applications and conditions of approval. However, in 2022, the Second District Court of Appeals determined that LAFCO, despite prevailing in the underlying court case, could not require or rely upon indemnification because it is not expressly authorized in the Cortese-Knox-Hertzberg Local Government Act of 2000. Without the ability to indemnify, the LAFCO will necessarily have to consider whether to make concessions to the applicant, or to not defend its actions."
- 7) **Policy Consideration.** The main question this bill is posing is "Who should pay the costs if a LAFCO is challenged in court after approving an application?" The choices appear to be either allowing LAFCOs to increase fees across their member agencies to cover litigation costs or allowing LAFCOs to require filing entities to pay those costs. By allowing a LAFCO to require an entity filing an application to indemnify the LAFCO and agree to pay for any litigation costs associated with the LAFCO's decision, this bill would answer that question. Ultimately, the Committee may wish to consider if applicants should bear the responsibility to defend a LAFCO if it is sued for approving an application.
- 8) **Arguments in Support.** According to the California Association of LAFCOs, the sponsors of this bill, "This bill will add new language to the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 (The Act) authorizing LAFCOs to enter into indemnification agreements with applicants. Counties and cities are already empowered to enter into, and require, indemnification and routinely do so with respect to discretionary land-use approvals. SB 1209 will provide LAFCOs with a similar authority in this situation.

"This bill is in response to a 2022 decision of the Second District Court of Appeals, which found that existing State law does not provide LAFCOs with the explicit authority needed to require indemnification. Absent an indemnification authority - and because LAFCO funding is statutorily required in a specified ratio from the county, cities, and special districts within a county - any costs to defend litigation end up being absorbed by a LAFCO's funding agencies. Consequently, SB 1209 will allow LAFCOs to use indemnification agreements, similar to those already in use by counties and cities in land use applications which, in turn, will prevent some costs to defend litigation from being shifted to a county, its cities, and its special districts."

- 9) **Arguments in Opposition.** According to the California Association of Resource Conservation Districts, “RCDs are special districts created by Division 9 of the Public Resources Code in which the Legislature declared RCDs legal subdivisions of the state. The services provided by RCDs are largely funded by state and/or federal grants, which also serve as the main fund source for RCDs’ basic administration costs. Most RCDs receive little to no local tax dollars to support RCD functions and the indemnification and defense requirements that may be imposed by SB 1209 are simply financially infeasible for most RCDs. Accordingly, many RCDs would be incapable of seeking sphere of influence changes or latent power activations that may be necessary to implement critical climate resilience and adaptation projects.

“CARCD is aligned with the LAFCO mission to discourage urban sprawl, preserve open space and prime agricultural lands and we appreciate that LAFCOs are being requested to approve requests that are antithetical to this mission. We agree with the intent of SB 1209 to shield LAFCO decision-making from lawsuits, or the threat of lawsuits, that would force LAFCOs into approving projects that allow for new developments on lands that should be protected or restored. However, we strongly disagree with the premise of SB 1209 being applied to RCDs. We believe the intentions of SB 1209 have some merit but apply too broadly and will cause serious harm to RCDs across the state.”

REGISTERED SUPPORT / OPPOSITION:

Support

California Association of LAFCOs [SPONSOR]

Alameda LAFCO

Butte LAFCO

Contra Costa LAFCO

Del Norte LAFCO

El Dorado LAFCO

Fresno LAFCO

Inyo LAFCO

Los Angeles County

Los Angeles LAFCO

Madera LAFCO

Marin LAFCO

Mendocino LAFCO

Merced LAFCO

Monterey LAFCO

Napa LAFCO

Nevada LAFCO

Orange LAFCO

Placer LAFCO

Riverside LAFCO

Sacramento LAFCO

San Francisco LAFCO

San Joaquin LAFCO

San Luis Obispo LAFCO

San Mateo LAFCO

Santa Barbara LAFCO
San Bernardino LAFCO
Santa Clara LAFCO
Shasta LAFCO
Solano LAFCO
Sonoma LAFCO
Stanislaus LAFCO
Tulare LAFCO
Yolo LAFCO

Opposition

California Association of Resource Conservation Districts

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