

Date of Hearing: May 4, 2016

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT

Susan Talamantes Eggman, Chair

AB 2471 (Quirk) – As Introduced February 19, 2016

**SUBJECT:** Health care districts: dissolution.

**SUMMARY:** Requires a local agency formation commission (LAFCO) to order the dissolution of a healthcare district without an election, if the healthcare district meets specified criteria. Specifically, **this bill:**

- 1) Requires a LAFCO to order the dissolution of a healthcare district without an election, if the healthcare district meets all of the following criteria:
  - a) The healthcare district does not currently receive a property tax allocation;
  - b) The healthcare district has substantial net assets; and,
  - c) The healthcare district does not provide a direct healthcare service.
- 2) Requires the dissolution, if a LAFCO orders the dissolution of a healthcare district subject to 1) above, to be subject to the provisions for winding up the affairs of a dissolved district, pursuant to existing law.
- 3) Provides the following definitions:
  - a) "Direct healthcare service" to mean the ownership or operation of a hospital, medical clinic, wellness center, or ambulance service.
  - b) "LAFCO" to mean the commission in whose sphere of influence the healthcare district exists.

**EXISTING LAW:**

- 1) Establishes the procedures for the organization and reorganization of cities, counties, and special districts under the Cortese-Knox-Hertzberg Local Reorganization Act of 2000 (Act).
- 2) Defines "dissolution" to mean the dissolution, disincorporation, extinguishment, and termination of the existence of a district and the cessation of all its corporate powers, except as the LAFCO may otherwise provide, pursuant to existing law, or for the purpose of winding up the affairs of the district.
- 3) Defines "sphere of influence" to mean a plan for the probable physical boundaries and service area of a local agency, as determined by LAFCO.
- 4) Provides any resolution adopted by LAFCO on or after January 1, 1986, ordering the dissolution of a healthcare district is subject to confirmation by the voters.

**FISCAL EFFECT:** None

**COMMENTS:**

- 1) **Healthcare Districts.** Near the end of World War II, California faced a severe shortage of hospital beds. To respond to the inadequacy of acute care services in the non-urban areas of the state, the Legislature enacted the Local Hospital District Law, with the intent to give rural, low-income areas without ready access to hospital facilities, a source of tax dollars that could be used to construct and operate community hospitals and health care institutions in medically underserved areas, to recruit physicians and support their practices. The Local Hospital District Law (now called the Local Health Care District Law) allowed communities to create a new governmental entity, independent of local and county jurisdictions that had the power to impose property taxes, enter into contracts, purchase property, issue debt, and hire staff. In general, the process of creating a hospital district started with citizens in a community identifying the need for improved access to medical care.

According to the Association of California Healthcare Districts, there are currently 78 districts, of which three have stand-alone skilled nursing facilities; 54 are rural; 34 hospitals, 20 of which are critical access; and, five have stand-alone clinics. These institutions provide a significant portion of the medical care to minority populations and the uninsured in medically underserved regions of the state and are mainly funded by Medicare, Medi-Cal, and district tax dollars.

- 2) **LAFCOs and District Dissolution.** LAFCOs are responsible for coordinating logical and timely changes in local governmental boundaries, conducting special studies that review ways to reorganize, simplify, and streamline governmental structures, and preparing a sphere of influence for each city and special district within each county. The courts refer to LAFCOs as the Legislature's "watchdog" over local boundary changes. The Act establishes procedures for local government changes of organization, including special district dissolution. LAFCOs regulate boundary changes through the approval or denial of proposals by other public agencies or individuals for these procedures.

The Act prescribes a process for the dissolution of special districts, which is similar to most boundary changes that require numerous steps: a) Initiation of LAFCO process, by petition of property owners or registered voters in the district or resolution of an affected agency; b) Noticed public hearing, testimony, and approval or disapproval by LAFCO; c) Additional public hearing for protests and in specified cases LAFCO must order an election on the proposed dissolution; d) Dissolution election, if required, among district's voters, which requires a majority vote approval; and, e) LAFCO staff files documents to complete the dissolution.

AB 912 (Gordon), Chapter 109, Statutes of 2011, created an expedited process for the dissolution of special districts. Under this expedited process, if the proposed dissolution is initiated by the special district's board and dissolution is consistent with a prior action of LAFCO regarding a special study, sphere of influence, or municipal service review, LAFCO can order dissolution without protest or election. If the dissolution was initiated by an affected local agency, LAFCO, or petition, LAFCO must hold a public hearing to consider protest, and if there is no majority protest LAFCO, must order the dissolution without an election. Existing law also requires that a resolution adopted by LAFCO ordering the dissolution of a healthcare district to be subject to confirmation by the voters. Due to this provision and the expedited dissolution process put in place by AB 912, there is some

ambiguity in existing law about a LAFCO's ability to order the dissolution of a healthcare district without an election.

- 3) **Bill Summary.** This bill requires a LAFCO to order the dissolution of a healthcare district without an election, if the healthcare district meets specified criteria. The criteria established by this bill would require the dissolution of a healthcare district that a) does not currently receive property tax; b) has substantial net assets; and, c) does not own or operate a hospital, medical clinic, wellness center, or ambulance service. The criteria established by this bill only currently apply to one district – Eden Township Healthcare District (District). This bill is sponsored by Alameda County.
- 4) **Author's Statement.** According to the author, "With the right focus of delivering direct health services and/or providing substantial financial support to various healthcare providers and organizations in a community, healthcare districts have the potential to improve and promote the health status of underserved communities. Yet, there are significant variations in the way healthcare districts operate and the rules that govern them. Due to this, many healthcare districts still exist that no longer own a hospital or provide any direct healthcare services to the community and therefore, may not be fulfilling their original intent and commitment to the residents of the district.

"For example, in Alameda County, Eden Township Healthcare District (ETHD) does not provide any direct healthcare services. Their revenue source is mostly derived from commercial property rental income which, along with cash and securities, has a net value of \$45.6 million. In 2015, ETHD spent 85% of its budget on administrative expenditures, such as salaries, benefits, utilities and other professional services, while only disbursing 15% of their budget on grants to service providers and sponsorships. Furthermore, ETHD pays less than half of 1% of its annual net assets towards charitable activities. AB 2471 will order the dissolution of a health care district without an election when it meets all of the following criteria... Currently ETHD in Alameda County is the only healthcare district that meets these criteria."

- 5) **Eden Township Healthcare District.** According to Alameda County Local Agency Formation Commission's (LAFCO) 2012 municipal service review (MSR), the District was established by the voters in 1948 to finance construction of Eden Hospital, which opened in 1954. In 1998, the District transferred all of the net operating assets and operations of the hospital to Sutter Health. In 2004, the District purchased San Leandro Hospital and leased it to Sutter Health. In order to comply with seismic safety laws, the District entered into an agreement with Sutter Health to replace Eden Medical Center. The agreement also gave Sutter the option to purchase San Leandro Hospital. On December 21, 2011, an appellate court ruled in favor of Sutter in litigation over the terms of the 2008 agreement. On October 31, 2013, Sutter transferred San Leandro Hospital to the Alameda Health System, the public health authority that operates Alameda County's health care system.

Currently, the District provides grant funding to health-related organizations through a Community Health Fund and owns three office buildings, where it leases office space to healthcare providers. The District does not receive any property tax, special tax, or benefit assessments. The main source of revenue is rental income. The District consists of 130 square miles and includes the City of San Leandro, most of the City of Hayward, and the

unincorporated areas of Castro Valley and San Lorenzo, and is governed by a five-member board of directors elected to four-year terms.

Alameda LAFCO's MSR identified three governance structure options for the District: a) Annexation of the City of Dublin by the District; b) dissolution; or, c) consolidation with Washington Township Healthcare District. The MSR found that while the District no longer owns and operates a hospital, it is premature to dissolve the District, pointing to the grant funding, leased office space, and an indication from the District of their willingness to provide direct services in the future.

- 6) **Controversy and Subsequent Legislation.** Recent controversy surrounding several healthcare districts has brought greater media and legislative scrutiny on several issues, including their fiscal management. The Assembly Committee on Accountability and Administrative Review conducted several hearings regarding healthcare districts, and focused specifically on healthcare districts that do not operate hospitals. Additionally, the Legislative Analyst Office (LAO) produced a report entitled, "Overview of Health Care Districts", in April 2012 in response to several healthcare districts that have declared bankruptcy since 2000. There have also been concerns regarding districts maintaining reserve balances in the tens of millions of dollars. For example, Peninsula Health Care District and Beach Cities Health District have each reported over \$45 million in unrestricted net assets (reserves) at the end of June 2011.

Additionally, according to the LAO report, several LAFCOs have considered dissolving districts. Five districts have been dissolved or otherwise reorganized since 2000. Since that time, the Contra Costa County LAFCO consolidated Mount Diablo Healthcare District into the City of Concord. The Mount Diablo Healthcare District did not operate a hospital and similar concerns were expressed about the amount of revenue spent on administrative costs, instead of on grant funding for community health needs. Contra Costa LAFCO is currently undertaking a special study to examine governance options, including dissolution, for West Contra Costa Healthcare District. Sonoma LAFCO is also in receipt of an application to begin the dissolution process for a healthcare district.

A Bureau of State Audits' (BSA) audit of Salinas Valley Memorial Health Care System found that the District's Board violated open meeting laws to grant overly generous compensation, retirement, and benefits to the chief executive officer. This Committee heard several bills addressing the employment contract between a healthcare district and hospital administrator, including AB 2115 (Alejo) of 2012; AB 2180 (Alejo), Chapter 322, Statutes of 2012; and, AB 130 (Alejo), Chapter 92, Statutes of 2013.

AB 2418 (Gordon and Dickinson) of 2012 would have required healthcare districts to expend 95% of any property tax revenue on current community healthcare benefits.

- 7) **Prior Bills that Established a Modified LAFCO Process.** In the past several years, the Legislature has established a modified LAFCO process or exempted specified requirements in the LAFCO process for the formation and consolidation of several special districts following a history of failed attempts at the local level including, AB 2453 (Achadjian), Chapter 350, Statutes of 2014, for the creation of the Paso Robles Water District; AB 3 (Williams), Chapter 548, Statutes of 2015, for the formation of the Isla Vista Community Services District; and, AB 1232 (Huffman), Chapter 518, Statutes of 2010, for the

consolidation of the Sewerage Agency of Southern Marin and its member districts, after notice and hearing, but without protest hearings.

- 8) **Related Legislation.** AB 72 (Bonta) of 2015, on the Senate Inactive File, would have authorized the District, until January 1, 2026, to impose special taxes within the District, subject to the approval of two-thirds of the District's voters.

AB 2737 (Bonta), pending in the Assembly Appropriations Committee, would require specified healthcare districts to spend at least 80% of their annual budget on community grants awarded to organizations that provide direct health services, and would prohibit more than 20% of their annual budget to be spent on administrative expenses. The parameters of AB 2737 were also established to address the District.

- 9) **Policy Considerations.** The Committee may wish to consider the following:

- a) **Limiting LAFCO Powers.** The Legislature has delegated the power to control local boundaries to the 58 LAFCOs. This bill bypasses LAFCO, and does not require the usual dissolution process to occur. This Committee has seen an increasing number of bills seeking to bypass the LAFCO process, therefore, the Committee may wish to consider if this bill is going against prior directives from the Legislature that designated fundamental powers to LAFCOs to make these types of decisions. The Committee may wish to ask the author why the current LAFCO process is not a viable option for the dissolution of the District and why this bill is necessary.

Opposition argues that this bill disregards prior actions taken by Alameda LAFCO pertaining to the District. Alameda LAFCO determined the District still has an indirect role in the provision of healthcare services within its existing boundaries. If the author does not agree with prior LAFCO actions or determinations regarding the District, the Committee may wish to consider if the LAFCO should be reexamined and altered as opposed to eliminating LAFCOs discretion outright.

- b) **Voter Involvement.** The dissolution process under LAFCO contains a number of required steps that allow for public involvement. For example, the voters have the opportunity to weigh in at a publicly noticed hearing, register their protest, and when enough protest is received, vote in an election. The Committee may wish to consider that this bill denies the voters the opportunity to weigh in on the dissolution of a district that was created by the voters.
- c) **Statewide Approach.** The Committee may wish to consider, while the criteria established by the bill is aimed at Eden Township Healthcare District, this bill applies statewide to any healthcare district that fits the criteria established by this bill. Because this bill prevents LAFCO and the public from weighing in on the question of dissolution, the Committee may wish to consider if statewide application is appropriate.
- d) **Healthcare Districts and LAFCO.** The relationship between LAFCOs and healthcare districts is unique in comparison to other special districts. The Local Healthcare District Law and the formation of some healthcare districts predate the Knox Nisbet Act, which created LAFCOs and formalized the process for establishing a hospital district. Due to the unique nature of healthcare services and the long history of healthcare district's principal act, the Committee may wish to consider if there is a need to more clearly

define the relationship between LAFCOs and healthcare districts, and undertake a closer examination of healthcare districts' service boundaries, the process of dissolution for healthcare districts, and the considerations LAFCOs are required to make when doing an MSR and determining the sphere of influence for healthcare districts.

- e) **Definitions.** Local agencies, not LAFCOs, have a sphere of influence; therefore, the Committee may wish to encourage the author to correct the definition in the bill for LAFCOs. Further, opposition argues that the bill does not define "substantial net assets" and leaves open the opportunity for wide interpretation.

10) **Committee Amendments.** In light of the considerations raised above, the Committee may wish to ask the author to take the following amendments:

- a) Narrow the scope of the bill down to Eden Township Healthcare District.
- b) Specify that the bill's provisions apply to Alameda LAFCO to order the dissolution of Eden Township Healthcare District if specified criteria in the bill are met.
- c) Require Alameda LAFCO to review compliance with AB 2737 (Bonta) and with all criteria in the bill.
- d) Add to the list of criteria that the District does not comply with AB 2737 (Bonta).
- e) Insert the expedited dissolution process pursuant to AB 912 (Gordon), if the criteria established by the bill are met, which would require Alameda LAFCO to hold at least one noticed public hearing, and after conducting protest proceedings, order an election only if majority protest is registered.

11) **Arguments in Support.** Supporters argue that the criteria for dissolution included in AB 2471 will dissolve healthcare districts in California that are no longer serving their original purpose when approved by the voters of the district. Supporters argue that this bill is very narrow, and therefore, would not affect the vast majority of healthcare districts in California who are continuing to service their communities, as promised.

12) **Arguments in Opposition.** Opposition argues that the existing local process should be fully utilized before resorting to state action. Opposition suggests amendments to address the process of dissolving a healthcare district without voter approval, but incorporates a local LAFCO process that provides an opportunity for community input.

**REGISTERED SUPPORT / OPPOSITION:**

**Support**

Alameda County [SPONSOR]

**Opposition**

Alameda Local Agency Formation Commission

Association of California Healthcare Districts (unless amended)

California Association of Local Agency Formation Commissions (unless amended)

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