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Transforming Local Governments

An Introductory Guide to Municipal Restructuring

INTRODUCTION/EXECUTIVE SUMMARY

Keeping up with rising personnel and operational costs while struggling to maintain fiscal solvency has forced many public agencies to rethink how municipal services are both provided and paid for. Beyond increasing internal efficiencies, through the implementation of a variety of creative and cost-saving programs, many local agencies in Orange County have also challenged the traditional paradigm of agencies solving problems within their own boundaries. Instead, they have successfully partnered with other agencies next door and across the County to increase efficiency and lower service costs.

Other agencies in California have faced more dire fiscal scenarios and have opted for legally restructuring their current operations through a variety of other strategies, including dissolution, merger, consolidation, disincorporation, activation of “latent powers,” and bankruptcy. How do these different options actually work? Which alternatives, if any, should be considered for my agency? What are the pros and cons of each? What role does LAFCO have, if any, in the implementation of these restructuring options?

“Gentlemen, we have run out of money. Now it’s time to think.”

Winston Churchill
A Resource Tool for the Public and Public Agencies

This introductory guide was developed as a resource tool to the public and public agencies and describes, in layman’s terms, options for operational restructuring of both cities and special districts. The guide is intended as an overview only, and is not exhaustive in its evaluation of each alternative. The procedures for dissolutions, mergers, consolidations, disincorporations and bankruptcies are legally and procedurally complex and may take various forms not presented in this guide. Interested agencies must work with their own legal counsel and local LAFCO to further research the requirements of their specific restructuring proposal to ensure that the appropriate procedures are followed.

Report Organization

The report is divided into two major sections: Management Options and Restructuring Options. The Management Options section primarily addresses successful cost-saving programs implemented by Orange County cities and special districts, including regional collaboration efforts and implementing shared services programs. The second section, Restructuring Options, focuses on formal governance restructuring options for public agencies that can legally change an existing agency’s boundary, function, responsibility, and/or financial obligations. These changes, which require some form of outside approval, (e.g., LAFCO, affected special districts/cities, the County and/or the courts) include consolidation, merger, dissolution, disincorporation, activation of an agency’s latent powers and bankruptcy.
MANAGEMENT OPTIONS

Each day, local agencies face an ongoing challenge to provide efficient and effective levels of municipal services to over three million Orange County residents. While some believe that the worst of the “Great Recession” is behind us, many Orange County agencies still endure considerable fiscal obstacles as they struggle to maintain a balanced budget and provide quality services to their residents. Many agencies have gone beyond the traditional “quick fix” (e.g., staff layoffs, cutting programs, reducing levels of services, borrowing from reserves, etc.) and have supplemented their budget-stretching strategies with some unique and creative ways to increase revenues and control expenses through regional collaboration efforts and sharing services. Many of these efforts have the potential to be replicated by other agencies within Orange County.

Innovative Management Options
Orange County is the home of 34 cities and 27 special districts led by forward-thinking leaders. During the latest economic downturn, many of these local agencies viewed this “new normal” as an opportunity to reevaluate their internal functions. As a result, innovative management options were developed and implemented in agencies across the County. These “outside the box” ideas often resulted in significant cost savings of taxpayer dollars.

In addition to individual accomplishments, there has been a surge in added-value from local agency participation in regional organizations such as the Association of California Cities – Orange County (ACCOC) and the Independent Special Districts of Orange County (ISDOC). These regional collaborations offer opportunities to educate local government leaders, promote good public policies, share ideas and explore creative solutions to pressing government issues. The following provides recent examples of how Orange County agencies have introduced new, innovative management options¹ and discusses the benefits from regional partnerships.

City of Buena Park: Establishing New Policies for Use of State Funds
The City of Buena Park established a policy to earmark funds returned from the State due to the elimination of redevelopment for economic development purposes. The City as a taxing entity received a one-time payment of approximately $3.3 million and will continue receiving an estimated $1.2 million per year in “residual” property taxes. The City agreed to set aside the entire $1.2 million plus half of the residual ($600,000) to assist in the funding of new

¹ Information courtesy of the Association of California Cities – Orange County
development, public improvements and the promotion of tourism, rather than applying the funds to ongoing operating costs.

City of Costa Mesa: Implementing Intra-department Collaborations
The City of Costa Mesa established a Neighborhood Improvement Task Force consisting of representatives from a variety of City and County departments (police, fire, code enforcement, health care, etc.) to develop and implement a multi-pronged strategy to tackle some of the City’s most stubborn problems, including homelessness, high-crime motels, problem properties and neighborhood safety. The short-term result has been an overall improvement in the overall condition of the City’s parks, an increase in the use of homeless services and more property owners in compliance with City codes.

Cities of Laguna Beach and Rancho Santa Margarita: Selling Rule 20A Credits
The California Public Utilities Commission (“CPUC”) sets Rule 20 policies and procedures for the conversion of overhead power lines and other equipment to underground facilities, a process called "undergrounding." Southern California Edison (“SCE”) allocates funding credits for such projects to local cities. In most cases, SCE supports undergrounding because it provides substantial aesthetic benefits to local communities.

In 2010, the City of Laguna Beach desired to undertake a utility undergrounding project but did not have sufficient funding. In contrast, the City of Rancho Santa Margarita (“RSM”) had almost $800,000 in undergrounding credits, but no feasible projects in the foreseeable future. RSM staff, knowing that SCE allows cities to transfer their unused Rule 20 credits to other cities, approached Laguna Beach and offered to sell the City its unused credits.

Following informal staff negotiations, Laguna Beach offered to buy RSM’s credits for 55 cents on the dollar. The result was a “win-win” for both cities – providing Laguna Beach with a discounted cost for the purchase of credits needed to pursue their undergrounding project and RSM with an infusion of General Fund cash.

City of Laguna Niguel: Streamlining Cell Site Approvals
The City of Laguna Niguel has developed and implemented an administrative process to allow cell sites to be located within the public right-of-way. The City Council approved a master lease agreement and established acceptable design standards and locational criteria. If a wireless carrier proposes a facility consistent with those provisions, both the lease and the design can be approved administratively. As part of the process, the City retained the services of a wireless consultant to help develop the design guidelines with the wireless industry. In the end, the city council, wireless industry representatives and the public were in full support of the approach.
The administrative process has resulted in significant time and money savings for the wireless applicants in securing leases and entitlements. The creation of cell sites within the public right-of-way also creates a new long-term revenue source for the City. The City has entered into 19 leases to date which will generate approximately $250,000 per year in General Fund revenue. The implementation of wireless sites thought the community also improves system capacity and reliability in the event of an emergency.

**City of Orange: Changing up the TEAM**

In late 2011, Orange’s top managers were called together for a brainstorming meeting to discuss some hard truths facing their city: a severe economic downturn, the current hiring freeze and related vacancies, institutional knowledge loss through several key staff retirements, and the impacts of concession-based labor negotiations, among others. The group formed a new leadership group called TEAM (Together Enhancing, Advancing and Motivating). TEAM was successful in re-energizing senior management within the City to aggressively and enthusiastically tackle these and many other pressing financial and organizational issues facing the City. In the end, the efforts of TEAM have resulted in a better trained, informed, leaner and more motivated workforce and a stronger leadership team that will serve the City well long into the future.

**City of Santa Ana: Partnering for Public Safety**

The City of Santa Ana is one of the largest cities in Orange County. The City’s highest priority is to provide and deliver public safety services to a population of over 350,000 as well as its business community. In an effort to continue to provide quality public safety services while cutting costs, the City recently partnered with the Orange County Fire Authority (OCFA) to provide city-wide fire and emergency medical services. The partnership involved the reduction of 272 full-time positions. It is expected to result in a savings of approximately $10 million annually for the City.

**City of Tustin: Waiving Fees to Improve Tustin**

On July 19, 2011, the City Council enacted the “Construction and Business License Fee Waiver Policy” to attract new businesses, retain existing businesses, and encourage improvements to residential and non-residential structures. The program allowed for the waiver of fees up to a total of $750,000 ($400,000 for building plan check and permits, and $350,000 for business licenses). The program was in effect during the 2011-2012 Fiscal Year or until the maximum waiver was reached, whichever occurred first.
**City of Westminster: Utilizing County Operations**
State law allows the County to contract with public agencies whenever it is economical and satisfactory to do so, which includes leasing equipment, performing various services, or furnishing goods for any district or municipal corporation within the County. With over 20 active cooperative agreements with public agencies, the County of Orange recently entered into a five-year contract with the City of Westminster to provide water billing and payment processing services for the City over the next five years (2013-2018). The City projects a savings of approximately $71,000 annually, while the County expects to receive revenue of approximately $17,000 per year.

**Orange County Fire Authority: Pulling the Trigger on Salary Increases**
In 2010, OCFA management requested concessions from all three of its labor groups. Labor agreed and as a result, a new “Trigger Formula” was approved to determine if, and when, future salary increases would be provided. The Trigger Formula required that specific OCFA fiscal health criteria be met first, with fiscal health encompassing a balanced General Fund budget and satisfaction of all OCFA reserve fund requirements prior to the granting of salary increases.

With approval of the Trigger Formula, the Board retained the right to determine service levels and associated expenditures in its adoption of the annual budget. As a result, if OCFA's revenues increased in its annual budget, and if a simultaneous service increase was needed to meet the needs of the communities served, the Board could approve that service increase. This could also prevent salary increases from being triggered. During the most recent contract negotiations, all OCFA labor groups supported the Trigger Formula, which was ultimately approved by the OCFA Board of Directors.

**Orange County Transportation Authority: Lowering Pension Obligations**
In 2012, OCTA implemented a pension-reform plan for existing administrative employees that will phase in employees paying 100 percent of their share of pension costs by January 1, 2017. The resulting pension cost savings will result in taxpayers saving $8.2 million over the next four years and $85 million during the next 20 years.

**Santa Margarita Water District: Going Paperless and Saving Agency Dollars**
In 2012, Santa Margarita Water District implemented a new information management system in its water quality laboratory that has produced remarkable operational efficiencies. The Hach Water Information Management System (WIMS) is a software program that combines data from 4,600 water testing variables into a central, secure database – optimizing water operations. Combining the WIMS with personal tablet devices (iPads) has provided the tools
needed for electronic reporting, analysis, and monitoring. This has eliminated the need for hand calculation checks by staff and redundant data entry.

The new software has streamlined SMWD’s water laboratory operations saving thousands of dollars each year in staff and reporting expenses. With this new system, SMWD’s water lab became the first paperless water testing laboratory in the United States, eliminating the need to print hundreds of pieces of paper each month. This private sector approach of utilizing technology to improve operational efficiency has freed up approximately 20 employee hours per month and will save the District $15,000 to $20,000 per year.

Other Management Options – Local Partnerships
In the past few years, many Orange County agencies have worked together to explore new ways to deliver municipal services through partnerships with neighbor agencies. Regional partnerships such as the Community Association of Rancho (CAR) in South Orange County and the North Orange County Coalition of Cities (NOCC), for example, have become successful models where municipal agencies have banded together to save money, increase efficiency in municipal service delivery, purchasing and contracting, and improved the quality of life for Orange County residents. Some of these partnerships are described below.

Association of California Cities – Orange County (ACCOC)
The Association of California Cities – Orange County (ACC-OC) was formed 2011 to serve as the hub for good public policy in Orange County. Through its numerous policy committees, the 501(c)(3) non-profit organization achieves impactful and tangible public policy ideas and solutions through a “from the ground up” and collaborative model. This approach recognizes that partnering with the academic, non-profit and private sectors helps to ensure that the best ideas are generated as part of a comprehensive and consensus-based process. To date, the organization’s best practices and policy solutions have resonated across the region and beyond, helping cities save money, operate more efficiently and serve the public as effectively as possible. Most importantly, these ideas are generated locally and respect the individuality of all OC cities and local governments.

Community Association of Rancho (CAR)
The Community Association of Rancho (CAR) was established in 2005 and consists of seven homeowners’ associations, the City of Rancho Santa Margarita, the Trabuco Canyon Water District, and the Santa Margarita Water District.

CAR was born out of an issue that the City was mandated to comply with, which in turn significantly impacted the HOA. The partnership then expanded to
address other local HOAs. For eight years, the group has been partnering on joint projects including infrastructure improvements, disaster preparedness, public safety and land use. The CAR stakeholder group represents a successful collaboration of private and public agencies.

**Independent Special Districts of Orange County (ISDOC)**
The Independent Special Districts of Orange County (ISDOC) is a membership association that represents the interests and provides advocacy on behalf of Orange County’s independent special districts. ISDOC was formed more than 30 years ago to serve the needs of Orange County’s water, wastewater, sanitary, cemetery, vector control, library, recreation and parks, and other districts that provide specialized services within their communities. The ISDOC Executive Committee guides the association and meets monthly. ISDOC membership meetings are held on a quarterly basis to provide a forum for its special district members to meet and discuss issues and share information of mutual interest.

**North Orange County Coalition of Cities (NOCC)**
Recognizing the changing fiscal landscape and growing service demands affecting service providers, city managers from seven Orange County cities (Brea, Yorba Linda, Buena Park, Fullerton, La Habra, Placentia and Orange) formed the North Orange County Coalition of Cities (NOCC) in 2009. The NOCC began meeting regularly to collaborate on various ways to increase their agencies’ collective efficiencies, including service sharing opportunities. What started out as a group of enlightened city leaders meeting informally to evaluate service delivery alternatives, has resulted in significant successes.

NOCC has implemented a joint Capital Improvement Plan (CIP) data base which identifies capital improvement projects on a regional basis. North Orange County cities are using this data base to identify infrastructure projects in the same geographic area. This approach often allows for joint-city contractor bids, a reduction in construction costs, and limits disruption for residents. NOCC was also instrumental in the implementation a joint fire command system between the Cities of Brea and Fullerton which has resulted in significant cost savings for both cities without a reduction in services. Currently, NOCC is preparing a fiscal study analyzing potential sharing of law enforcement services between four of the NOCC member cities.

**OC LAFCO’s Community Islands Task Force**
For over 10 years, cities, special districts, the County and LAFCO have worked together to provide efficient levels of services to the remaining unincorporated
areas in Orange County. The ongoing collaboration has led to the transition of unincorporated territory to city jurisdictions through the annexation of over 40 islands, totaling an estimated 30,000 acres. During the most recent efforts, LAFCO partnered with the County and four cities (La Habra, Placentia, Newport Beach, and Stanton) to form the Community Islands Task Force (CTF) – a group dedicated to heightening awareness of the associated issues and benefits of annexation for the remaining unincorporated islands.

Through the leadership and participation of these agencies, the CTF effort looks beyond annexation and includes a framework for exploring alternative methods to align the interests of the County, cities, and residents and create “whole and healthy” communities regarding municipal service delivery. Going forward, these collaborative efforts may result in the efficient delivery of municipal services to all Orange County residents.

**OC LAFCO’s Shared Services Program**
One of LAFCO’s State mandates is to evaluate the delivery of services by cities and special districts, and highlight potential collaborative opportunities. The Commission developed an innovative approach to fulfill this mandate through an online, web-based program. Initially, LAFCO utilized a stakeholder group consisting of County, city, and special district representatives to design the Shared Services Program.

Since 2011, Orange County agencies have utilized the program to increase communication and maximize current resources. As a result, a stakeholder group (Fleet Maintenance Working Group) initially consisting of 10 agencies (the County of Orange and multiple special districts and cities) was formed to discuss potential agency sharing of resources. Moving two years forward, the group has grown to 30 public agencies and the effort has resulted in cooperative agreements between agencies and discussions between other agencies have been initiated. The recent success stories, as shown in Attachment A, along with the ongoing interest in reducing operational expenses represent how sharing resources may lead to enhanced internal efficiencies and increased collaborations among public agencies.

In addition to the management options discussed above, there are instances where municipal agencies may want to consider legally restructuring their operations and/or service boundaries through a variety of reorganization strategies. The next section, “Restructuring Options,” discusses alternative restructuring alternatives and LAFCO’s role in their review and approval.
RESTRUCTURING OPTIONS

The restructuring options discussed in this section, if implemented, could result in significant change for a local agency, including altering its physical boundaries, service responsibilities, and/or governing boards. Other options could serve to allow an agency to restructure its finances or dissolve the agency’s operations entirely with its assets and responsibilities taken over by another agency. Implementation of each of these options is often complex – both fiscally and politically. To be successful, agency restructuring will require the participation and support of the affected agencies. Without agency cooperation, it is challenging, and often impossible, for LAFCO alone to restructure local governments.

All of the restructuring options discussed below - consolidation, dissolution, merger, disincorporation, activation of an agency’s latent powers and bankruptcy - require approvals by LAFCO, other agencies (e.g., cities, counties, and special districts) willing to take over services, and/or the Federal court system (municipal bankruptcy). The section below summarizes each of the six restructuring options, their strengths and potential complications, and the approval process for each (including a flow chart illustrating a step-by-step process). Following each section are examples of agencies that have implemented these restructuring options. A comparison summary sheet of all the reorganization options is also available on page 38.
CONSOLIDATION

What is it?
In 1986, following the consolidation of three major laws governing boundary changes, the State Legislature added a unified definition of “consolidation” to the Cortese-Knox Local Government Reorganization Act of 1985. Under the law, a consolidation means the joining of two or more cities into a single city or two or more special districts into a single district. The formal definition (Government Code Section 56030) is: “The uniting or joining of two or more cities located in the same county into a single successor city or two or more districts into a single new successor district.” Another restructuring option similar to consolidation is a merger, which occurs when a city assumes responsibilities of a special district. For more information on mergers, please refer to page 20.

Prior to January 1, 2005, only special districts formed pursuant to the same “principal act” (the laws under which the district was originally formed) could consolidate. Now, consolidation of two or more special districts not formed under the same principal act is permitted if certain procedures are followed.

When should it be considered?
Consolidating cities into a single city or consolidating special districts into a single district should be considered when consolidation would result in: overall long-term cost savings in the delivery of municipal services, elimination of duplicative administrative positions and overhead, increased operational efficiency, more efficient use of agency facilities, and/or a willingness of affected agencies to explore consolidation. Generally, the fiscal/operational evaluation of a potential consolidation is completed as part of a municipal service review (MSR), a sphere of influence (SOI) study of affected agencies by the local LAFCO, and/or through a detailed fiscal and operational study conducted by a special district or city.

What is the effect of consolidation?
Upon approval, the reorganized city or special district takes over all services within the combined territory of the consolidated agencies. Specifically, the consolidated special district or city assumes all the powers, rights, duties, obligations, functions and properties of the predecessor district or city which consolidated to form the new city or district. In addition, the consolidated agency becomes liable for all debts of the predecessor agency.

Consolidation, like any structural reorganization approved by LAFCO, is complex and has long-term political, financial and service-related implications for both local agencies and residents. Any agency reorganization must be thoroughly reviewed and evaluated by LAFCO, elected officials, affected agencies and the public to ensure that the proposed change will benefit residents over the long-term. Once approved, it can be difficult and costly to “undo” a structural reorganization.
What is the process for a consolidation? What is LAFCO’s involvement?

A consolidation can be initiated in the following ways:

- For special district consolidations:
  - A resolution of LAFCO
  - A resolution of application submitted by one of the independent special districts wishing to consolidate with another district.
  - A resolution of application submitted by two or more independent special districts.
  - A resolution of any affected agency
  - A petition signed by not less than 5% of the registered voters within each of the special districts wishing to consolidate (or not less than 5% of the number of landowners owning not less than 5% of the assessed value of land within each of the special districts).

- For city consolidations:
  - A petition of two or more cities signed by not less than 5% of the registered voters in each city.
  - A resolution of any affected agency

LAFCO may only initiate a consolidation of special districts if it is consistent with a recommendation or conclusion of certain studies prepared by LAFCO, including (but not limited to) a municipal service review analyzing existing agencies and spheres of influence in the service area under review. Prior to approving a consolidation, LAFCO is also required to make both of the following determinations:

- Public service costs of a proposal LAFCO is authorizing are likely to be less than or substantially similar to the costs of alternate means of providing the service.
- Consolidation promotes public access and accountability for community services needs and financial resources.

Once initiated, LAFCO staff is required to prepare an analysis of the proposed consolidation and conduct a noticed public hearing. After evaluating the staff report, staff recommendations and hearing public testimony, LAFCO may approve, modify, or deny the proposal. If it is approved, LAFCO may also adopt terms and conditions for the consolidation.

If approved by LAFCO, a special district or city consolidation is not required to be placed before the voters unless sufficient written protest has been filed with LAFCO during a specified “period of protest.” The amount of protest required to meet the threshold requiring an election varies depending on how the consolidation is initiated and whether the affected territory was uninhabited or inhabited.

What could make it work?

- Comprehensive studies by LAFCO, including but not limited to, municipal service reviews and sphere of influence studies, identifying cost and revenue impacts, accountability issues, and service levels under a consolidation proposal.
• Agencies willing to explore consolidation as a potential restructuring option.
• Cities or districts with shared communities of interest.
• If a consolidation results in stabilization of the tax base for affected agencies.
• Effective stakeholder working group processes exploring the pros and cons of consolidation.
• Clear, credible data and analysis for decision makers and residents.
• Opportunities for public review and comment.
• Time – structural reorganization of agencies may not happen quickly, but “seeds” can be planted through a public review/discussion of governance options and updated fiscal analyses that, over time, may ultimately result in positive change.
• Opportunity to dictate the number of board members within the new consolidated agency

What are potential obstacles?
• Difficult for elected city and special district representatives to give up authority and disband agencies.
• Challenging to find cities and special districts willing to consider consolidation.
• A consolidated district or city becomes liable for all debts of the predecessor district or city.
• Community identity: residents identify with their own city and district; change is difficult.
• Potential for reduced political accessibility and accountability.
• Concerns often arise that a city consolidation may impact residents’ property values and/or quality of life.
• Distrust by elected officials and residents of the fiscal and operational studies analyzing consolidation alternatives.
• Combining two special districts or cities may raise complex personnel issues, including staffing, compensation, salaries, benefits, and integration of retirement plans.
• Combining two special districts or cities that have different financial situations (e.g., one financially sound and one near fiscal collapse) can be challenging.

Successful consolidations in Orange County
  ➢ **April 2006** – Irvine Ranch Water District and Santiago County Water District Reorganization (RO 06-04)
  ➢ **September 2000** – Consolidation of the Irvine Ranch Water District and the Los Alisos Water District (DC 00-05)
  ➢ **October 1998** – South Coast Water District and Capistrano Beach Water District Consolidation (RO 97-18)
  ➢ **March 1998** – Coastal Municipal Water District-Municipal Water District of Orange County Consolidation (RO 97-06)
  ➢ **January 1998** – Consolidation of County Sanitation District Nos. 1,2,3,5,6,7,11,13 & 14 (DC 97-30)
Dissolution

What is it?
Dissolution applies to special districts only. When a special district is dissolved, it no longer exists. The formal definition (Government Code Section 56035) is: “Dissolution means the disincorporation, extinguishment, or termination of the existence of a district and the cessation of all its corporate powers except for the purpose of winding up the affairs of the district.” Dissolution (unlike “consolidation”) does not apply to cities. The parallel process for cities is called “disincorporation” and is discussed later in this report.

When should it be considered?
Dissolution of a special district should be considered: (1) when a district’s services are no longer needed, (2) when a district is experiencing financial distress and alternative service providers have been identified, (3) to eliminate overlapping responsibilities, and/or (4) to improve the efficiency and effectiveness of municipal service delivery to residents. Generally, this evaluation is done as part of a municipal service review (MSR), a sphere of influence (SOI) study of affected agencies by the local LAFCO, and/or through a detailed fiscal or operational study conducted by a special district or affected agency.

If LAFCO initiates dissolution of a district on its own, State law requires that the proposal be consistent with specified studies and recommendations, and LAFCO makes the following determinations with regard to the proposed dissolution:

- Public service costs of a proposal that LAFCO is authorizing are likely to be less than or substantially similar to the costs of alternate means of providing the service.
- Promotes public access and accountability for community services needs and financial resources.

What is the effect of dissolution?
If LAFCO approves a dissolution, the dissolved district is “extinguished” and all of its corporate powers cease except to wind up the affairs of the district or as required by a term or condition imposed on the dissolution by LAFCO. If the terms and conditions of the dissolution call for annexation of the district into a single existing district, the remaining assets of the dissolved district are distributed to the existing successor district. In addition to the general provisions, the Commission may also impose specific terms and conditions to the proposed dissolution, including the designation of a successor agency.

If the dissolution calls for annexation and distribution of remaining assets of a dissolved district into two or more existing districts, then the existing district containing the greater assessed value of all taxable property with the territory of the dissolved district becomes the successor district.
district. For dissolution without annexation, a city or county will become the successor agency for the district depending on which one contains the greatest assessed value of all taxable property within the territory of the dissolved district.

A successor agency collects the dissolved district’s assets and is empowered to wind up the business of the district – ensuring that all debts are paid, distributing assets and all other lawful purposes of the benefit of the lands, inhabitants and taxpayers within the territory of the dissolved district, as far as practicable.

Dissolution, like any structural reorganization approved by LAFCO, is complex and has long-term political, financial and service-related implications for both local agencies and residents. Any agency reorganization must be thoroughly reviewed and evaluated by LAFCO, elected officials, affected agencies and the public to ensure that the proposed change will benefit residents over the long-term. Once approved, it can be difficult and costly to “undo” a structural reorganization.

**What is the approval process for a dissolution? How is LAFCO involved?**

As a result of the Gotch Amendment (AB 1335) to the Cortese-Knox-Local Government Act of 1985, proposals to dissolve a special district may be initiated by LAFCO. The purpose of the Gotch Amendment was to consolidate overlapping districts into a more coherent system of local government or dissolve districts that have outlived their purpose.

Dissolutions can be initiated in four different ways:

- A resolution of LAFCO.
- Adoption of a resolution of application to LAFCO by any affected agency.
- A petition signed by not less than 10% of the registered voters within the district.
- A petition signed by not less than 10% of the number of landowners with the district who also own not less than 10% of the assessed value of land within the district.

Once initiated, LAFCO staff is required to prepare an analysis of the proposed dissolution and conduct a noticed public hearing. After evaluating the staff report, staff recommendations and hearing public testimony, LAFCO may approve, modify, or deny the proposal. If it is approved, LAFCO may also adopt terms and conditions for the dissolution.

If approved by LAFCO, a special district dissolution is not required to be placed before the voters unless sufficient written protest have been filed with LAFCO during a specified “period of protest.” The amount of protest required to meet the threshold requiring an election varies depending on how the dissolution was initiated and whether the affected territory was uninhabited or inhabited.
What could make it work?
- Comprehensive studies by LAFCO, including but not limited to municipal service reviews and sphere of influence studies, identifying cost and revenue impacts, accountability issues, and service levels under a dissolution proposal.
- Special districts willing to explore dissolution as a potential restructuring option.
- Effective stakeholder working group processes exploring the pros and cons of dissolution.
- Clear, credible data and analysis for decision makers and residents.
- Opportunities for public review and comment.
- Time – structural reorganization of agencies may not happen quickly, but “seeds” can be planted through a public review/discussion of governance options and updated fiscal analyses that, over time, may ultimately result in positive change.

What are potential obstacles?
- Change can be difficult for special districts and residents.
- Special districts providing services sometimes provide an “identity” for a community that residents fear may be lost if a special district is dissolved.
- Politically, it is often difficult for elected board members to disband their own agency.
- While quantifying fiscal impacts from a potential dissolution (whether positive or negative) can be fairly straightforward, it is more challenging to gauge the quality and level of services which will be provided by a successor agency.
- There may be challenges addressing personnel issues of district employees following dissolution, including employment absorption, continuation of health care benefits, compatible salary ranges, integration of retirement systems, etc.
- Although LAFCOs have the power to initiate dissolutions (with or without the consent of the district and the city), it is difficult politically for LAFCOs to do so without agreement from affected agencies.
- Since the passage of the Gotch Bill (AB 1335) in 1993, which gave LAFCOs the power to initiate dissolutions, only one LAFCO-initiated proposal in Orange County over the past 13 years has led to the dissolution of a special district.

Successful dissolutions in Orange County
- **March 2009** – Dissolution of County Service Area 25 (Aliso Viejo) (DS 08-06)
- **April 2005** - Laguna Niguel Community Services District Dissolution (DS 05-02)
- **December 1998** – Carpenter Irrigation District Reorganization to Irvine Ranch Water District (RO 98-04)
- **November 1984** – Detachment No. 84-1 from the Yorba Linda Library District (DS 84-06)
Restructuring Option
DISSOLUTION
Government Code Section (GCS) 56035

Initiation Process
GCS 56375, 56380, 56634, 56870, 56871

Resolution of LAFCO
Resolution of affected agency
Petition of registered voter or property owner

LAFCO Hearing

LAFCO Approval
If proposal consists of a single dissolution: Order without protest and election proceedings if initiated by subject agency

Initiated by LAFCO
Order without election, unless majority protest and is consistent with GCS 56378, 56425, or 56430 GCS 57077.1(b)(1)(A)
Order election regardless of subject agency protest and there is 10% or more protest within any subject agency GCS 57077.1(b)(3)

Order Dissolution, if less than majority voter approval GCS 57079
Order election, if 25% or more protest

Terminate proceedings, if less than majority voter approval GCS 57079

Order Dissolution, if less than 25% protest GCS 57077, 57203

Order subject to election if subject agency has not objected and there is 25% or more protest within any subject agency GCS 57077.1(b)(2)
Order subject to election if subject agency has objected and there is 25% or more protest within any subject agency GCS 57077.1(b)(2)

Order Dissolution, if majority voter approval GCS 57078

Terminated proceedings, if 50% or more protest GCS 57078

Conducting Authority

Not initiated by LAFCO
Order subject to election if subject agency has objected and there is 25% or more protest within any subject agency GCS 57077.1(b)(2)

Order election, if 25% or more protest

Order Dissolution, if majority voter approval GCS 57078

Terminated proceedings, if 50% or more protest GCS 57078

LAFCO Disapproval
Proceedings terminated (one year wait unless waived by LAFCO)
MERGER

What is it?
A merger occurs when a special district’s responsibilities and finances are taken over by a city. The formal definition (Government Code Section 56057) is: “The termination of the existence of a district when the responsibility for the functions, services, assets, and liabilities of that district are assumed by a city...” The term merger is sometimes confused with consolidation. There are distinct differences between the two – mergers can only occur between a city and special district. Consolidations, discussed on pages 12-15, combine two or more cities, or two or more special districts, into a single agency.

Prior to 1965, State law required that when an entire special district was included within the boundaries of a city (e.g., through annexation, incorporation or other reorganization), that special district was automatically “merged” into the city, thereby eliminating the special district. In 1965, the law was changed (“District Reorganization Act of 1965”) to require that all mergers be subject to LAFCO review.

When should it be considered?
Merging a district with a city should be considered when a district’s functions/operations can be more efficiently and effectively delivered by city over the long-term. Generally, this evaluation is done as part of a municipal service review (MSR) and sphere of influence (SOI) study of affected agencies by the local LAFCO, and/or through a detailed fiscal and/or operational study conducted by a special district or city.

If LAFCO initiates a merger of a special district with a city on its own, the law requires that the proposal be consistent with specified studies and recommendations and that LAFCO make the following determinations with regard to the proposed merger:

- Public service costs of a proposal that LAFCO is authorizing are likely to be less than or substantially similar to the costs of alternate means of providing the service.
- Promotes public access and accountability for community services needs and financial resources.

What is the effect of a merger?
On the effective date of the merger, the district ceases to exist and all district funds and all district property are vested in the city. The city becomes liable for all debts of the merged district. The city must use district funds and property to pay outstanding bonds and other obligations of the merged district. If any debts are to be paid from taxes levied on property in the district, the city council is required to collect those taxes as they become due as provided for under the principal act of the merged district. All funds that are unencumbered by debt
may be used for any lawful purpose by the city, however, the city, “so far as practicable,” must use those funds to benefit the land and inhabitants within the merged district area.

Merger, like any structural reorganization approved by LAFCO, is complex and has long-term political, financial and service-related implications for both local agencies and residents. Any agency reorganization must be thoroughly reviewed and evaluated by LAFCO, elected officials, affected agencies and the public to ensure that the proposed change will benefit residents over the long-term. Once approved, it can be difficult and costly to “undo” a structural reorganization.

**What is the approval process for a merger? How is LAFCO involved?**

Mergers are under the purview of the local LAFCO and can be initiated in four different ways:

- A petition filed by at least 5% of the registered voters living within the district or at least 5% of the registered voters living within the city (but outside the boundaries of the district).
- A petition filed by at least 5% of the number of landowners who own not less than 5% of the assessed value of the land within the district.
- A resolution by the legislative body of any affected district, school district, city or county.
- A resolution adopted by LAFCO.

Once initiated, LAFCO staff is required to prepare an analysis of the proposed merger and conduct a noticed public hearing. After evaluating the staff report, staff recommendations and hearing public testimony, LAFCO may approve, modify, or deny the proposal. If it is approved, LAFCO may also adopt terms and conditions for the merger.

If a merger is approved, LAFCO is required to set a “period of protest“ which allows affected cities, affected special districts, and registered voters an opportunity to file protest. If sufficient voter protest is received, or if an affected city or special district objects by resolution to the merger proposal, LAFCO is required to place the merger proposal before the voters. If insufficient written protest is received to require an election, the merger becomes effective as of the effective date specified in LAFCO’s resolution of approval.

**What could make it work?**

- Comprehensive studies by LAFCO, including but not limited to municipal service reviews and sphere of influence studies, identifying cost and revenue impacts, accountability issues, and service levels under a dissolution proposal.
- Special districts and cities willing to explore merger as a potential restructuring option.
- Effective stakeholder working group processes exploring the pros and cons of merger.
- Clear, credible data and analysis for decision makers and residents.
- Opportunities for public review and comment.
• Time – structural reorganization of agencies may not happen quickly, but “seeds” can be planted through a public review/discussion of governance options and updated fiscal analyses that, over time, may ultimately result in positive change.

• The establishment of a subsidiary district may result in the special district’s revenues remaining in the subject territory.

What are potential obstacles?

• Change can be difficult for cities, districts and residents.

• Special districts providing services sometimes provide an “identity” for a community that residents fear may be lost through merger with a city.

• Politically, it is often difficult for elected district board members to disband their own agency.

• Personnel issues, including the absorption of special district employees into city positions, employment benefits, integration of retirement systems and formulas, salary ranges, etc. can be complex.

• While quantifying fiscal impacts from a potential merger (whether positive or negative) can be fairly straightforward, it is more challenging to gauge how the quality and level of services could be impacted by a merger.

• Some believe that a special district’s distinct revenues (which are generally dedicated to a single category of services) will be diluted over time by city programs competing for revenue.

• The potential for reduced political accessibility and accountability can occur when a special district board is disbanded.

• Finding a city willing to take over a district with fiscal and/or service challenges may be difficult.

• Although LAFCOs have the power to initiate mergers (with or without the consent of the district and the city), it is difficult politically for LAFCOs to do so without agreement from both affected agencies.

Successful mergers in Orange County

- **September 1998** – Laguna Beach County Water District Reorganization to the City of Laguna Beach (RO 97-17)
- **September 1998** – City of San Juan Capistrano and Capistrano Valley Water District Reorganization (RO 96-15)
- **November 1993** – Capistrano Bay Park and Recreation District and City of Dana Point (RO 93-16)
Restructuring Option
MERGER
Government Code Section (GCS) 56057

Initiation Process
GCS 56650, 56653, 56654, 56864

Resolution of LAFCO
Resolution of affected agency
Petition of registered voter or property owner
(5% petition threshold)

Subject district adopts resolution of consent
GCS 56861

70 day wait period

LAFCO Hearing

Initiated by LAFCO
Not initiated by LAFCO

Order Election,
Election within affected territory if more than 10% protest and regardless of subject territory objection
GCS 57107, 57113

Order Election,
if subject agency has objected and there is 25% or more protest within subject agency
GCS 57107

Order Merger,
if subject agency has not objected and there is less than 25% protest within affected territory
GCS 57107

Order Merger,
if majority voter approval
GCS 57176

Terminate Proceedings,
if less than majority voter approval
GCS 57176, 57078

Subject district adopts resolution to file alternate proposal
GCS 56861

Terminate Proceedings,
if disapproved by LAFCO (one year wait period)
GCS 56884
DISINCORPORATION

What is it?
When a city is disincorporated, the municipal responsibilities are taken over by a successor agency which, in most cases, is the representing county. In some cases, however, services could most efficiently be assumed by a special district. Similar to dissolution which focuses on special districts, disincorporation addresses the termination of a city. For more information on mergers, please refer to page 16. The formal definition (Government Code Section 56034) is: “Disincorporation means the dissolution, extinguishment, or termination of the existence of a city and the cessation of its corporate powers, except for the purpose of winding up the affairs of the city.”

In California, 17 cities have disincorporated. However, since the formation of LAFCOs in 1963, only two cities have disincorporated – the City of Cabazon in 1972 and the City of Hornitos in 1973. Of these, it should be noted that Hornitos was disincorporated by State legislation and not through the LAFCO process. Cabazon went through the process described in Cortese Knox Hertzberg Local Government Reorganization Act of 2000. However, it was processed under a previous set of statutes. There has not been a disincorporation processed in California under current law.

LAFCOs throughout the State have identified shortcomings and ambiguity in the current laws governing the disincorporation process. OC LAFCO is taking the lead in forming an advisory group of LAFCO, county, city and legal representatives to develop and propose legislative changes to clarify the disincorporation process.

When should it be considered?
Disincorporation of a city is a complex and expensive restructuring option. Viewed by many as the option of last resort, no California city has disincorporated in over 40 years. Disincorporation should be considered if the subject city is experiencing significant, long-term revenue shortfalls, ineffective management, can no longer provide an adequate level of services to its residents, has identified a successor agency willing to take on its debts and service obligations, and has exhausted all other restructuring alternatives.

What is the effect of disincorporation?
If the voters approve the disincorporation, LAFCO is responsible for preparing a statement identifying the city’s debt, the balance in the city’s treasury, and the amount of any taxes and other payments due the city that have not yet been paid. Upon the effective date of the disincorporation, the successor agency (most likely the county) is responsible for winding up the affairs of the disincorporated city. The successor agency must utilize the assets of the city to pay off debt and other obligations. If there is insufficient money in the city’s treasury to pay any city indebtedness, the board of supervisors is required to continue to collect taxes from territory formerly within the city to help pay the city’s debts. Any funds remaining after all city
obligations have been paid are required to be transferred to school districts, community college districts or special districts within the boundaries of the former city. The law also allows use of excess funds to be used for the improvement of roads within the disincorporated territory. The distribution of these funds is at the sole discretion of the successor agency. A mechanism to identify the ongoing obligations may be required if insufficient assets remain for the successor agency to pay off city debt and obligations. The successor agency bears this additional financial burden.

**What is the approval process for a disincorporation? How is LAFCO involved?**

Disincorporation can be initiated through LAFCO by: (1) resolution of an affected agency (city, county or special district within the subject city) or (2) by petition of landowners or registered voters. Pursuant to Government Code Section 56765, the initiation of disincorporation by petition requires no less than 25% of the registered voters or landowners. Disincorporation cannot be initiated by LAFCO.

Proponents, as part of the filing materials for disincorporation, must submit a plan for services which identifies for the local LAFCO and the public the scope and level of services to be provided to the affected area. The plan should compare existing services to proposed services and levels to be provided by successor agencies, identify any discontinued services, evaluate the fiscal implications of disincorporation on all affected agencies, and address the disposition of city employees. Additionally, the associated California Environmental Quality Act (CEQA) document may be required to identify the impacts associated with the proposed disincorporation. Once initiated, LAFCO staff is required to prepare an analysis of the proposed disincorporation and conduct a noticed public hearing. After evaluating the staff report, staff recommendations and hearing public testimony, LAFCO may approve, modify, or deny the proposal. If it is approved, LAFCO may also adopt terms and conditions for the disincorporation.

LAFCOs have broad authority to include terms and conditions of any proposed disincorporation, which may include annexation of the subject territory to an adjacent city/district or the imposition of a new tax as part of the required voter approval of any disincorporation process. If disincorporation is approved by LAFCO, the County Board of Supervisors must submit the disincorporation proposal to the voters for confirmation. A simple majority determines the outcome of the measure unless new taxes are an element of the proposal. There is no protest hearing. All money paid into the county treasury pursuant to the disincorporation process is required to be placed in a special fund established for the purpose of settling the affairs of the disincorporated city.

**What could make it work?**

- Comprehensive studies by LAFCO, including but not limited to municipal service reviews and sphere of influence studies, identifying cost and revenue impacts, accountability issues, and service levels under a dissolution proposal.
- Effective stakeholder working group processes exploring the pros and cons of disincorporation.
• Clear, credible data and analysis for decision makers and residents.
• Opportunities for public review and comment.
• Agencies can utilize LAFCO municipal service reviews, sphere of influence studies and fiscal analyses to provide background data for disincorporation applications.
• Time – structural reorganization of agencies may not happen quickly, but “seeds” can be planted through a public review/discussion of governance options and updated fiscal analyses that, over time, may ultimately result in positive change.

What are potential obstacles?
• Disincorporation process is an expensive, complex process and requires a significant effort by the subject city and successor, both before and after disincorporation.
• Disincorporation cannot be initiated by LAFCO.
• The process has rarely been used, and its legal effect is not well understood. There has not been a disincorporation processed in California under current law.
• If initiated by petition, the signature threshold for disincorporation is the highest required by law – 25% of the registered voters or landowners.
• Disincorporation cannot eliminate or restructure debt.
• Proponents are required to demonstrate to LAFCO why disincorporation is the preferred course of action; if the underlying financial stressors are tied to a single event, such as a large legal judgment, bankruptcy could allow for a restructuring of obligations and might be a more advisable alternative.
• Disincorporation would require LAFCO to undertake a complex, detailed process of determining how to avoid unconstitutional impairment of contracts and to transfer services to the county (or other successor agency) in a way that would not unduly burden the county while continuing to provide essential services the residents of the former city.
• Personnel issues, including the disposition of city employees, benefit payouts, etc. can be complex.
• Disincorporation cannot impair the rights of any bondholder or creditor of any county, city or district.
• The disincorporation process allows the successor to impose new taxes to address any financial obligation within the city territory; however California’s Propositions 13, 62, and 218 require voter approval for any new taxes and may prevent the necessary funding source placing additional burden on successor agency.
• Current law does not specify how a distressed city pays the costs associated with the disincorporation process, including the LAFCO fees.
• Given the lack of precedent, any disincorporation might involve litigation over both its process and legal effect.

Examples of disincorporations in California
➢ 1973 – City of Hornitos (by statute)
➢ 1972 – City of Cabazon
➢ No disincorporation has been processed in California under current State law.
Restructuring Option
DISINCORPORATION
Government Code Section (GCS) 56034

Initiation Process
GCS 56650, 56653, 56654, 56764

Resolution of affected agency
Submittal of Plan of Services and identification of a successor agency

Petition of registered voter or property owner
(25% petition threshold)
Submittal of Plan of Services and identification of a successor agency

LAFCO Hearing

LAFCO Approval

Order Disincorporation subject to an election
GCS 57077, 57116

LAFCO Disapproval

Terminate Proceedings
(One year wait period unless waived by LAFCO)
GCSC 56884

Order Disincorporation, if majority voter approval

Terminate Proceedings, if less than majority approval
GCSC 57179
ACTIVATION OF LATENT POWERS

What is it?
When a special district is formed, its powers and responsibilities are determined by the “principal act” under which the district was formed and approved by LAFCO. “Active” powers are those that are actually being provided by a special district. “Latent” powers are those services that are authorized for the special district through its principal act but which have not been actively provided by the district. Pursuant to Government Code 61000 et Seq., if a special district was not providing a service they were authorized, or is allowed under law, the district is not able to provide, or add, that service without LAFCO approval. Examples of services that could be provided by a special district (i.e. Community Services District) through LAFCO’s activation of latent powers include, but are not limited to, police, park and recreation, animal control, and street maintenance services.

When should it be considered?
Activation of latent powers should be considered when: (1) a special district’s service needs includes services authorized under its principal act, (2) the proposed service(s) can be provided more efficiently and effectively than the current provider or existing providers in the area, (3) the cost of the new service has no or minimal financial impact on customers, and (4) the special district has sufficient revenues to provide the service(s) or the special district proposes concurrent approval of a funding source (e.g., parcel tax, utility tax, etc.) to pay for the new service(s). Affected agencies may support activation of latent powers if all considerations listed above are addressed. However, in the past, the County of Orange has encouraged annexation or other forms of organization to efficiently deliver municipal services to unincorporated areas rather than activation of latent powers.

If a special district initiates an application to activate latent powers, the district is required to submit a plan of services for Commission review which must include:

- The total estimated cost to provide the new service
- The estimated cost of services for customers
- Identification of existing service providers and potential fiscal impact to customers of utilizing existing providers
- Plan for financing the new service
- Alternative options to latent power activation

What is the effect of activation of latent powers?
If LAFCO approves the activation of a latent power (or powers) for a special district, that power is established, and the special district is authorized to provide that service commencing on the effective date determined by the Commission through a term or condition.
The activation of latent powers, like any structural reorganization approved by LAFCO, can be complex and has long-term political, financial and service-related implications for both local agencies and residents. Any agency reorganization must be thoroughly reviewed and evaluated by LAFCO, elected officials, affected agencies and the public to ensure that the proposed change will benefit residents over the long-term. Once approved, it can be difficult and costly to “undo” a structural reorganization.

**What is the approval process for the activation of latent powers? How is LAFCO involved?**

The activation of latent powers is initiated by a resolution of application by the district board of directors. Prior to submitting a resolution of application, the legislative body of the special district shall conduct a public hearing regarding the initiating resolution. Any affected local agency, affected county, or any interested person who wishes to appear at the hearing shall be given an opportunity to provide oral or written testimony on the resolution.

Once initiated, LAFCO staff is required to prepare an analysis of the proposed activation of latent powers and conduct a noticed public hearing. After evaluating the staff report, staff recommendations and public testimony, LAFCO can approve or disapprove (with or without amendments) the proposal for the establishment of a new or different function or class of service. The commission cannot approve a proposal for the establishment of new or different functions or class of services within the jurisdictional boundaries of a special district unless the commission determines that the special district will have sufficient revenues to carry out the proposed services. If approved, LAFCO may also adopt terms and conditions for the activation of latent powers.

The establishment of a new or different function or class of service is not subject to an election, unless specified in the district’s principal act. The activation, expansion, or divestiture of latent powers is effective on the date established by LAFCO. If denied by the Commission, the applicant must wait one year before reapplying for the activation of latent powers.

**What could make it work?**

- Clear, credible data and analysis for decision makers and residents.
- Opportunities for public review and comment.
- Special districts and cities willing to explore the activation of an agency’s latent powers as a potential restructuring option.
- Effective stakeholder working group processes exploring the pros and cons of expanding a district’s powers.

**What are potential obstacles?**

- Change can be difficult for residents.
- If special district revenues are insufficient to pay for the new service, securing approval of an additional funding source from customers/residents can be challenging.
- Providing a dedicated, long-term funding source for the new service may be complex.
• The evaluation of the quality and level of service provided by existing providers versus proposed service levels provided through a special district can be difficult.
• Opposition from current service providers of a perceived “takeover” of services.
• Disagreement among customers within the special district boundary regarding service providers.
• Annexation to a city or other reorganization alternatives may be determined to be a superior long-term governance option by the Commission.

Examples of activation of latent powers in California

➢ **September 2009** – Silverado Community Services District Activation of Latent Powers for Street Maintenance
➢ **June 2008** – Easton Community Services District Activation of Latent Powers for Recreation and Park Services and Landscape Maintenance Services
➢ **December 2007** – Town of Discovery Bay Community Services District Activation of Latent Powers for Landscaping, Street Lighting and Maintenance Services
➢ **May 2004** – Cabazon County Water District Activation of Latent Powers for Wastewater Services
Restructuring Option
LATENT POWERS
Government Code Section (GCS) 56050.5

Initiation Process
GCS 56021, 56824.10, 56824.12, 56654

Resolution by subject district

LAFCO Hearing

LAFCO Approval
No election unless specified in district principal act
GCS 56824.14

LAFCO Disapproval
Proceedings terminated. One-year wait to reapply unless waived by LAFCO
GCS 56884

Latent Powers
Activation, Expansion, or Divestiture effective on date established by LAFCO
GCS 56824.14
BANKRUPTCY

What is it?
Chapter 9 of the Federal Bankruptcy Code provides for the financial reorganization of municipalities, including cities, towns, villages, counties, taxing districts, municipal utilities and school districts facing a backlog of unpaid bills. The primary purpose of filing Chapter 9 bankruptcy is to provide a financially distressed government agency protection from its creditors while it reorganizes to make itself more fiscally stable. Reorganization of debt extends debt maturities, reduces the amount of principal debt or interest on debt, and/or refinances the debt by obtaining a new loan. Chapter 9 is similar to Chapter 11, which applies to most private companies (except banks and insurance companies), in that both provide a mechanism for restructuring obligations under the protection of the bankruptcy court’s “stay.” This automatic stay buys time to allow municipalities to work out their finances without incurring additional debt or interest on outstanding loans.

Although municipalities generally handle bankruptcy proceedings without state interference, state law governs whether municipalities may file for bankruptcy at all. There are 24 states (including California) that specifically authorize or conditionally authorize municipal bankruptcy.

When should it be considered?
Filing Chapter 9 municipal bankruptcy is generally viewed as a last resort. It should only be considered when: (1) a municipality’s finances can be restructured and the municipality is willing to adopt a plan to restructure its debt; (2) current and projected cash flow threatens its ability to provide for the basic health and safety of its citizens; and (3) all other efforts to put a municipality’s fiscal house in order have been unsuccessful.

What is the effect of municipal bankruptcy?
- A key benefit to filing for municipal bankruptcy is the entitlement for a legal “time out.” Allowing the municipality to “freeze” operations, payments and creditor demands allows municipal decision makers to closely review their finances without the clock running down.
- The financial review can identify where the municipality is losing the majority of its funds, and whether spending cuts or higher taxes can eventually sustain the expenditures.
- Bankruptcy provides time to develop a plan to “right the boat.”
- Bankruptcy can, however, take years to result in any positive impacts.
What is the process for bankruptcy? What is LAFCO’s involvement?

- Municipalities which are eligible to file bankruptcy (as outlined in the Bankruptcy Code and State law) must first demonstrate that they are insolvent, they are willing to develop a plan to adjust its debts, and they have attempted to avoid filing by failing to reach a negotiated settlement with its creditors.
- Once a bankruptcy petition is filed, the Bankruptcy Code requires that the Chief Judge of the Federal Court of Appeals of the Circuit in which the case is filed to assign a judge to each Chapter 9 case.
- LAFCO may be considered a creditor in some agency bankruptcy proceedings.
- LAFCO’s has no official role in bankruptcy proceedings; agencies may utilize LAFCO municipal service reviews, sphere of influence studies and fiscal analyses, however, to provide background data for bankruptcy filings.
- The primary responsibilities of the bankruptcy judge in a Chapter 9 case are to:
  - Determine eligibility for bankruptcy
  - Oversee the assumption or rejection of contracts and unexpired leases
  - Confirm or reject a plan of adjustment to address claims against the bankruptcy

What are potential obstacles?

- Municipalities that seek bankruptcy relief often experience the immediate suspension and/or downgrade of their credit ratings, particularly if bondholders are not fully repaid.
- Filing and pursuing Chapter 9 bankruptcy is very expensive and typically includes both significant legal and financial consulting fees.
- Bankruptcy likely will be viewed by residents and workers as a stigma that could linger long after the municipality emerges from bankruptcy.
- Often bankruptcy is very difficult for employees and can undermine staff morale.
- Bankruptcy may provide for a disincentive to attract investment and new businesses.
- It is unclear at this time whether public employee pensions, a contributing factor to some cities’ fiscal instability, can be reduced when the city they work for files bankruptcy.

Examples of recent filings for municipal bankruptcies in California

- **October 2012** – Mendocino Coast Health Care District
- **August 2012** – City of San Bernardino
- **July 2012** – City of Mammoth Lakes
- **June 2012** – City of Stockton
- **May 2008** – City of Vallejo
- **December 2004** – County of Orange
### Initiation Process

*Section 109(c), 101(40)*

### Eligibility

The Bankruptcy Codes set forth four additional eligibility requirements

*Section 109(c)*

### Commencement of the Case

Municipalities must voluntarily seek protection under the Bankruptcy Code

*Section 303, 901(a)*

### Assignment of Case to a Bankruptcy Judge

One significant difference between chapter 9 cases and cases filed under other chapters is that the clerk of court does not automatically assign the case to a particular judge.

*Section 921(b)*

### Notice of Case/Objections/Order for Relief

The Bankruptcy Code requires that notice be given of the commencement of the case and the order for relief.

*Section 923*

### Automatic Stay

The stay operates to stop all collection actions against the debtor and its property upon the filing of the petition.

*Section 363(a), 901(a)*

### Proofs of Claim

In a chapter 9 case, the court fixes the time within which proofs of claim or interest may be filed.

*Section 925*

### Dismissal

*Section 921(c)*

### Plan for Adjustment of Debts

*Section 941*

### Confirmation Standards

*Section 943(b), 901(a)*

### Discharge

*Section 944(b)*
GLOSSARY OF TERMS

- **Affected City** – Any city that contains or would contain, or whose sphere of influence contains, or would contain territory for which a change of organization is proposed or ordered, either singularly or as part of a reorganization.

- **Affected District** – A special district that contains, or whose sphere of influence contains, any territory for which a reorganization or a change of organization is proposed or ordered.

- **Affected Local Agency** – Any local agency that contains, or would contain, or whose sphere of influence contains, any territory within any proposal or study to be reviewed by the commission.

- **Affected Territory** – Any territory, for which a change of organization or reorganization, or sphere of influence change, is proposed or ordered.

- **Change of Organization** – A change of organization means any of the following: city incorporation, district formation, annexation to a city or district, detachment from a city, detachment from a district, disincorporation of a city, district dissolution, consolidation of cities or special districts, merger of a city and a district, and establishment of a subsidiary district.

- **Commission** – A local agency formation commission (LAFCO).

- **Conducting Authority** – The commission of the principal county, or the commission’s executive officer when authorized by the commission, when exercising its responsibility to conduct protest proceedings following approval by the commission of a change or organization or reorganization.

- **Consolidation** - The uniting or joining of two or more cities located in the same county into a single new successor city or two or more districts into a single new successor district.

- **Disincorporation** - The dissolution, extinguishment, or termination of the existence of a city and the cessation of its corporate powers, except for the purpose of winding up the affairs of the city.
• **Dissolution** - The disincorporation, extinguishment, or termination of the existence of a district and the cessation of all its corporate powers, except as the commission may otherwise provide pursuant to Section 56886 or for the purpose of winding up the affairs of the district.

• **Incorporation** – The creation or establishment of a city. Any area required for incorporation of a city must have at least 500 registered voters residing within the affected territory at the time the proposal is initiated.

• **Inhabited Territory** - The territory within which there reside 12 or more registered voters. The number of registered voters as determined by the elections officer shall be established as of the date a certificate of filing is issued by the executive officer. All other territory shall be deemed "uninhabited."

• **Initiate or Initiation** – The issuance of a certificate of filing by the LAFCO executive officer.

• **Interested Agency** – Each local agency which provides facilities or services in the affected territory that a subject agency would provide.

• **LAFCO** – Acronym for the Local Agency Formation Commission, a state mandated agency created by State Legislature in 1963 to act on local agency boundary changes.

• **Latent Service or Power** – Those services, facilities, functions, or powers, authorized by the principal act under which the district is formed, but that are not being exercised, as determined by the commission pursuant to subdivision (i) of Section 56425.

• **Merger** – The termination of the existence of a district when the responsibility for the functions, services, assets, and liabilities of that district are assumed by a city.

• **Municipal Bankruptcy (Chapter 9)** – Legal protection to financially stressed municipality of its creditors through excusing or adjusting of debts.

• **Municipal Service Review (MSR)** - a review of the municipal services provided by a county, city or special district, evaluating how services are currently provided and how the local agency is planning to provide services in the future given growth and population projections, infrastructure needs, and fiscal conditions.
• **Principal Act** – In the case of a special district, the law under which a special district was formed; in the case of a city, the general laws or the city charter.

• **Proposition 13** – Property tax limitation initiative, approved by voters on June 6, 1978, which fundamentally changed the manner in which property was assessed, taxes were levied, and property tax revenue was allocated to local governments. Prior to 1978, local governments in California could set aside property tax rates independent of the rates set by other local governments. Property tax bills reflected the aggregate of each tax rate levied within the TRA (tax rate area) where property was located. Proposition 13 limited the aggregate property tax rate to a constitutional maximum of one percent of assessed value and assigned responsibility for allocating property tax revenue to the State.

• **Proposition 218** – The Right to Vote on Taxes Act is a constitutional amendment passed by voters in 1996. Proposition 218 requires voter approval prior to imposition or increase of general taxes, special taxes, assessments, and certain user fees.

• **Protest Proceedings** – LAFCO decisions may be subject to landowner or registered voter protest. If protest proceedings are not waived by LAFCO, the commission gives notice and sets the proposal for hearing. The Conducting Authority hears the proposal at the notice time and determines the value of written protest. The Conducting Authority must either: (1) order the change; (2) order the change subject to an election; or, (3) terminate proceedings, depending upon the value of written protest that is received.

• **Registered Voter** - Any person registered to vote under, and pursuant to, the Elections Code.

• **Subsidiary District** – A district in which a city council is designated as, and empowered to act as, the ex officio board of directors of the district.

• **Sphere of Influence (SOI)** – State law requires LAFCOs to develop a sphere-of-influence (SOI) for cities and special districts. Spheres represent a plan for the probable physical boundary and service area of a local agency. LAFCOs are required to review and update each sphere every five years.

• **Uninhabited Territory** – Territory which contains less than 12 registered voters.

• **Voter** – A landowner-voter or a registered voter.
## Restructuring Options – Summary Sheet

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<th>Impact</th>
<th>Potential Complications</th>
<th>Approval Authority</th>
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</thead>
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<tr>
<td>Consolidation</td>
<td>Joining two or more cities into a single city or two or more special districts into a single special district.</td>
<td>Potential overall long-term cost savings in municipal service delivery; elimination of duplicative admin positions and overhead; more efficient use of agency facilities.</td>
<td>For cities - petition signed by 5% or more of the registered voters of affected cities; For special districts - Board resolution, resolution of at least one affected district, or petition signed by not less than 5% of registered voters within each district, or not less than 5% of the number of landowners owning not less than 5% of the assessed value of land within each of the special districts.</td>
<td>Reorganized city or special district takes over all services within the combined territory of the consolidated agencies.</td>
<td>Difficult for elected representatives to give up authority; challenging to find cities and special districts willing to consider consolidation; loss of community/district identity; reduced political accessibility/accountability; complex personnel issues when staffs are merged.</td>
<td>LAFCO</td>
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<tr>
<td>Dissolution</td>
<td>Termination and cessation of all corporate powers of a special district; applies to special districts only.</td>
<td>When special district has outlived its original purpose; when special district services no longer needed; when alternative service providers have been identified that improve and efficiency of municipal service delivery to residents.</td>
<td>Resolution by LAFCO; special district resolution; petition signed by at least 10% of registered voters or landowners (owning at least 10% of the assessed value within the district)</td>
<td>Dissolved district is &quot;extinguished&quot; and all corporate powers cease except to wind up affairs of the district.</td>
<td>Difficult for elected board members to disband their own agency; change for residents can be difficult; politically difficult for LAFCO to initiate without agreement from affected agencies.</td>
<td>LAFCO</td>
</tr>
<tr>
<td>GOVERNMENT STRUCTURAL OPTION</td>
<td>DEFINITION</td>
<td>WHY CONSIDER</td>
<td>INITIATION PROCESS</td>
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<td>Merger</td>
<td>When a special district's responsibilities are taken over by a city.</td>
<td>When a district's functions/operations can be more efficiently and effectively delivered by a city in the long-term.</td>
<td>Resolution by LAFCO; resolution of any affected district, school district, city or county; petition signed by at least 5% of the registered voters living within the district or at least 5% of the registered voters living within the city (but outside the district); petition signed by at least 5% of the number of landowners who own not less than 5% of the assessed value of the land within the district.</td>
<td>District ceases to exist and all district funds and all district property are vested in the city. City becomes liable for all debts of the merged district.</td>
<td>Change can be difficult for residents; potential loss of community identity; concern that special district's revenues will be diluted over time by city programs; finding a city willing to take over a struggling district may be difficult; personnel-related issues.</td>
<td>LAFCO</td>
</tr>
<tr>
<td>Disincorporation</td>
<td>When a city's municipal responsibilities are taken over by a successor agency (in most cases the representing county).</td>
<td>When subject city experiencing significant, long-term revenue shortfalls and/or ineffective management which prevents provision of an adequate level of services to its residents.</td>
<td>Resolution of affected agency; petition signed by no less than 25% of registered voters or landowners.</td>
<td>Disincorporated city is &quot;extinguished&quot; and the successor agency (usually the county) is responsible for winding up the affairs of the disincorporated city and providing services to residents.</td>
<td>Process rarely used and may involve litigation over both its process and legal effect; cannot eliminate or restructure debt; current law does not specify how a distressed city pays the costs associated with the incorporation process; potentially complex personnel matters; ability of successor agency to impose new taxes may be impaired by Propositions 13, 62 and 218.</td>
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<td>Latent Powers</td>
<td>Those services, facilities, functions, or powers, authorized by the principal act under which the district is formed, but that are not being exercised.</td>
<td>The cost of the new service has no or minimal financial impact on customers and the district has sufficient revenues to provide the service(s).</td>
<td>Resolution of application by the district board of directors.</td>
<td>Establishes a new or different function or class of service to the designated district.</td>
<td>Providing a dedicated, long-term funding source for the new service may be complicated.</td>
<td>LAFCO</td>
</tr>
<tr>
<td>Bankruptcy</td>
<td>Provides financially distressed government agency protection from its creditors while it reorganizes to make itself more fiscally stable.</td>
<td>When an agency's ability current and projected cash flow threatens its ability to provide for the basic health and safety of its citizens; all other efforts have failed; and the agency is willing to adopt a plan to restructure its debt.</td>
<td>Affected agency files a bankruptcy petition in Federal Court; Chief Judge of the Federal Court of Appeals for the Circuit assigns a judge to case who determines eligibility for bankruptcy and confirms or rejects a plan of adjustment to address claims against the bankruptcy.</td>
<td>Allows for a legal &quot;time out&quot; to freeze operations, payments and creditor demands; allows municipal decision makers to closely review their finances; provides time to develop a financial restructuring plan to &quot;right the ship.&quot;</td>
<td>Municipalities that file bankruptcy will experience the immediate suspension and/or downgrade of their credit ratings; process is expensive and typically includes both significant legal and financial consulting fees; may be a disincentive to attract investment and new businesses; unclear at this time if public employee pensions can be reduced when a city files bankruptcy.</td>
<td>Federal Courts</td>
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