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CLIENT/MATTER NUMBER  
153375-100

**MEMORANDUM**

**TO:** Board of Directors  
Los Medanos Community Hospital District

**FROM:** Thomas L. Driscoll, General Counsel

**DATE:** July 8, 1999

**RE:** Considerations in the Dissolution of a California Health Care District

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You have asked for an outline of the issues associated with the dissolution of a health care district. What follows is a five part analysis, focusing first on the procedures for dissolving a district, followed by discussions of the transfer of assets, the assumption of liabilities, the associated costs, and conclusions and recommendations.

**A. Procedure**

1. **Initiating dissolution proceedings.** Dissolution proceedings can be initiated in three primary ways: (a) resolution of the district board of directors (Gov. Code<sup>1/</sup> § 56800); (b) petition by district voters (§ 56700); or (c) resolution by the Local Agency Formation Commission ("LAFCO") following a study (§ 56375). Dissolution can also be proposed as part of a reorganization initiated by another public agency.

a. **Resolution of Application.** A health care district board of directors may adopt a "resolution of application" requesting dissolution. The resolution should state the nature of the proposal and list all proposed changes of organization, set forth the description of the boundaries of the affected territory, contain the reasons for the dissolution, set forth the terms and conditions sought from LAFCO (if any), request that proceedings be taken for the proposal, and state whether the proposal is consistent with the sphere of influence of the affected district. (§ 56700, 56800(c).) The terms and conditions generally address what happens to any employees and their benefits, what happens to the taxes (both special taxes and

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<sup>1/</sup> Unless otherwise indicated, all sections cited herein refer to the Government Code.

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general taxes), and what agency gets which assets of the district. (§ 56844.) The sphere of influence for each particular agency is determined by LAFCO. (§ 56426.) The district must submit a certified copy of the resolution of application to the executive director of the local LAFCO, along with a plan for services which generally describes the level and range of the services to be extended to the affected territory, and how and when those services will be provided after the dissolution. (§ 56653.)

b. Petition. A petition submitted to the executive director of LAFCO can also request dissolution. (§ 56758.) The petition must be signed by five percent of the registered voters of the district, or five percent of the number of landowners within the district who also own at least five percent of the assessed value of land within the district. The signatures must be obtained within six months of the date of the first signature, and the petition must be submitted to LAFCO within 60 days after the date of the last signature. (§ 56705.) The petition must include the same information as the resolution of application, including the proposed terms and conditions of the dissolution. (*See* § 56700.)

We understand that a petition regarding dissolution is currently circulating. We have not seen or reviewed that petition; accordingly, we are unable to advise you at this time whether the petition satisfies the foregoing requirements and would thus be legally sufficient to accomplish its intended purposes.

c. LAFCO-initiated. Although LAFCO can do a study and itself initiate a dissolution, this has rarely happened. LAFCOs generally do not have resources to fund such studies. (*See* § 56378, 56425.)

2. **LAFCO's Response.** LAFCO is generally required to conduct a study and hold a hearing on the proposal according to the time frames described below. After LAFCO receives a resolution of application or a petition for dissolution, it has thirty days to determine whether the application is complete, legally sufficient and thus acceptable for filing. (§ 56828.) If after thirty days there has been no determination by LAFCO, the application is generally deemed accepted. (§ 56828(f).) Once the application is accepted, LAFCO must issue a certificate of filing and then begin reviewing the filed application to prepare a report setting forth its recommendation. (§§ 56828(g), 56833.) The report must be completed at least five days prior to the hearing date. (*Id.*)

A hearing is to be held no later than 90 days after issuance of the certificate of filing, in order to determine whether or not to proceed with the dissolution, what terms and conditions should apply to the dissolution, and whether an election should be set. (§ 56828(i).) LAFCO must make a decision within 35 days after the hearing, by adopting a "resolution making determinations". (§ 56851). The resolution includes any required findings or

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determinations and directs the appropriate "conducting authority" (the County Board of Supervisors, in the case of a district dissolution) to initiate proceedings.

Any agency may propose a competing reorganization to LAFCO containing terms and conditions in conflict with any other proposal. For example, a city or county could adopt a resolution proposing that it be the successor agency to the district, or that it annex territory and establish the district as its subsidiary. LAFCO must consider a conflicting application and may appoint a reorganization committee which can extend the process for up to a year. (§ 56827.5.)

The local LAFCO is generally composed of two county representatives, two city representatives and one general public representative. (§ 56324.) Thus, it is important that both the county's and the cities' interests are addressed in the dissolution proposal.

3. **Board of Supervisors.** The County Board of Supervisors is designated as the conducting authority charged with ensuring that the dissolution occurs. If LAFCO approves of the dissolution, then it must send a "resolution making determinations" to the County Board of Supervisors. Within 35 days of LAFCO's adoption of a resolution making determinations, the Board must set a hearing to occur no less than 15 days and no more than 60 days after the date of the notice. (§ 57002.) Thirty days after the hearing, the Board must adopt a resolution which (1) makes a finding on the value of any written protests received, and (2) either terminates the proceedings if a majority protest exists or orders the change of organization subject to confirmation of the voters. (§ 57077.) (Health care district dissolutions always require an election under section 57083.5.) The Board's resolution must include several elements, including a date for the election and the terms or conditions required in the dissolution. (§ 57100.)

The Board of Supervisors has one year after LAFCO approval to complete these proceedings unless an extension is obtained. (§ 57001.)

4. **Election.** The election must be held on the next regular election date occurring at least 88 days after the date the Board of Supervisors adopts its resolution. (§ 57132.) It is held at the expense of the district, but costs may be lower if the election is consolidated with other elections. (§ 57150(c).) A majority vote of the votes cast within the district is required for passage. (§ 57176.)

5. **Terms and Conditions.** Under section 56844, LAFCO has the authority to subject the dissolution to its own terms and conditions covering issues such as taxes, employees, distribution of assets, and other outstanding obligations. If LAFCO does not impose specific terms and conditions, and no other specific terms and conditions are included

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in the proposal, then the fallback provisions of Government Code §§ 57450-57463 apply, as follows:

a. Taxes. Taxes levied for bonded indebtedness are required to be continued to be levied for that purpose until the indebtedness is paid off. (Health & Safety Code § 32312.) The terms and conditions could specify for the payment of those taxes in the winding up of the district or for the successor agency take over the indebtedness. (§ 57458.) For this purpose, the boundaries of the district will remain separate tax rate areas, at least until the bonds are paid off.

Taxes levied for general purposes typically go to the agency which will become responsible for providing the services previously provided by the dissolving district. The Revenue and Taxation Code requires the agencies whose service area are affected by the dissolution to negotiate an exchange of property tax revenues. (Rev. & Tax. § 99.) This negotiation must occur within 60 days from the date the county auditor issues estimates on the assessed valuations of the territory subject to the dissolution. (*Id.*)

b. Employees. Any employees and their benefits are generally picked up by the successor agency in the case of a dissolution. This may not be an issue for Los Medanos, if it has no employees.

c. Assets. If after the winding up of the district's affairs there are any assets remaining, they generally are conveyed to the successor agency. But if the terms and conditions of the dissolution do not address conveyance of assets, they will be distributed to the agency designated in section 57457.

d. Outstanding contracts and agreements. As with the assets, if there are remaining contractual obligations of the dissolving agency, they are generally assumed by the successor agency.

**B. Assets**

The District has four general classes of assets:

- (1) Real Property (i.e., the Los Medanos Hospital and related parking areas, which are subject to a long term lease to Contra Costa County);
- (2) The furniture, fixtures and equipment that are used for the ongoing operations of the District and which are located in the office provided by the County in the Los Medanos Hospital building;

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- (3) Cash on hand; and
- (4) Special and general tax revenue.

As noted above, all of these assets will likely be conveyed to the successor agency under the dissolution plan as finally approved by LAFCO.

C. Liabilities

The District has three general areas of liability following its emergence from bankruptcy late last year:

- (1) Payment of the 1977 Bonds that were used to construct the Los Medanos Hospital;
- (2) Obligations created under the District's Plan For the Adjustment Debt ("Bankruptcy Plan"); and
- (3) Medical records maintenance.
  - a. 1977 Bonds. Efforts have been underway for some time to refinance the 1977 Bonds in order to;
    - (1) obtain a lower interest rate;
    - (2) eliminate the cumbersome and administratively costly corporate structure that was used to issue the bonds originally (and which has created considerable cost to the District as a result of political infighting and disruptive behavior emanating from the so-called "Building Corporation"); and
    - (3) facilitate the dissolution of the District, should that decision ultimately be made.

Ironically, efforts to refinance the Bonds have been stalled because of the pendency of the dissolution debate. The investment banker originally hired to facilitate the financing and to raise the money necessary to pay off the 1977 Bonds has concluded that the uncertainty created by the dissolution debate has undermined its ability to complete the project. While we continue to explore alternative refinancing methods, for now we must assume that the 1977 Bonds will remain in place. The Bonds are actually the obligation of the Building Corporation which, as a technical legal matter, sees to their repayment through funds it is entitled to receive from the District as a result of a Lease that has existed since the hospital was constructed. (As a practical matter, the District has always paid the 1977 Bond obligations directly to the Bond Trustee.) Under that Lease, the District leased the hospital building from

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the Building Corporation and pays approximately one million dollars per year in rent. The District uses special tax revenues, in like amount, which District taxpayers have agreed to pay through 2004.

Under the terms of that Lease, "neither the Lease nor any interest of the District...shall be...assigned, sublet or transferred by the District by voluntary act or by operation of law (e.g., dissolution) or otherwise, except with the prior written consent of the Building Corporation, which shall not be unreasonably withheld." Similarly, the Building Corporation may not "agree or consent to alter, modify or cancel...[t]he...Lease...without the written consent of the Trustee".

Although we believe that the District can ultimately dissolve notwithstanding the continuing obligations under the Bonds, the dissolution of the District does raise several legal issues, the resolution of which may prove expensive. The Building Corporation, in the context of the recent bankruptcy, acknowledged a Court Order that confirmed that it had assigned all of its rights, including its right to consent to an assignment of the Lease, to the Bond Trustee. While nothing has changed which would negate the legal effect of that acknowledgement (or the Court Order), the Building Corporation could nevertheless challenge its validity, and challenge the assignment of the Lease which would be effectuated by operation of law as part of the dissolution, and the costs incurred by the Building Corporation would be chargeable to the District under the terms of the Lease.

Whether or not the Building Corporation interjects itself into the matter, the Bond Trustee could, and based on prior experience most likely would, interject itself into the matter and its expenses, including attorneys' fees, would also be chargeable (arguably, at least) to the District. (Counsel for the Bond Trustee has historically incurred very substantial attorneys' fees in advising the Bond Trustee in connection with these Bonds.)

Although we believe that the "assignment by operation of law" effectuated by the dissolution process would render argument to the contrary by the Building Corporation and/or the Bond Trustee ineffective to derail the dissolution or (more importantly) accelerate the obligations under the Bonds, we cannot provide any assurance that one or both of these parties would not involve themselves aggressively in the matter and then attempt to foist substantial legal fees upon the District ( and ultimately upon the taxpayers) as part of this process.

Whether the Bonds remain as they are, or are refinanced (should an alternative prove workable), the special tax that has been levied and collected since the late 1970's will continue to be levied and collected until the Bonds are repaid in full. This is true whether or not dissolution occurs.

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b. Bankruptcy Plan. Under the terms of the 1998 Bankruptcy Plan, the District reorganized itself so as to be absolved generally of its prior debts with the exception of the 1977 Bonds, but assumed other obligations as part of the Plan. Its only continuing operational obligation is the maintenance of medical records, as described below. In order to finance the repayment of creditors however, the District entered into an arrangement with the Office of Statewide Health Planning and Development of State of California ("Cal-Mortgage") pursuant to which Cal-Mortgage provided funding for the repayment of both secured and unsecured creditors in the bankruptcy ("Cal-Mortgage Loan"). The Cal-Mortgage Loan is fully amortized over a 12-year period, and bears simple interest at the rate of 8% per year. The District is obligated to make payments on account of principal and interest of \$400,00.00 per year for the next twelve years. The Cal-Mortgage Loan is secured by a first deed of trust on the Los Medanos Hospital property. In addition, the District has agreed that all rental income payable by the County under the County's lease with the District will be paid directly by the County to Cal-Mortgage for the entire twenty year term of the lease (plus the District has guaranteed a minimum annual lease payment of \$500,000 per year for an additional two-year term). (The County has Two (2) Five-year options to extend the term of that lease.) All of these terms must be honored as part of the dissolution plan.

While the payment of rent has been structured as a matter between the County and Cal-Mortgage, the payment of \$400,00.00 per year beginning with this fiscal year ending June 30, 2000, must be paid from general taxes collected from District residents, as they have been in prior years. Even if a dissolution occurs, this obligation will continue and the related taxes (which the District's successor will likely insist upon for the LAFCO plan) will continue to be levied and collected by the successor to the District.

c. Medical Records. The District's only residual obligation from the operation of the Hospital is the retention of medical records of the former patients of the Hospital. The District has adopted a resolution setting forth how those medical records will be stored, accessed, made available to former patients, and ultimately destroyed. The District is arranging for a facility where the medical records can be appropriately maintained and accessed until ultimate destruction, all in accordance with California's detailed regulations on this topic. However, there is an ongoing cost for this medical record storage (approximately \$500.00 per month) and the successor to the District (should a dissolution occur) will be responsible for arranging access to these medical records at the request of former patients, as and when those requests are made. Any successor to the District under a planned dissolution will be entitled to levy and collect taxes as necessary to carry out this obligation.

D. Costs

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The District (and upon its dissolution, its successor), will be responsible for the payment of all of the District's liabilities incurred in the dissolution process as well as in the payment of its liabilities until all of those obligations have been paid in full. The successor to the District will also be entitled to be paid for its costs in carrying out these obligations of the District. In all cases, these costs will ultimately be paid by the taxpayers through the continuation (whether modified up or down) of property taxes, as levied and collected by the District's successor.

a. Cost of Dissolution Procedure. The cost of dissolving the District could be substantial. We estimate (and this is only an estimate) that the costs of responding to the current petition drive and/or initiating the process from the District's side, and then completing the dissolution process, will include attorneys' fees of \$25,000 - \$100,000, consulting/accounting fees of \$3,000-\$10,000, as well as miscellaneous costs for printing, postage, meeting/hearing expenses, documentation expenses, recording fees, etc. In addition, the cost of the election that must be held in the event of a successful petition or resolution process could range from \$40,000-\$60,000, and LAFCO could seek reimbursement of its costs, which could reach \$10,000.

b. Ongoing Administrative Costs. For quite some time now, the District has been operating without any paid staff (with the exception of the very limited, part-time expense of a board secretary to process mail, take minutes at board meetings, etc.). All other activities have been taken care of by District board members who do get paid \$100.00 for attendance at each board meeting they attend, but who get paid nothing for the time they devote to the District's other activities. Some board members put in substantial amounts of time seeing to the ongoing obligations of the District. While a dissolution will save the \$500.00 a month that the District now pays to the District board members as stipends for their attendance at board meetings, the successor agency will be entitled to payment for ongoing costs associated with winding up the District's affairs and maintaining its ongoing obligations, such as: bookkeeping, accounting, clerical, audit, insurance, utilities, file storage, security, legal and consulting fees, etc.

**E. Conclusions/Recommendations**

Under current circumstances, the District collects approximately \$1,550,000.00 per year in taxes. \$1,000,000.00 (approximately) is "restricted" and is used solely for repayment of the 1977 Bonds. This will continue to be collected and used for this purpose and this purpose only, regardless of whether the District dissolves or whether the Bonds are refinanced. Another \$400,000.00 of general taxes is levied, collected, and is now committed to the repayment of the Cal-Mortgage Loan for the next twelve years. This will continue, regardless of whether or not the District dissolves. There is another \$150,000.00



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(approximately) of general taxes that is now levied and collected and used for ongoing District operations. Approximately \$500 per month will continue into the distant future for the maintenance of medical records, regardless whether or not dissolution occurs. The other ongoing expenses for winding up and carrying out the ongoing District obligations will diminish over time and ultimately be reduced, effectively to zero, but that will take at least several years to be reduced substantially, and then fully twelve years to be reduced to only a nominal level. The costs of dissolution will be incurred in the short term and will be paid out of taxes on a current basis. While it is true that the taxes associated with the District will ultimately (after twelve years) be reduced effectively to zero, there will essentially be no short term (3-5 year) savings to District taxpayers under a dissolution plan.

Accordingly, a decision on dissolution should be made on the basis of long term financial considerations as well as whether or not a continuing district can provide the local taxpayers with benefits that are worth the approximately \$150,000.00 of general tax revenue which is not otherwise allocated to predetermined obligations.

Please let us know if we can provide any further information or analysis on this very important question.