

---

## SENATE COMMITTEE ON GOVERNANCE AND FINANCE

Senator Mike McGuire, Chair  
2021 - 2022 Regular

---

**Bill No:** SB 418  
**Author:** Laird  
**Version:** 1/24/22  
**Consultant:** Peterson & Favorini-Csorba

**Hearing Date:** 2/2/22  
**Tax Levy:** No  
**Fiscal:** No

### *PAJARO VALLEY HEALTH CARE DISTRICT*

*Creates the Pajaro Valley Health Care District.*

### **Background**

**Local government boundaries.** The Legislature has the authority to create, dissolve, or otherwise modify the boundaries and services of local governments. Beginning in 1963, the Legislature delegated the ongoing responsibility to control the boundaries of cities, county service areas, and most special districts to local agency formation commissions (LAFCOs) in each county. The responsibilities and authority of LAFCOs have been modified in subsequent legislation, including a major revision of the LAFCO statutes in the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 (AB 2838, Hertzberg). The courts often refer to LAFCOs as the Legislature’s watchdog over boundary changes.

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

**Healthcare districts.** Near the end of World War II, California faced a severe shortage of hospital beds. To respond to the inadequacy of acute care services in rural areas, the Legislature enacted the Local Hospital District Law to provide medically underserved areas without access to hospital facilities the ability to form special districts that could be a source of tax dollars for constructing and operating community hospitals. SB 1169 (Maddy, 1994) changed the name of the law to “The Local Healthcare District Law” to better reflect the shift in the provision of healthcare services outside hospital settings.

The powers and duties granted to healthcare districts under existing law have remained largely unchanged while the demographics of areas the districts serve, access and provision of healthcare services, and the districts themselves have vastly changed. For example, following the change in law in 1994, 14 healthcare districts have filed for bankruptcy, and over one-third of the healthcare districts in California have either closed or sold their hospital, thus moving away from the original legislative intent of “hospital districts.”

State law allows healthcare districts to exercise various powers, including to lease or own property; build and operate healthcare facilities and services, including emergency services, free

clinics, diagnostic and testing centers, health education programs, wellness and prevention programs, rehabilitation, and aftercare; to provide assistance to other entities to carry out those services; and to sell their assets.

Healthcare districts, like other special districts, are subject to review in a municipal service review or special study by a LAFCO to examine the efficiency and effectiveness of the services they provide. Similarly, healthcare districts must also receive approval from LAFCO to exercise its powers or change its boundaries.

New healthcare districts can be formed according to procedures laid out in the Local Healthcare District Law, the District Organization Law, and LAFCO Law. These procedures provide multiple opportunities for local agencies and voters to weigh in on the question of district formation. These procedures include: an impartial analysis by the LAFCO of the proposed formation; a determination that the district is “feasible, economically sound, and for the public interest,” and a requirement that a majority of voters approve of the formation of the district.

A five-member board of directors manages each healthcare district. Each member must be a registered voter residing in the district and serves a four-year term, with the exception of the initial board. The board of supervisors of the county with the greatest share of land in the district appoints the initial board. Upon appointment, the board selects two members by lot to serve two-year terms with the remaining three serving four-year terms.

Most healthcare districts receive a share of local property taxes; some levy special parcel taxes, and some charge for services. Some healthcare districts generate revenues from district resources, such as property lease income; and some districts receive grants from public and private sources.

**Watsonville Community Hospital.** Watsonville Community Hospital (WCH) is a 106-bed facility that provides acute care and emergency services to residents in the Pajaro Valley, which spans across southern Santa Cruz and northern Monterey counties. WCH currently employs over 600 people including 200 physicians. The hospital also has a contract with Kaiser Permanente to provide hospital services for Kaiser patients. The hospital serves significant numbers of low-income, underinsured, and patients of color. As such, 43 percent of WCH’s gross revenue comes from the Medi-Cal program for low-income Californians, and 30 percent comes from the MediCare program that serves aged and disabled Californians.

The current WCH facilities opened in 1998 after the 1989 Loma Prieta earthquake seriously damaged the previous hospital. The previously not-for-profit hospital was sold in 1998 to a private for-profit company, Community Health Systems (CHS). Community healthcare partners formed the Community Health Trust of Pajaro Valley with the proceeds of the sale and had right of first refusal if CHS decided to sell it. Facing financial difficulties, the private owners decided to sell the hospital in 2019, but Community Health Trust of Pajaro Valley decided not to purchase the hospital, and instead another private entity purchased the facility. According to the partners of the Pajaro Valley Healthcare District Project (PVHDP), which is a partnership formed by the County of Santa Cruz, the City of Watsonville, the Community Health Trust of the Pajaro Valley, and Salud Para La Gente, WCH administration has changed 20 times over the last 21 years of for profit-ownership. During the COVID-19 pandemic, the hospital has operated at a loss and, as of August 2021, the corporation running the hospital reported a year-to-date cash flow shortfall of over \$17 million among other financial troubles.

These financial challenges prompted WCH to file for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code on December 5, 2021, which would allow it to reorganize the corporation and sell the hospital. WCH has sufficient funds to keep the hospital open through March 2022 as the court adjudicates the bankruptcy filing. PVHDP formed so they could combine financial resources and enter into a “stalking horse” bid agreement with WCH, which means the court can designate the stalking horse bidder, in this case PVHDP, as the winner without holding the court-supervised auction if it does not receive any other qualified bids. Under this agreement, which PVHDP entered into with WCH and filed with the court on January 10, 2022, PVHDP can purchase the hospital according to terms it has agreed upon with WCH unless another entity bids a higher amount provided that PVHDP meets certain benchmarks by February 14, 2022, including:

- Passing legislation to create the district off the Assembly Floor with a supermajority vote by February 13, 2022;
- Debtors are satisfied that legislation authorizing an appropriation to the district or the County of Santa Cruz from the state budget is probable based on facts and circumstances known on February 13, 2022;
- PVHDP providing a Good Faith Deposit in the amount of \$4.4 million; and
- Debtors are satisfied that the district has sufficient committed funds (excluding any additional funds that may be appropriated to the district through the state budget) to fund hospital operations and the administrative costs from April 1 to May 31, 2022, which debtors, in consultation with other parties, estimated to be approximately \$5 million.

If a sale is not complete by March 2022, PVHDP says there is a chance that the hospital may close. To limit the risk of missing the deadlines for PVHDP to acquire the hospital, PVHDP wants to establish the district through legislation rather than pursue voter approval.

### **Proposed Law**

Senate Bill 418 forms the Pajaro Valley Health Care District (PVHCD) and allows it to exercise the powers of a healthcare district once the Santa Cruz County board of supervisors appoints an initial board of directors. The bill outlines the district’s territory and specifies that, following the formation of the PVHCD, LAFCO law governs any change of organization.

The bill requires the district’s board of directors to adopt a resolution to divide the district into zones that provide for representation in accordance with demographic and geographic factors of the district area within five years of the first board meeting. The board must hold a public hearing on the proposed zones to allow district electors to present their views in relation to the proposed zoning, but does not have to incorporate those views into the resolution. The zones must go into effect for the next PVHCD election after enactment of the resolution for which there is time to implement the zones and elections within the zones.

SB 418 requires the district to notify the Santa Cruz County LAFCO when the district, or any other entity, acquires WCH. If the district does not acquire the hospital, the LAFCO must order its dissolution. Additionally, the district must notify the LAFCO if it subsequently sells the hospital or stops providing healthcare services at the facility. If either occurs, the LAFCO must order the district’s dissolution. If the LAFCO orders the district’s dissolution in these cases, the dissolution does not require: (1) a protest process, (2) any additional findings to justify the dissolution, (3) a study beforehand, or (4) a property tax sharing agreement.

The bill includes findings and declarations to support its purposes.

### **State Revenue Impact**

No estimate.

### **Comments**

1. Purpose of the bill. According to the author, “The Watsonville Community Hospital located in Santa Cruz County is an essential health care provider in the region, serving primarily low-income, under- and uninsured populations of color, and has proved crucial in helping those impacted by COVID-19 throughout the pandemic. Last year, the current owner/operator of the Watsonville Community Hospital announced its intention to file for Chapter 11 bankruptcy protection in early December and close the hospital in January. While the creditor has deferred closure through March 2022, immediate action is required to ensure the vital services and jobs that support the health care safety net remain in Watsonville. In response to the potential closure, a new not-for-profit organization, Pajaro Valley Healthcare District Project (PVHDP), was created by the County of Santa Cruz, the City of Watsonville, Salud Para La Gente, and the Community Health Trust of the Pajaro Valley, to form a new California healthcare district. The goal of Senate Bill 418 is to create the urgently needed hospital district to ensure the Watsonville Community Hospital remains open. The PVHDP has the first opportunity to acquire the hospital, and this bill will help local partners raise the necessary funds. Without SB 418, local partners face an uphill battle to save the hospital from closure.”

2. Skipping the line. While the Legislature has the authority to create, change, or dissolve local agencies, creating PVHCD via legislation circumvents the normal process for district formation. Instead of placing the decision whether to form the district in front of local agencies, who possess intimate knowledge of local services, and local voters to whom the district will be accountable, SB 418 places the decision in front of the Legislature. In doing so, it circumvents key safeguards designed to ensure that district formation is desirable and sustainable, including economic analysis and opportunities for local residents to weigh in on the district’s formation. Without completing this process, it is unclear whether creating a new healthcare district is the best option for providing health care to the community compared to other public sector alternatives, such as Santa Cruz County or the nearby Salinas Valley Memorial Healthcare System. However, completing this process may not meet the deadlines set by the Court adjudicating the bankruptcy filing. If the district is not created, it cannot successfully acquire the hospital, which could result in the hospital’s closure unless another bidder emerges. The Committee may wish to consider whether these urgent circumstances justify bypassing the typical formation process, and whether other processes to review the economic sustainability of the district should be implemented.

3. Show me the money. How the district plans to finance the initial hospital acquisition and ongoing operations remains unclear. PVHDP’s draft business plan identified capital needs of \$64.4 million to acquire and begin operating the hospital. This includes \$45 million in acquisition costs, \$18 million to operate the hospital for six months, and \$1.4 million in administrative and consulting costs. While the draft business plan did not identify how PVHDP plans to cover these costs, it anticipates the following financial support:

- The County Administrative Officer of the County of Santa Cruz will be making a recommendation to the Board of Supervisors on January 25 to provide \$5 million in funding for the acquisition.
- PVHDP has also secured funding from the Community Health Trust of the Pajaro Valley, Salud Para Le Gente, and the City of Watsonville.
- PVHDP has made requests for additional funding from Kaiser Permanente, CommonSpirit, Sutter Health, Community Hospital, and the Central Coast Alliance for Health.

Whether all this funding materializes, and whether additional revenue sources prove necessary to support hospital operations after the initial acquisition period, remains uncertain. The Committee may wish to consider whether it has sufficient information on how the district plans to finance the acquisition, and what information it wants to review to assess the long-term fiscal sustainability of the district.

4. Headed in the right direction? Healthcare districts have been the subject of repeated scrutiny over the last several years. In 2017, the Assembly Local Government Committee held an oversight hearing on healthcare districts and found that of the 79 healthcare districts in existence at the time, many provided no direct healthcare services and instead only provide grants to other organizations. That same year the Little Hoover Commission issued a report that LAFCOs could do more to assess whether every healthcare district should continue to operate. In a few cases, healthcare districts have been subject to legislative efforts to dissolve or reorganize them, including:

- AB 2471 (Quirk, 2016) would have required the Alameda County LAFCO to order the Eden Township Healthcare District's dissolution if the District met specified criteria. This bill died on the Senate Inactive File.
- SB 522 (Glazer, 2018) dissolved the existing Board of Directors of the West Contra Costa Healthcare District and required the Board of Supervisors of Contra Costa County to either serve as or appoint the district board.
- AB 903 (Frazier, 2021) would have dissolved the Los Medanos Community Healthcare District and designated the County of Contra Costa as the successor agency to the district. This bill failed passage in the Senate Governance and Finance Committee.

Even if SB 418 successfully creates the district, there is no guarantee that the newly formed district will successfully acquire the hospital. To prevent the district from existing without a hospital to operate, SB 418 requires the district's dissolution if it does not acquire the hospital. Additionally, if the district does acquire the hospital but ultimately decides to sell it or stop providing health care services at the facility, the bill also requires the district's dissolution. While these guardrails limit the ability for the district to function without owning the hospital, the district could still acquire the hospital and lease it to a private entity, leaving the management of this lease as the district's sole responsibility. The Committee may wish to consider whether the Legislature should create another health care district given the recent challenges other districts have faced, or whether additional safeguards or oversight over the district are necessary to assess whether the district continues to serve an important role in providing healthcare in the future.

5. Urgency. As an urgency statute, SB 418 must be approved by 2/3 vote of each house of the Legislature. Regular legislation takes effect on the January 1 following its passage, but urgency bills take effect as soon as they are passed, signed, and chaptered.

6. Special legislation. The California Constitution prohibits special legislation when a general law can apply (Article IV, §16). SB 418 contains findings and declarations explaining the need for legislation that applies only to PVHCD.

7. Gut and amend. As introduced and approved by the Senate, SB 418 contained provisions relating to sea level rise. Amendments taken in the Assembly deleted the initial contents of SB 418 and inserted the current language relating to PVHCD. Because this topic was never heard in the Senate, the Senate Rules Committee referred the amended bill under Senate Rule 29.10(d) to the Senate Governance and Finance Committee for a hearing on the Assembly's amendments. At its February 2 hearing, the Committee has two choices:

- Hold the bill
- Return the bill to the Senate Floor.

### **Assembly Actions**

Assembly Local Government Committee:  
Assembly Floor:

8-0  
69-0

### **Support and Opposition** (1/31/22)

#### **Support:**

Pajaro Valley Healthcare District Project  
(sponsor)  
Association of California Healthcare  
Districts  
California Hospital Association  
California Medical Association  
California Nurses Association  
California Special Districts Association  
California Teamsters  
Catholic Charities Dioceses of Monterey  
City of Monterey  
City of Watsonville  
Community Action Board of Santa Cruz  
County  
Community Bridges  
Community Foundation Santa Cruz County  
County of Monterey  
County of Santa Cruz  
Court Appointed Special Advocates for

Children of Santa Cruz County (CASA)  
Dientes Community Dental  
Digital Nest  
District Hospital Leadership Forum  
Driscoll's Inc.  
El Pajaro Community Development  
Corporation  
Encompass Community Services  
Foodwhat?!  
Graniterock  
Health Improvement Partnership of Santa  
Cruz  
Hospice of Santa Cruz  
Jacob's Heart Children's Support Services  
Kaiser Permanente  
Monarch Services of Santa Cruz County  
Pajaro Valley Prevention and Student  
Assistance, INC.  
Pajaro Valley Unified School District  
S. Martinelli & Company

Salud Para LA Gente  
Santa Cruz Community Health Centers  
Santa Cruz Community Ventures  
Santa Cruz County Childhood Advisory  
Council  
Santa Cruz County Office of Education  
Second Harvest Food Bank of Santa Cruz  
County  
SEIU  
Sutter Health

Teen Kitchen Project  
Under One Roof  
United Way of Santa Cruz  
Watsonville Film Festival  
Watsonville Law Center  
Ywca of Watsonville

Opposition: None submitted.

-- END --