# MEMORANDUM – CONFIDENTIAL

**TO:** Anita Grant, County Counsel

**FROM:** Shanda Harry – Deputy County Counsel

**DATE:** April 20, 2018

**SUBJECT:** Agreements with the City of Lakeport – Re: Annexation

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## QUESTION PRESENTED:

Are the three agreements between the County of Lake and the City of Lakeport regarding Annexation by the City of Lakeport of certain County areas of South Lakeport valid and enforceable? Further, what rights does the City of Lakeport have to the South Main area that is considered part of their "Sphere of Influence?"

## BRIEF ANSWER

Do to the change in laws, the elapse of time, change in circumstances and the original vagueness of the agreements they would not be enforceable. Finally, the rights that a City has in its "sphere of influence" is vague and subject to case law that has not been thoroughly considered in case law at the status of pre-annexation but the City of Lakeport would have to go through a LAFCO application process to extend or deny the extension of services in to South Main pre-annexation.

## CONTRACT CONSTRUCTION GENERALLY

Under basic contract law "[a]n offer must be sufficiently definite, or must call for such definite terms in the acceptance that the performance promised is reasonably certain." (1 Witkin, Summary of Cal. Law (9th ed. 1987) Contracts, § 145, p. 169, citing Rest.2d Contracts, § 33; see also *Mutz v. Wallace* (1963) 214 Cal.App.2d 100, 109, 29 Cal.Rptr. 170, *Richards v. Oliver* (1958) 162 Cal.App.2d 548, 561, 328 P.2d 544.) "Where a contract is so uncertain and indefinite that the intention of the parties in material particulars cannot be ascertained, the contract is void and unenforceable. (*Cal. Lettuce Growers v. Union Sugar Co.* (1955) 45 Cal.2d 474, 481, 289 P.2d 785; see Civ.Code, § 1598.)

The basic law of contracts is instructive here as the following agreements between the City of Lakeport and the County of Lake either were uncertain when they were signed or have become uncertain due to the change of circumstances and relevant tax/revenue law over time. Thus, it is important to note the general philosophy behind contact interpretation going forward.

**AGREEMENT NOT REQUIRED**

It is important to note that these agreements are based on the Cortese–Knox Local Government Reorganization Act of 1985 (Gov.Code, §§ 56000–57550, hereafter Cortese– **352 Knox Act). LAFCOs as they exist today are the product of the Knox-Nisbet Act of 1965, the purposes of which include "the discouragement of urban sprawl," the "orderly formation and development of local governmental agencies," and the encouragement and planning of "well-ordered, efficient urban development patterns with appropriate consideration of preserving open-space lands within such patterns." (Gov.Code, §§ 54774, 54774.5.)[5] The LAFCO for each county reviews and approves or disapproves proposed local government changes of organization, including annexations of territory. (§§ 56017, 56021, 56375).[2] Annexation proceedings may be initiated by the annexing city's resolution, or, depending on the locale, by petition of 15 or 25 percent of the registered voters, or property taxpayers owning that percentage of assessed valuation, in the territory proposed to be annexed. (§§ 56650, 56753, 56800.)

While city subject to application to annex incorporated territory is required to negotiate property tax revenue exchange with county, it is not required to reach or conclude agreement as to property tax revenue exchange, even though such agreement is precondition to local agency formation commission's (LAFCO) issuing certificate of filing and setting application for hearing. West's Ann.Cal.Gov.Code § 56828; West's Ann.Cal.Rev. & T.Code § 99. (*Greenwood Addition Homeowners Assn. v. City of San Marino* (1993) 14 Cal.App.4th 1360, 1367, 18 Cal.Rptr.2d 350;

Therefore, there is no requirement that the County of Lake enters in to any agreement with City of Lakeport, or come to any agreement for taxation at any time. The agreements are merely a consideration not a requirement.

**AGREEMENTS:**

The pre-annexation agreements that are being considered in this memo are between the County of Lake and the City of Lakeport signed on February 18, 1997, April 17, 2001 and February 26, 2002.

**AGREEMENT NUMBER 1:**

*AGREEMENT BETWEEN THE COUNTY OF LAKE AND CITY OF LAKEPORT FOR REVENUE REDISTRIBUTION PERTAINING TO THE CITY OF LAKEPORT SOUTH LAKEPORT REORGANIZATION – PHASE I*

The above agreement was entered into on February 18, 1997. This Agreement concerns a revenue sharing agreement for lost property tax revenue for the County in the event of the City of Lakeport follows through with plans for South Lakeport Reorganization (Annexation of South Lakeport).

Section 4.2 Termination Due to change In Law

At this time the argument can be made that the agreement is no longer valid due to changes in the law that have occurred between now and 1997. The agreement specifically states that in "entering into this Agreement, the parties mutually assume the continuation of the

existing statutory formula for the distribution of available tax revenues to local government and that assumption is a basic tenet of this Agreement."

Although not the exact circumstances of the subject agreement, a look at what constitutes a terminated contract under a "contracts clause" analysis can give some insight. The Supreme Court has directed that a sequential analysis to determine whether state law violates the Contract Clause. *See* Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400, 411-12, 103 S.Ct. 697, 704-05, 74 L.Ed.2d 569 (1983). Our first task is to determine "whether the state law has, in fact, operated as a substantial impairment of a contractual relationship." *Id.* at 411, 103 S.Ct. at 704 (quoting *Allied Structural Steel*, 438 U.S. at 244, 98 S.Ct. at 2722). "This inquiry has three components: whether there is a contractual relationship, whether a change in law impairs that contractual relationship, and whether the impairment is substantial." *General Motors Corp. v. Romein*, 503 U.S. 181, 186, 112 S.Ct. 1105, 1109, 117 L.Ed.2d 328 (1992).

In the 20 years that have passed since the signing of this agreement there have been substantial changes which impair the way tax revenue has been allocated to local governments from the state. Just a few of those substantial changes are the following:

***Vehicle License Fee/ Property Tax Swap (2004)***

In 2004 and 2008 the state sold bonds to finance state budget deficits (Economic Recovery Bonds, ERB). These bonds were repaid by a complicated swap of taxes necessitated by the need to have a dedicated source of revenue to repay the bonds. 1/4 of 1 cent sales tax revenue which had gone to local governments was dedicated to repaying the ERBs. The loss of sales tax revenue for local governments was replaced with ERAF funds and the state backfilled the schools for the loss of the ERAF revenue.

***Proposition 1A (November 2004*)**

This constitutional amendment, approved by the voters, was designed to protect against further reduction or diversion of property tax and sales tax and strengthen the state's obligation to reimburse local governments for state-mandated programs. It allows the state to borrow money from local governments no more than twice in a decade. Repayment of the loan must be paid back within three years.

***Proposition 22 (November 2010)***

This constitutional amendment approved by the voters, prohibited the state from taking revenue derived from locally imposed taxes, such as hotel taxes, parcel taxes, utility taxes and sales taxes, as well as local public transit and transportation funds from Proposition 42 gas tax or the Highway Users Tax. This proposition arose from an action by the California State Legislature in 2009 to "raid" $ 5 billion from city, county, transit, redevelopment and special district funds.

***Realignment (Criminal Justice, 2011)***

AB 109 and AB 117 began the transfer of the responsibility from the State prisons to counties for custody of low level criminal offenders and for the monitoring of certain parolees. The Legislature provided the counties with funding as part of the budget process. This realignment was triggered in large part by the need to reduce overcrowding in the state's prisons to comply with federal court orders. Proposition 30, which was approved by voters in November 2012, contains a provision that requires the state to continue to transfer to local governments

each year the same share of tax revenues transferred in 2011 in order to meet these new responsibilities.

***Redevelopment Agency Abolition (2011)***

Proposition 18, passed in 1952 and established a process under a city or county that could declare an area to be blighted and in need of redevelopment. After this declaration, most property tax revenue growth from the "project area" would be distributed to the city or county's redevelopment agency, instead of the other local agencies serving the project area. By 2011, about 11% of all property tax revenue statewide was going to redevelopment agencies, rather than counties, cities, and schools. As a result of Proposition 1A the Legislature was powerless to reallocate this revenue. So in 2011, the Legislature passed AB X1 26, which eliminated redevelopment agencies in California. As a result, the property tax revenue previously distributed to the redevelopment agencies will go to other local governmental entities, including school districts.

The changes above are significant and thus the agreement between the City and the County clearly has been terminated do to the change in law, a possibility that was anticipated at the time of signing as a possible concern.

Thus, it is a stainable position to deem the agreement terminated based on Section 4.2 – Termination Due to Change in Law.

**AGREEMENT NUMBER 2:**

*PRE-ANNEXATION AGREEMENT REGARDING PROPOSED UNDERGROUND UTILITY DISTRICT AND POSSIBLE ROAD IMPROVEMENTS IN THE SOUTH LAKEPORT AREA OF THE COUNTY OF LAKE*

The above agreement was entered into on April 17, 2001. Leaving aside the fact that it can be argued that the April 17, 2001 agreement is based on the 1997 agreement and thus as the 1997 agreement is terminated then the 2001 agreement is also as a result terminated, the 2001 agreement has its own problems that render the agreement unenforceable.

This agreement has a time limitation built into the agreement. In section 1 of the agreement the language reads as flows: “In event City files an application to annex any portion of the above-referenced area along South Main Street-Soda Bay Road adjacent to its present southerly boundary within six (6) years of the date of this agreement the City agree…” to enter into various future agreements and undertake various actions. Six years from April 17, 2001 passed in 2007 and to this date the City of Lakeport has not filed an application to annex any portion of the South Main street area.

Even though a later section (Section 5) states that the “agreement shall continue in full force and effect until the parties hereto have performed their obligations hereunder,” the six year limit stated earlier in the agreement clearly points to the fact that a limited time frame was anticipated from the agreement.

It is clear that in the mind of the parties the agreement was go into effect in a reasonable amount of time, when conditions under which the agreement was made were still similar to when

the agreement was entered into. As a result this agreement can be considered no longer enforceable.

**AGREEMENT NUMBER 3:**

*PRE-ANNEXATION AGREEMENT REGARDING SALES TAX ALLOCATION IN THE SOUTH LAKEPORT AREA OF THE COUNTY OF LAKE*
*FEBRUARY 26, 2002*

The above agreement entered into on February 26, 2002 by and between the County of Lake and the City of Lakeport deals with the County's plan to undertake road improvements in the South Lakeport Area.

The Roadway repair and reconstruction activities on South Main have been started but not completed by the County in this area – a fact which has no bearing on the validity of the contract.

The problem with the validity of this agreement is how vaguely the terms are worded. Perhaps the intent was to be vague and only represent a general plan for City and the County to work together, but never the less the vagueness of the terms renders the documents unenforceable. See Ladas v. California State Auto. Assn., 19 Cal. App. 4th 761, 770 (1st Dist. 1993) ("Where a contract is so uncertain and indefinite that the intention of the parties in material particulars cannot be ascertained, the contract is void and unenforceable." (citing California Lettuce Growers v. Union Sugar Co., 45 Cal. 2d 474, 481 (1955) and California Civil Code section 1598)); Moncada v. W. Coast Quartz Corp., 221 Cal. App. 4th 768, 777 (6th Dist. 2013) (same).

. Section 2. Of the agreement lacks specify as to the obligations of the parties. The "County and the City agree to enter into a sales tax sharing agreement similar to" the agreement entered into in 1997 (discussed above). The term "similar" is not defined and is vague making it impossible to pinpoint what exactly is required of each party. No doubt what each party considers similar will be different and therefore should have been defined in the original agreement.

Section 2 also contains the phrase the 'obligation to enter into a sale tax sharing agreement is conditioned upon the following:" One of the conditions is that the City and County agree to a property tax exchange with an agreed to average share. Again these terms "agreed to" and "average share" are not defined and are subject to interpretation. A condition that requires the parties to come to an agreement is at it most basic not an agreement to do anything specific because if they cannot agree then actions cannot be taken. Here again the language sounds nice and congenial but is not enforceable as to anything specific.

Also the 5th "Whereas" in the agreement is no longer true as the County and City are no longer on the same financial footings as they were in 2002 and thus the conditions under which the agreement were undertaken have changed. The County, having been subject to numerous disasters (Valley Fire etc.), is no longer in a positive financial footing and the City, having avoided most of those disasters is in a different position.

Finally, the agreement has a statement in it that an application that would …take effect within ten years of the date of this agreement. Although the agreement does not technically have

an end date the inclusion of this statement illustrates that the parties saw some action happening on annexation within a ten year period. A ten year period that pasted in February of 2012.

**SUCCESSIVE WRITINGS**

It is also important to note that the County of Lake and the City of Lakeport have undertaken no additional "writings" regarding this the issue of Annexation or Pre-Annexation since the date of the last agreement in February 2002. Clearly, the County and the City understood that a writing should be used to distill any agreement they want to make with each other. The fact that there have not been any writings on this issue between the two entities in over 16 years speaks volumes. If any continued or new understanding were intended the City of Lakeport and the County of Lake would have reduced those agreements to a successive agreement.

**SPHERE OF INFLUENCE**

The "South Main" area that the City of Lakeport has considered annexing is a part of the City of Lakeport's "sphere of influence." A sphere of influence is a plan for the probable physical boundaries and service area of a local agency, as determined by the (commission) LAFCO. LAFCOs are responsible for establishing a sphere of influence for each city and district whose boundaries are regulated by LAFCO. Typically, a sphere of influence is the territory a city or district is expected to annex.

Cities and districts cannot provide services outside their sphere of influence except in very limited circumstances. With the passage of the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 (California Government Code Section 56000 et seq.) LAFCOos are required to update spheres of influence every five years either in conjunction with, or after completing, service reviews. This Act was enacted to encourage 'planned, well-ordered, efficient urban development patterns with appropriate consideration of preserving open-space [and agricultural] lands within those patterns and to discourage urban sprawl and encourage 'the orderly formation and development of local agencies based upon local conditions and circumstances.' " (*Sierra Club v. San Joaquin Local Agency Formation Com.* (1999) 21 Cal.4th 489, 495, 87 Cal.Rptr.2d 702, 981 P.2d 543.).

Most relevant to the question of what rights a city has in its sphere of influence pre-annexation is the statement that a city "has only those express (or necessarily implied) powers which are specifically granted to it by statute." (*City of Ceres v. City of Modesto* (1969) 274 Cal.App.2d 545, 550, 79 Cal.Rptr. 168.) A LAFCO's powers are set forth in section 56375. Most pertinent to this case, section 56375, subdivision (p) provides that a LAFCO has the power and duty "[t]o authorize a city or district to provide new or extended services outside its jurisdictional boundaries pursuant to Section 56133." Section 56133 provides, in pertinent part:

"(a) A city or district may provide new or extended services by contract or agreement outside its jurisdictional boundaries only if it first requests and receives written approval from the [LAFCO] in the affected county.

"(b) The [LAFCO] may authorize a city or district to provide new or extended services outside its jurisdictional boundaries but within its sphere of influence in anticipation of a later change of organization.

As can be noted the City of Lakeport "may" have some rights to extend services by contract in the sphere of influence. However, it requires the authorization of LAFCO to do so pre annexation. Although there does not seem to be any case law that details a city trying to stop the County from adding services to the City's sphere of influence – it can be extrapolated that stopping the County would also need LAFCOs authorization. At this point the City of Lakeport has not applied to LAFCO and therefore have no extra powers in their sphere of influence.

## CONCLUSION

The three agreements between the County of Lake and the City of Lakeport are for various reason subject to the argument that they are unenforceable, void or terminated. Therefore, any application that the City of Lakeport makes to annex South Main should be subject to the Rules of LAFCO and the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 without being effected by any of the above agreements. Further, if the City of Lakeport wants to have any "say" in the County projects in the South Main area before annexation they will need to apply to LAFCO and go through the full required process.