Presentation on Act 47[1]

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On behalf of the staff and Members of the Local Government Commission, we wish to the thank the Chairs and Members of the Senate Community, Economic & Recreational Development Committee, the Senate Local Government Committee, and the House Urban Affairs and Local Government Committees for permitting us to offer comments on the developmental history and significant challenges of Act 47.[2] **In the twenty-four years that have passed since the enactment of the Municipal Financial Recovery Act, issues have arisen, including some recently, which make a comprehensive review of the statute's effectiveness a necessity. However, we will emphasize the two most important considerations that Act 47 attempted to address but which continue to be challenges: (1) potential constitutional limitations and (2) the process of addressing the question of nonviable municipalities.**

[1] Much of this background information is directly extracted from *Municipal Fiscal Distress, Background and Legislative Remedy*, January 1987, prepared by Local Government Commission staff members, Michael P. Gasbarre, Danette S. (Hobbs) Magee, and Andrew Sislo, Esq. For purposes of this presentation, further attribution to this document is not provided.

[2] The act of July 10, 1987, P.L. 246, No. 47, known as the "Municipal Financial Recovery Act."

In June 1985, the Local Government Commission authorized the formation of a Task Force to study problems associated with distressed municipalities and to formulate a legislative proposal to hopefully alleviate these problems. The Task Force was comprised of Members of the General Assembly, and individuals representing various municipal associations, state agencies, research organizations, business interest groups, the university community, and the United States Bankruptcy Court.

The Task Force commenced its work in October 1985, by reviewing legislation and statutes from Pennsylvania and other states to aid in drafting a proposal that best reflected the current state of distressed municipalities in Pennsylvania. Much original thought and language also was included in the Task Force's proposal to accomplish three objectives that the members believed needed to be addressed:

(1) Development of a state assistance plan to aid distressed municipalities in restoring their financial integrity, while leaving principal responsibility for the conduct of financial affairs of the municipality to its locally elected officials.

(2) Creation of an updated procedure to enable distressed municipalities to file for municipal debt readjustment action under federal law.

(3) Development of a procedure to consolidate distressed municipalities that were no longer considered economically viable. The procedure enacted at the time was voluntary and required approval of a majority of voters in each municipality proposed to be consolidated. As an incentive, merged or consolidated municipalities were to be given priority in all state community and economic development funding.[3]

The general philosophy of the Task Force was to draft legislation that would enable distressed municipalities to assist themselves through the adoption of an acceptable financial plan. Task Force members, and, upon introduction of legislation that became Act 47, Members of the Local Government Commission, were opposed to an outright state "bailout" of municipalities in fiscal distress. This was seen as an unwise incentive for financially marginal communities to seek financial aid without recognizing their own fiscal limitations. Therefore, distressed municipalities that refused to adopt a fiscal

[3] The consolidation and merger provisions were repealed with the enactment of the Uniform Merger and Consolidation Act, 53 Pa.C.S. § 731 et seq., in 1994.

plan pursuant to Act 47 would be no longer eligible to receive most entitlements or grants.

Of particular importance, the Task Force and the staff and Members of the Commission were very much aware of limitations on legislation affecting the state-local relationship by the Constitution of Pennsylvania. These provisions relate to restrictions on local and special legislation, the extent of permissible regulation of local financial affairs by a public or private commission or association, and the assumption of local debt by the Commonwealth. The Constitutional limitations were addressed as follows:

(1) <u>General vs. Special or Local Law</u> – Article III, Section 32, of the Pennsylvania Constitution prohibits the General Assembly from enacting local or special laws that can be provided for by a general law, and specifically, the General Assembly may not pass any special law that regulates the affairs of counties, cities, townships, wards, boroughs, or school districts. Thus, Act 47 was drafted as a general law applicable to all classes of local government subsequent to its enactment, although the act was suspended in its application to Philadelphia in 1991 with the passing of the Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the

First Class.[4] Other state models which were examined during the formation of Act 47, such as New York recovery statutes for specific municipalities, were deemed constitutionally deficient in Pennsylvania because of this restriction. Act 47 recognizes that all local governments function as instrumentalities of the state and that, as such, their fiscal integrity impacts the general health, safety, and welfare of the entire Commonwealth. Accordingly, the establishment of a statutory classification and mechanism for addressing problems of fiscal distress has a natural relationship to a proper state purpose, and is based upon real distinctions between fiscal stability and fiscal collapse.

(2) <u>Assumption of Municipal Debt</u> – Article VIII, Section 9, of the Constitution prohibits the Commonwealth from assuming the debt, or any part thereof, of any county, city, borough, incorporated town, township, or similar general purpose unit of government unless the debt was incurred to enable the Commonwealth to suppress insurrection or to assist the Commonwealth in the discharge of its present indebtedness. Once debt is incurred by a local government, it must remain local debt. Act 47 does not permit

[4] The act of June 5, 1991, P.L. 9, No.6.

or require the Commonwealth to assume the debts of municipalities.[5] In fact, in relation to the grant and loan program provided for in Chapter 3 of Act 47, a distressed municipality must use state monetary resources solely for the purposes of payment of current operating expenses. Current operating expenses do not constitute debt or unfunded debt as defined in the Local Government Unit Debt Act.[6]

(3) <u>Delegation of Certain Powers Prohibited</u> – Of all the restrictions imposed by the Constitution on state financial oversight of local government, Article III, Section 31, arguably is the most constraining. It prohibits the General Assembly from delegating "to any special commission, private corporation, or association, any power ---

--- to make, supervise or interfere with any municipal improvement, money, property or effects, or

--- to levy taxes or

--- [to] perform any municipal function whatever."

The Task Force discussed whether a board of control similar to provisions existing for school districts could be created to actively control local

[5] No controlling case law exists which defines the prohibition on the Commonwealth "assuming" municipal debt.
[6] Section 303 (a) of Act 47.

governments' finances, but rejected the premise on advice of counsel due to this constitutional provision. Consequently, Act 47 was originally enacted without a mandate on municipalities to adopt and implement the solvency plans prescribed within it, and did not create a special commission, public or private, to control the fiscal affairs of a distressed municipality, or seize the policy-making power of the local governing body.

Article III, Section 31, referred to by one commentator as a "ripper clause,"[7] was the first of its kind in state constitutions in the United States. It was adopted after the Constitutional Convention convened in late 1872 at a time during which special and local legislation were used to grant favor to private industries and quasi-public entities at the expense of municipal governments and its citizens. The historical reasons for the adoption of Section 31 have largely vanished with the passage of time, and the tension between the provision and the modern era resulted in an amendment in 1967 that expressly provided an exception for binding arbitration in fire and police labor disputes. Arguably, the provision was never contemplated to prohibit the Commonwealth from directly intervening to stop the effects of fiscal distress from adversely affecting the welfare of a municipality's residents or

[7] David O. Porter, *"The Ripper Clause in State Constitutional Law: An Early Urban Experiment – Part I"*, 1969 Utah L. Rev., pgs 287-325; David O. Porter, *"The Ripper Clause in State Constitutional Law: An Early Urban Experiment – Part II"*, 1969 Utah L. Rev., pgs. 450-491.

other adjoining municipalities. Given the breadth of the provision's prohibition, the economic challenges facing municipal government and the interconnected nature of the fiscal health of state and local government, further amendment may be required to address modern challenges. In light of these challenges, the statements of Professor David O. Porter in 1969 seem prescient today:

> **A single constitutional clause is too narrow and may even be dysfunctional, as it is so difficult to amend. This argument, coupled with a review of the history of the ripper clauses, gives considerable support to the familiar proposition that constitutions should be restricted to broad policy statements. In relation to cities, the fundamental law needs to allow flexibility for legislative and municipal experimentation to deal with emerging problems. Outdated or narrow constitutional clauses often become artificial barriers to the effective handling of current problems. The ripper clause has not served as such a barrier, but perhaps a more effective way to promote orderly and effective adaptation to the changing physical and human environments of our cities is**

through constitutional provisions framed more broadly than the ripper clause.[8]

In addition to constitutional concerns, the Task Force was faced with the significant problem of addressing the issue of nonviable municipalities. In the early 1980s, with the demise of the steel industry, several Pennsylvania communities, most notably those in western Pennsylvania, experienced significant job losses that had a direct effect on the resultant tax base. These communities suffered from conditions that could be clearly stated as long-term distress caused by structural changes in their local economy resulting in the retrenchment of funding sources which the municipalities previously heavily relied on to balance annual budgets. In an effort to address municipalities experiencing significant and damaging changes in their funding sources and the loss of population due to substantial decreases in employment, it became apparent to the Task Force that some municipalities had already become unable to provide necessary municipal services without considerable state assistance. Significant debate focused on whether these municipalities should be forcibly merged or consolidated into neighboring municipalities after a period of time during which the Commonwealth would provide

[8] David O. Porter, *"The Ripper Clause in State Constitutional Law: An Early Urban Experiment – Part II"*, 1969 Utah L. Rev., p. 491.

financial incentives to encourage such boundary changes. However, practical considerations soon won out over the larger policy issue of whether nonviable communities should exist. The Task Force realized that a forced merger or consolidation frankly was a "non-starter," and would result either in failure of the General Assembly to consider fiscal solvency legislation or in outright defeat of the bill. As a result, the draft of what became Act 47 provided a voluntary merger and consolidation option for distressed municipalities and neighboring communities that involved initiating the process by a joint agreement of the governing bodies supportive of a merger or consolidation or by initiative of the voters and the conduct of a referendum in all municipalities involved in the boundary change.[9] As an incentive, a consolidated or merged municipality was given priority in all community and economic development funding by the Commonwealth. Incentives notwithstanding, to date, no mergers or consolidations involving Act 47 communities has occurred.

In an attempt to measure the effectiveness of Act 47, the Local Government Commission sponsored an external program evaluation of the statute four years after its enactment by the Graduate School of Public Policy and

[9] The merger and consolidation procedures provided in Act 47 were repealed by Act 90 of 1994.

Administration at Penn State.[10] The conclusions relating to voluntary boundary change were sobering if not predictable. The authors stated:

> **The provision of Act 47 that outlines a process for voluntary consolidation of distressed municipalities with other jurisdictions is not in its present form viable. The reason is obvious: it is highly unlikely (and understandable) that residents of a jurisdiction, which enjoy relative fiscal health, will be willing through initiative and referendum to incorporate within their legal borders a jurisdiction that does not. Without changes, this provision of the Act is by-and-large meaningless.[11]**

The authors further concluded that consolidation or merger may be the only realistic available long-term remedy, but that approval of a referendum in affected municipalities is a "compelling force against any consolidation, no matter how needed or seemingly rational." Thus, the program evaluation came to the same conclusion as the Task Force, that policy and practical

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[10] *"Coping with Fiscal Distress in Pennsylvania's Local Governments: A Program Evaluation of Act 47,"* Department of Public Administration, Graduate School of Public Policy & Administration, The Pennsylvania State University, April 1991.

[11] *Coping with Fiscal Distress in Pennsylvania's Local Governments: A Program Evaluation of Act 47, p.20.*

considerations outweigh, no matter how controversial, the mandatory dissolution of municipalities no longer financially sustainable.

Finally, we would like to impart some thoughts on the additions of Chapters 6 and 7 to Act 47 that are provided by Senate Bill 1151. It is an accurate statement that those who crafted Act 47 never envisioned a situation where a distressed municipality would fail to adopt either the coordinator's solvency plan or an alternative that could be drafted by a municipality's chief executive officer or governing body. Act 47's penalties, the loss of most state funding and the inability to incur additional debt, was thought to be too severe for that failure. In a concession to Article III, Section 31, the alternative plan provisions were added. However, as recent events have occurred, leaving a municipality to its own demise by inaction or failures of governing is unreasonable from the standpoint of who pays the ultimate price – the very residents of the distressed municipality. Leaving a fiscally insolvent and likely destitute community with no solution to alleviate its fiscal condition is a clear weakness of Act 47. Without any other viable options, there may be no choice but for the Commonwealth to exercise its sovereign and plenary police power to protect the public health, welfare and safety of local residents. In a 1980 case, the Pennsylvania Supreme Court stated that the "police power [of the

Commonwealth] is fundamental because it enables civil society to respond in an appropriate and effective fashion to changing political, *economic,* and social circumstances, and thus to maintain its vitality and order. The police power of state (must therefore be) . . . as comprehensive as the demands of society require under the circumstances."[12] In an earlier case, the Court stated the following: "That the legislature may properly exercise its police power in an attempt to remove causes of economic stress for the public welfare cannot be doubted."[13] In its report to the Constitutional Convention in 1967, the Local Government Committee in its recommendation on the proposed Article IX, Section 1, of the Pennsylvania Constitution stated, "It is intended that the General Assembly shall have the continuing responsibility to provide for local government and the power to regulate all levels of local government, notwithstanding any provisions granting authority to all local government units to frame and adopt charters, or the grant of power to municipalities to adopt provisions for 'residual powers'. This section preserves flexibility by enabling the General Assembly to make changes as required."[14] Thus, to the extent that Article IX contemplates the ability of municipalities to enact optional plans and charters, it also recognizes the

[12] *National Wood Preservers, Inc. v. Commonwealth of Pennsylvania, Department of Environmental Resources,* 414 A.2d 37, 42-43 (Pa. 1980) (internal quotations and citations omitted)(emphasis added).
[13] *Department of Labor and Industry v. New Enterprise Rural Electric Co-op, Inc.*, 352 Pa. 413, 417, 43 A.2d 90, 92 (1945).
[14] Report to the Convention of the Committee on Local Government, Constitutional Convention 1967-1968, p.3

sovereignty of the Commonwealth to provide for and control local government. There is no doubt that Chapter 6 relating to declaration of a fiscal emergency and Chapter 7 that provides for the appointment of a receiver, are innovative. Article III, Section 31 prohibits a special commission, private corporation or association from interfering with or regulating municipal fiscal affairs. Neither the Governor nor a receiver appointed by the court could reasonably be considered a special commission or association in light of the origin of this provision.

Act 47's constitutionality has been challenged and successfully defended.[15] It was very carefully engineered to withstand the test of time and it has. It provides a mechanism for willing municipalities that are experiencing financial difficulties to request state assistance. It now provides a mechanism for some municipalities that request state assistance but fail to act with the state means to address an unsustainable situation. Without speaking to the procedural aspects of Act 47 which the Department of Community and Economic Development is better able to address as the administrator of the statute, our staff would leave these final thoughts for the Members of the

[15] *Wilkinsburg Police Officers Association By and through Harder v. Commonwealth of Pennsylvania*, 129 Pa.Cmwlth 47, 564 A.2d 1015 (1989), affirmed 636 A.2d 134 (Pa. Dec. 30, 1993).

General Assembly to consider as policy options to improve the capability of Act 47:

- **Should Article III, Section 31, of the Constitution of Pennsylvania be amended to expressly provide for direct state intervention to alleviate municipal fiscal distress?**
- **Should Article III, Section 32, of the Constitution of Pennsylvania be amended to permit Pennsylvania, similar to New York and other states, to craft "special legislation" to concisely deal with individual financially distressed municipalities in a limited manner without violating the current provisions that appear to prohibit interference with municipal affairs?**
- **Should the General Assembly enact specific boundary change legislation relating to the consolidation and merger of *nonviable* distressed municipalities outside the current initiative and referendum process?**
- **Should Chapters 6 and 7 be expanded to all municipalities in addition to cities of the third class?**

If acted upon, consideration of the Constitutional amendments would provide even greater public discourse and understanding by the citizens of the

Commonwealth of the fiscal difficulties that many local governments are experiencing. Healthy debate would center on the need for more state action versus local control, but perhaps after 25 years it is time for that debate to occur. Although the scope of constitutional limitations, including those contained within Article III, Section 31, may be subject to reevaluation and clarification, particularly in situations where a municipality under Act 47 fails to take corrective action, they nevertheless remain and should be examined in light of solutions to municipal fiscal distress in other states without them.

The nonviability of municipalities and the ultimate discussions on the correct course of action may be considered provocative by some, but the continued inaction really does not address the issue. Nonviable municipalities should not be dependents of the state. If they are unable to survive on their own, then the question arises, "Should they exist?" If not, what should take their place?

Chapters 6 and 7 were drafted to address an immediate concern. Up until this year, no municipality had refused to adopt either a coordinator's plan or a plan of their own. The implicit message of the chapters is that inaction has consequences and certain municipalities have fair notice that participation in Act 47 requires active involvement and constructive action. Failure to do so is

no longer a choice. Although the application of the chapters is limited, the remote prospect of municipalities of other classes failing to act when faced with fiscal distress is real. Therefore, the General Assembly may wish to debate the merits of extending the provisions of Chapters 6 and 7 to all municipalities.

Thank you for allowing us to offer comments and we would be glad to respond to your questions.