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Act 47: Pennsylvania Says Enough Is Enough. Or Is It? Ballard Spahr.

Pennsylvania Governor Tom Corbett today signed House Bill 1773 (HB 1773) into law, significantly overhauling the Municipalities Financial Recovery Act, known as Act 47. Enacted in the 1980s to provide assistance to municipalities that were suffering from collapsed tax bases following the closure of many western Pennsylvania steel mills, Act 47 was intended to help distressed municipalities control their expenses (particularly labor arbitration awards), enhance revenue through additional taxing authority, and qualify for certain Commonwealth grants and no-interest loans on a priority basis.

Twenty-eight municipalities across the Commonwealth have been officially declared financially distressed under Act 47—with others contemplating such a determination, and undoubtedly even more able to qualify under the law if they wished to do so. Unfortunately, only nine have had their determinations lifted. It is noteworthy that 14 municipalities have been in the Act 47 program more than 10 years, some more than 20 years. Given the apparent difficulty of overcoming municipal financial distress (or the reluctance of municipal officials to make difficult choices required to alleviate it), and with the hindsight of an apparently successfully negotiated resolution to the City of Harrisburg's defaults and insolvency, the General Assembly determined to amend the law.

A New Timetable To Manage Distress

While Act 47 recovery plans are typically written with a five-year shelf life, after which an updated plan is typically put in place, the new amendments impose a five-year time limit for municipalities to exit Act 47. At the same time, the amended law permits the recovery plan coordinator to ask the local Court of Common Pleas for a one-time, three-year extension. For municipalities already in Act 47 and operating under a recovery plan, the termination date for their distressed status will be five years from the effective date of the most recent recovery plan or amendment. If their current plan is scheduled to expire within one year or less of the effective date of the Act 47 amendments, the municipality is subject to an automatic extension of three years from the termination date of the current recovery plan or plan amendment.

By adding this time limit, the Commonwealth is emphasizing the need for municipal officials to take a hard look at their underlying financial structure, including collective bargaining agreements. The question is whether the maximum of eight years under Act 47 will be enough time to implement significant and successful financial structural changes. Labor costs are one of the most significant contributing factors to a municipality's fiscally distressed status. Collective bargaining agreements, however, typically last four or more years. Under Act 47's new time limits, it is likely that a municipality will have at most only one opportunity to reduce its labor costs through collective bargaining during an Act 47 designation. The practical effect of the new amendments must be warmly welcomed by municipal employees.

Since the expiration provisions may not provide sufficient time for a municipality to solve its labor cost issues, it is essential that a municipality times its entry into Act 47 when its collective bargaining agreements are scheduled to expire and that it uses the Act 47 tools effectively and fully when it has the opportunity to do so. While a time limit might be a reasonable idea, an arbitrary limit may be too short to permit meaningful change to alleviate long-term municipal fiscal distress. It is questionable whether five or eight years is enough time for a municipality to significantly reverse the other causes of fiscal distress, such as a declining population and eroding business tax base, deteriorating infrastructure, and declining investment, that in many cases have been declining for years. The main focus of a successful state oversight regime should be providing the tools that municipalities need to regain their footing; whether the new time limit and other amendments do so remains to be seen.

Four Exit Scenarios

In the fifth year of a municipality's Act 47 status, the recovery plan coordinator must complete a report setting forth the financial condition of the municipality and make one of the following findings:

- The conditions within the municipality warrant a termination of distressed status.
- The conditions warrant a three-year extension and exit plan.
- The conditions justify a request by the Secretary of the Department of Community and Economic Development (Secretary) for a determination of fiscal emergency.
- The conditions warrant disincorporation of the municipality.

After public notice, a comment period and a public hearing, the Secretary will issue an administrative determination of termination status and the reasons for such determination. Factors considered in the Secretary's determination include elimination of operating deficits, projected balanced budgets, projected revenues, stable debt obligations, and resolution of all financially adverse claims or judgments against the municipality. This determination is subject to appeal by specific parties identified in the new law, including a collective bargaining representative

Receivership: Doubling Down on the Harrisburg Approach

The mismanagement and crisis of inaction that resulted in the installation of a state-appointed receiver for the City of Harrisburg ended in 2013 with the adoption of the "Harrisburg Strong Plan"—the innovative financial recovery plan that allowed Harrisburg to avoid municipal bankruptcy and reposition itself for long-term renewal. The Harrisburg Strong Plan received national recognition, and the strategies implemented in it have been viewed as a potential "blueprint" for restructuring municipal obligations for distressed cities that is both cheaper and faster than a Chapter 9 bankruptcy filing. A number of the lessons learned from Harrisburg appear to have informed some of the Act 47 amendments.

Chapters 6 and 7 of Act 47 govern the fiscal emergency and receiver provisions. Upon the Secretary's request, the Governor may determine that a fiscal emergency exists if the distressed municipality is insolvent (or projected to be insolvent in the next six months), and the municipality either (1) is unable to continue providing vital and necessary services; or (2) has failed to approve the coordinator's plan or an alternative plan that had been approved by the Secretary. Upon determination of a fiscal emergency, the Governor may then formally declare the municipality to be in a state of fiscal emergency, and direct the Secretary to develop an emergency action plan to ensure the maintenance of vital and necessary services. During a state of fiscal emergency, the Governor may exercise the authority of the municipality's elected or appointed officials and may assume any of their powers, including the powers to, among other things, collect funds, obtain emergency financial aid, and enter into contracts and agreements on behalf of the municipality for vital and necessary services. The elected and appointed officials may continue acting in their respective offices and capacities, as long as no action or decision conflicts with the emergency action plan, order, or exercise of power by the Governor.

Shortly after the declaration of fiscal emergency, the municipality's governing body must negotiate a consent agreement with creditors and any other interested parties. The consent agreement must incorporate a plan setting forth measures designed to provide long-term financial stability to the municipality and maintain vital and necessary services. Once a consent agreement is negotiated, the Secretary will decide whether to approve it. If the consent agreement is approved, the municipality's governing body must enact an ordinance adopting it. The status of fiscal emergency will end when the Secretary determines that the municipality is solvent and is not projected to be insolvent within 180 days or less, and is able to maintain vital and necessary services after the termination of fiscal emergency.

If the consent agreement is not approved, or the municipality fails to enact an ordinance adopting it, the Governor may appoint a receiver for the municipality. The receiver will then develop a recovery plan for the municipality. Such a plan is expected to ensure that vital and necessary services continue, the municipality's lawful financial obligations are paid, and required pension fund payments are deposited in a timely manner. The plan will also authorize a number of other actions, including the sale and conveyance of municipal property; approval, modification, or termination of contracts; and any other decisions the receiver deems appropriate.

The recovery plan must be confirmed by the Court of Common Pleas unless it finds clear and convincing evidence that the plan is arbitrary, capricious, or wholly inadequate to alleviate the fiscal emergency. Confirmation of a recovery plan requires the elected and appointed officials to undertake the acts set forth in the plan and suspends their authority to exercise power on behalf of the distressed municipality under law, charter, ordinance, rule, or regulation to the extent that such power would interfere with the powers granted to the receiver or the recovery plan's goals.

The receiver's term will end two years after appointment, with the option for one or more extensions of up to two years as approved by the court. The receivership also terminates automatically upon certification from the Secretary that the fiscal emergency has ended and the Governor rescinds the declaration. If the municipality remains financially distressed upon the expiration of the receivership period as determined by the Secretary, the recovery plan shall remain in effect and the Secretary will appoint (or re-appoint) a coordinator to administer the recovery plan in accordance with the timeline and requirements of Act 47.

Unlike some other states' receivership laws, notably Michigan's Act 436, the Commonwealth's receivership provisions under these amendments do not expressly allow a receiver to reject, modify, or terminate existing collective bargaining agreements. This difference is critical because high labor costs are usually the largest contributor to a municipality's fiscal distress. The new receivership provisions do, however, put labor leaders on notice that absent their willingness to negotiate contracts based on a municipality's reasonable capacity to pay for labor, the contracts may end up being impaired to a greater extent under a Chapter 9 bankruptcy proceeding.

Disincorporation – A Radical Approach

The original Act 47 anticipated that some municipalities may, in fact, be "nonviable" due to the long-term loss of their tax bases. In practice, the lack of interest in municipal consolidation on the part of more financially balanced adjoining communities has prevented determinations of nonviability. The new amendments provide that a municipality unable to exit Act 47 could legally be deemed nonviable, resulting in "disincorporation." For purposes of this section of the law, a "municipality" is defined as a "county, city, borough, incorporated town, township and home rule municipality that does not provide a police service or fire service through its employees." The City of Philadelphia is not included in this definition, however.

The disincorporation provisions of the Act 47 amendments seem to be the clearest "warning shot" from the General Assembly to municipal leaders that their inability, or reluctance, to overcome perpetual financial distress will no longer be tolerated. While the reality of disincorporation may at first seem to position the distressed community for an easier path toward consolidation with skeptical neighbors, in practice, the disincorporation option may be of limited value if it does not apply to large numbers of municipalities with police and fire employees.Under the disincorporation provisions, if the Secretary determines that disincorporation is warranted, the Secretary must provide notice to the municipality's governing body and recommend disincorporation. Within 45 days of this determination, the governing body may enact an ordinance initiating the disincorporation, or, if the governing body fails to do so, a petition signed by a majority of registered electors of the municipality (those voting in the last gubernatorial election) may be submitted to the Court of Common Pleas. After another round of notice and hearing, the court will then issue a decree approving the ordinance's validity or granting the petition unless it finds by clear and convincing evidence that the municipality should remain incorporated because of a reasonable expectation that the municipality is viable.

If the court were to take the extraordinary step of issuing a disincorporation decree, a service district administrator would be appointed by the Secretary to establish an essential service plan. The service district administrator will enjoy broad powers, including the ability to sell or convey the municipality's assets; repay debts, bonds, and other obligations; seek a writ of mandamus against the municipality's governing body to carry out the disincorporation; approve, negotiate, or terminate contracts for services; identify essential services; apply for grants and loans; establish fees; and contract for professional services for the municipality. After the decree but before implementation of disincorporation, the municipality must enact a budget providing for the payment of every current obligation before the date of disincorporation and provide for the transfer and administration of any municipal pension assets to a private or public pension fund. The municipality's governing body may adopt recommended governing standards to be included in the essential service plan. Once the plan has been filed, there will be another round of notice, public meeting and comment, as well as an opportunity to appeal the final plan, before final filing of the plan.

On the date of disincorporation, the terms of all elected officials of the municipality automatically terminate and no person shall be elected or appointed, all ordinances of the municipality are nullified, all corporate powers granted to the municipality under its charter or the municipal code terminate, and the municipality shall be deemed an unincorporated service district.

Revenue Enhancement

The Act 47 amendments also set forth a number of changes to what municipalities operating under the program can do. These include expressly conditioning the increase in the earned income tax upon equal imposition on both residents and commuters. They also allow a municipality to triple the usual $52 maximum local services tax rate. It is important to note that municipalities will retain the ability to maintain this higher local services tax after exiting Act 47.

Municipalities in Act 47 will still not be allowed to change labor contracts already in place. They will, however, be able to pursue changes to labor contracts through the applicable collective bargaining process and Act 111 interest arbitration procedures. The existing provisions of Act 47 mandate that the collective bargaining agreement that results from those procedures must comply with the Act 47 recovery plan that is in place at that time (with very limited exceptions).

The amendments also remove a provision allowing municipalities with distressed municipal pension plans to use added revenue from the higher local services tax to pay pension debt. Certain provisions are specific to Pittsburgh, which entered Act 47 in 2003. Unlike other Act 47 municipalities, Pittsburgh would not have an opportunity to increase its local services tax in lieu of an earned income tax. Act 47 does not apply to the City of Philadelphia.

Although the Act 47 amendments passed the General Assembly easily, these changes address Act 47 procedures and levels of state oversight; they do little to alleviate the underlying financial, demographic, or structural problems causing the financial distress. If nothing else, the amendments should serve notice to Pennsylvania municipal leaders and voters that the General Assembly expects municipalities to make meaningful and politically difficult decisions to address their fiscal situation in a timely manner, or risk losing local control of their municipalities. The legislative intent is clear: the days of perpetual Act 47 status and “treading water” financially are numbered. The question is whether the General Assembly has provided adequate tools to enable municipalities to achieve that result on schedule, or at all.

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Attorneys in Ballard Spahr’s Municipal Recovery Initiative have hands-on experience representing governments in matters of public finance; public-private partnerships; bankruptcy, restructuring, and capital recovery; labor and employment; tax; land use; and intergovernmental relations. Our attorneys have a track record of success helping financially distressed municipalities with issues such as accessing capital markets, negotiating and arbitrating labor contracts, and monetizing assets.

The firm’s Public Sector Labor and Employment practice is a multidisciplinary labor and employment law practice that represents cities and municipalities in all aspects of Act 47, including the development of early intervention programs and financial recovery plans, pension and post-retirement health care issues, collective bargaining and grievance and interest arbitration under Act 195 and Act 111, and all other employment, labor, and personnel issues.

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