STATE OF MICHIGAN
OAKLAND COUNTY CIRCUIT COURT

WILLIAM NOFAR, individually and as representative of a class of similarly-situated persons and entities,

Plaintiff,

v.

CITY OF NOVI, MICHIGAN
a municipal corporation,

Defendant.

Case No. 2020-183155-CZ
Hon. Judge Nanci Grant

HEARING DATE:
April 13, 2022

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PLAINTIFF'S MOTION FOR PARTIAL SUMMARY DISPOSITION AS TO COUNTS I AND II OF HIS COMPLAINT PURSUANT TO MCR 2.116(C)(10)

Plaintiff William Nofar ("Plaintiff"), individually and on behalf of a class of similarly situated persons and entities, hereby moves the Court, pursuant to MCR 2.116(C)(10), for partial summary disposition as to the claims in Counts I and II of the Complaint based upon Defendant's violation of the Prohibited Taxes by Cities and Villages Act, MCL 141.91, which provides:

> Except as otherwise provided by law and notwithstanding any provision of its charter, a city or village shall not impose, levy or collect a tax, other than an ad valorem property tax, on any subject of taxation, unless the tax was being imposed by the city or village on January 1, 1964.

In support of this motion, Plaintiff relies upon the following Brief in Support.

BRIEF IN SUPPORT

I. INTRODUCTION

This is an action challenging the water and sewer rates and charges (the "Rates" and "Charges"), imposed by the City of Novi (the "City") on citizens who draw water from the City's water supply system and who dispose of their sanitary sewage through the City's sewer system. Since at least 2015, the City has set its Rates at a level far in excess of the rates that were necessary to finance the actual costs of providing water and sewer services (the "Rate Overcharge"). The Rates during this period resulted in the accumulation of cash reserves far in excess of those necessary to support the City's water and sewer function. Indeed, between July 1, 2015 and June 30, 2019, the City increased its cash and investments in the Water and Sewer Fund from $56 million to almost $70 million through its imposition of the Rate Overcharge. These unrestricted assets represent almost three times the City's annual water and sewer-related expenditures.

Regardless of the reasons the City accumulated the cash reserves, the City's conduct has been unlawful. On the one hand, if the City accumulated the funds to finance future capital improvements, the Charges constitute an unlawful tax on its water and sewer customers because, among other reasons, the customers have been forced to pay for improvements in a period of time significantly shorter than the useful lives of those improvements, and those improvements will benefit future users of the system who will enjoy the benefits of the improvements without having paid for them. On the other hand, if the City arbitrarily and capriciously accumulated the funds without a plan to spend them on future capital improvements, the City's Rates and Charges have been "unreasonable."

This motion is based solely on the "Unlawful Tax Claims" stated in Counts I and II of Plaintiff's Complaint, which allege that the Rate Overcharges constitute unlawful taxes in violation of the Michigan Prohibited Taxes by Cities and Villages Act, MCL 141.91 (Counts I and II). Plaintiff accepts, **for the purpose of this motion only**, the City's contention that its cash hoard was

accumulated for the purpose of funding specific capital improvements to its water and sewer system. This motion seeks a determination that the portion of the charges the City imposed on its water and sewer customers between 2015 and 2019, which generated revenues that the City used to cash-finance a major new sewer facility (the "Retention Facility") that was mandated by Wayne County and which will serve the City for many decades (the "Retention Facility Charges"), constituted unlawful taxes that were imposed in violation of MCL 141.91. The Retention Facility Charges – which again are only a portion of the City's total overcharges – exceeded $10 million.

The Facility was designed and built to accommodate significant future expansion of the City's sewer system and, as a result, the City's current water and sewer customers not only financed up-front a major infrastructure improvement that will serve the City for at least 30-50 years, but they also paid for an improvement that will benefit future users of the system who have not been required to pay for that benefit. Consistent with that purpose, the City expressly agreed at the time it authorized construction of the Retention Facility that the Facility would serve the City at large, and not "individual property owners and users thereof." *See* Exhibit 18 hereto at p. 6. Nonetheless, the City wholly-funded the cost of constructing the Retention Facility through Charges imposed on "individual property owners and users" of the City's water and sewer system.

As a matter of law, the City's method of financing the Retention Facility constitutes a clear violation of the tax prohibitions of *Bolt v. City of Lansing*, 459 Mich. 152, 587 N.W.2d 264 (1998) (Exhibit 1 hereto), which defined the difference between "user fees" and taxes, and imposed the following limitations on municipal utility charges:

- Sewage disposal can properly be viewed "as a utility service for which usage-based charges are permissible, and not as a disguised tax," **only** where "the charge for … sanitary sewers reflects the actual costs of use, metered with relative precision in accordance with available technology, **including some capital investment component**." *Id* at p. 164-64 (emphasis added).
- In defining the bounds of the "capital investment component" that may be included in sewer rates, the Court held that it was impermissible to impose charges to finance capital improvements that would "enable the city to fully recoup its investment, in a period

significantly shorter than the actual useful service life of the particular public improvement." *Id.* at 164.

- If a municipality includes an impermissible "capital investment component" in its sewer rates, the sewer charge is "not structured to simply defray the costs of a 'regulatory' activity, but rather to fund a public improvement designed to provide a long-term benefit to the city and all its citizens." *Id.*

The City has violated these principles by forcing its water and sewer customers, through their Rates, to finance the County-mandated Retention Facility upfront, even though the Retention Facility (a) has an actual useful service life of at least 30-50 years, and (b) the Facility will service future customers in areas of the City that have not even been developed yet. The City clearly has "fully recouped" its investment in the Retention Facility in a period significantly shorter than the "actual useful service life" of the Retention Facility. For the reasons discussed more fully below, the Court should grant Plaintiff's Motion for Summary Disposition as to Counts I and II of his Complaint.

II. STATEMENT OF UNDISPUTED FACTS

A. The City's Accumulation Of Cash In Its Water and Sewer Fund

The Class Period in this case begins July 1, 2015. As of June 30, 2015, the City's Water and Sewer Fund had approximately **$56 million** in unrestricted cash and investments. *See* Exhibit 2 hereto. Notwithstanding this cash hoard – representing over $3,000 for each of the City's approximately 18,000 water and sewer customers – the City planned to keep increasing its cash reserves through at least June 2019. In fact, the City's budget for the fiscal year beginning July 1, 2016 forecasted multi-million dollar surpluses through at least the fiscal year ending June 30, 2019. *See* Exhibit 4 hereto p. 79. The City's budget for the fiscal year ending June 30, 2017 projected that the revenues of the Water and Sewer Fund would exceed its expenses by (1) $5,729,340 in the fiscal year ending June 30, 2017, (2) $4,288,919 in the fiscal year ending June 30, 2018 and (3) $4,102,752 in the fiscal year ending June 30, 2019. *Id.* That is, the City planned to accumulate another $13 million via its rates by June 30, 2019.

The City's actual cash accumulation in the Water and Sewer Fund between July 1, 2016 and June 30, 2019 mirrored the plan reflected in its fiscal year 2017 budget. By June 30, 2017, the City had

$63.9 million in unrestricted cash and investments in the Water and Sewer Fund. *See* Exhibit 5 hereto. *See also* Johnson Dep. (Exhibit 6 hereto) at p. 37-38 (conceding the accumulation of over $5 million during fiscal year 2017). One year later, on June 30, 2018, the City's Water and Sewer Fund had reached $66.5 million in unrestricted cash and investments. *See* Exhibit 7 hereto. And by June 30, 2019, the Fund had accumulated a total of over **$69 million** in cash and investments. *See* Exhibit 8 hereto.[1] This $11 million accumulation of cash in just three years—corresponding almost exactly to the budgeted cost of the Retention Facility—was fully consistent with the projections in the 2015-16 budget, proving that it was not inadvertent but rather intentional.

B. By 2019, the City's Cash Hoard Dwarfed The Cash Reserves Of Comparable Municipalities

The City also has bragged to it residents about allegedly "keeping its rate increases very low compared to other communities." *See* Exhibit 9 hereto at p. 11. But the reality is that by June 2019, the City had amassed far more money through its Water and Sewer charges than many other similarly situated communities. In order to aid the Court's understanding of the magnitude of the City's overcharges, the chart below compares the financial position of the City's Water and Sewer Fund with the financial positions of the water and sewer funds of other Southeast Michigan municipalities with similar populations and water and sewer cost structures as of 2019:

Municipality	Population	W&S Cash[2]	Annual O&M[3]	Net W&S Cap. Assets[4]

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1 The $69 million included a $3 million receivable from the City's Capital Improvement Fund created by a "loan" the Water and Sewer Fund made to that unrelated fund in 2019. *See* Exhibit 8 hereto.

2 These figures represent the unrestricted cash, cash equivalents, and investments held by each of the referenced municipality's water and sewer fund as of June 30, 2019, as represented in each municipality's certified annual financial reports.

3 These figures represent the annual operations and maintenance expenses of each of the referenced municipality's water and sewer funds (including depreciation expenses) for the fiscal year ending June 30, 2019, as reflected in each municipality's certified annual financial reports.

4 These figures represent the "net" monetary value of each municipality's water and sewer capital assets, which generally corresponds to the original cost of those assets minus accumulated depreciation. Again, these figures are derived from each of the referenced municipalities' certified annual financial reports.

Novi	55,000	$69 million	$25.2 million	$121 million
Bloomfield Twp.	41,070	$12 million	$22.3 million	$69.8 million
Royal Oak	59,195	$6.3 million	$27.2 million	$93.8 million
Livonia	94,249	$21.1 million	$36.8 million	$79.9 million
Dearborn Hgts	55,857	$9.3 million	$20.3 million	$95.9 million
W. Bloomfield	65,916	$17.1 million	$26.3 million	$118.9 million
St. Clair Shores	59,528	$15.7 million	$21.6 million	$96.9 million[5]

C. In 2020, the City Cash Funded The Entire $10+ Million Cost Of the Retention Facility—A Major Infrastructure Improvement To Its Sewer System.

The City is now in the midst of a belated effort to justify its accumulation of cash in the Water and Sewer Fund by accelerating its capital improvement plan and associated spending. In January 2021, the City's engineer, Ben Croy, stated the following to the City's outside consultants:

> **We are intentionally trying to spend down some of the fund balance** now that we have some of our large cost projects under control now. So, once we get to the targeted fund balance, it will no longer show a reduction year to year. [Exhibit 11 hereto (emphasis added)]

The City's financial statements confirm that, in the subsequent fiscal year ending June 30, 2021, the City spent **$12.5 million** on water and sewer improvements, *see* Exhibit 12 hereto, compared to just **$2.3 million** in the fiscal year ending June 30, 2019. *See* Exhibit 8 hereto. Moreover, in the fall of 2021, the City amended its FY 2022 budget to **increase** water and sewer capital expenditures during the current fiscal year by over $13 million. *See* Exhibit 13 hereto at p. 5.

As part of its belated effort to "spend down" its cash reserves, the City paid at least **$10 million in cash** to pay up-front for the major new Retention Facility which is designed to serve both current and future sewer customers. The City's finance director confirmed that the City paid Oakland County, which was responsible for constructing the Retention Facility, over $10 million in a lump sum payment in June 2020. Johnson Dep. (Exhibit 6 hereto) at pp. 72-75. *See also* Auger Dep. II (Exhibit 14 hereto)

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[5] Relevant excerpts from the certified annual financial statements of these municipalities that confirm these numbers are collected and included in Exhibit 10 hereto.

at p. 97. Recent documents authored by the City suggest that the total cost of the Retention Facility ultimately will exceed **$15 million**. *See* Exhibit 13 hereto (amendment to budget for FY 2022 increasing the amount set aside for the Retention Facility by $5.45 million).[6]

In 2018, the City described the Retention Facility project as follows:

> The design of the Huron Rouge Sewage Disposal System (HRSDS) Sanitary Retention facility project is underway, with construction of the facility anticipated to begin late 2019. This project, formerly known as the Eight Mile Equalization Basin, addressed the periodic contract exceedances of the city's sanitary sewer flow rate. This retention facility will temporarily detain a calculated volume and reduce the rate of release, resulting in a controlled flow from the city outlet into the HRSDS system.
>
> … The facility will consist of approximately 1,000 feet of box culvert pipe (10' x 15'), which is capable of storing one million gallons. **This volume of storage was based on the future sanitary needs of Novi, taking into account planned and potential future development**. [Exhibit 16 hereto (emphasis added).][7]

In his deposition, the City's engineer described the important role the Retention Facility will play in ensuring that the City complies with its contractual sewage flow requirements to Wayne County, which operates the Huron Rouge Sewage Disposal System to which the City sends its sewage flows:

> Q. Describe if you were to talk to a jury about what that retention basin is, can you describe what it is and what it does?
>
> A. It is intended to control high flow situations to reduce the release rate downstream from the city. So typically during storms when sewers will see high flow,

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[6] Notably, the City's cash-financing of the Retention Facility was inconsistent with the City's own Debt Management Policy, which provided that the City would finance major capital improvements like the Retention Facility with debt, as opposed to paying cash. *See* Exhibit 15 hereto. That Policy states that "[d]ebt issuance is a proper and acceptable means by which the City finances certain long-range projects" and that "[d]ebt shall be primarily issued to finance capital projects with a relatively long life (10+ years)." *Id.* at pp. 1-2. The City properly recognized that **"[s]uch a means of financing provides for beneficiaries of improvements to pay for these improvements over time in a structured way**." *Id.* at p. 1 (emphasis added). The Retention Facility is exactly the type of major long-term improvement that the City intended to debt-finance instead of funding it with current cash.

[7] The relationship between the City, Oakland County and Wayne County as it relates to sewage disposal and treatment was described in Exhibit A to the contract governing the Project (Exhibit 18 hereto) as follows:

> The Huron-Rouge Sewage Disposal System (HRSDS) is operated and maintained by the Oakland County Water Resources Commissioner's Office (WRC). The HRSDS serves the City of Novi and a small portion of the City of Northville. The HRSDS discharges to the Rouge Valley Sewage Disposal System (RVSDS), which is owned and operated by Wayne County. Flow in the HRSDS is ultimately treated at the Great Lakes Water Authority Water Resource Recovery Facility.

this extra high flow will be diverted into the retention basin and released at a slow controlled rate.

Q. And my understanding is this basin is about a million gallons?

A. Correct.

Q. Capacity is a million gallons, right?

A. Yes.

Q. My understanding is you have limits on how much sewage you can put into the Huron Rouge system, and that this facility helps equalize that flow so that you don't exceed your capacity limitations; is that fair?

A. Yes.

Q. And the city was required to have this constructed and it was done by the county on the city's behalf, correct?

A. Yes. [Croy Dep. (Exhibit 17 hereto) at pp. 24-25]

There is no question that the Retention Facility necessarily was financed by Water and Sewer Rates imposed on Plaintiff and the Class. Indeed, the City expressly told its residents in 2019 that its capital improvements through 2022 (which necessarily included the Retention Facility) would be financed by "current rates." In an April 1, 2019 Budget Message to City residents (Exhibit 9 hereto at p. 11), the City Manager stated:

> The City of Novi continues to invest significantly in **water and sewer** infrastructure on an annual basis to ensure the transmission and distribution systems are adequate now and into the future. **More than $10.6 million in water and sewer capital improvements are planned over the next three years; all being paid from current rates** and not having to issue debt while keeping annual rate increases very low compared to other communities. [Emphasis added.]

When the City Council approved the contract for the Retention Facility in June 2019, the City's director of public services, Jeff Herczeg, specifically assured the Council that the Facility would be financed by Rates paid by the City's water and sewer customers and that the City had set aside those funds for that specific purpose. The minutes of the June 3, 2019 Council meeting (Exhibit 19 hereto) plainly confirm these facts:

> Mayor Pro Tem Staudt wondered where the funds are coming from that are paying for this. Mr. Herczeg said the funds will come from Water & Sewer. Mayor Pro Tem Staudt asked where the Water & Sewer funds come from. **Mr. Herczeg replied they come from rates.** Mayor Pro Tem Staudt asked if the funds are intended to develop and expand infrastructure. Mr. Herczeg said yes, that is correct. **Mayor Pro**

Tem said the funds that were allocated for exactly the purpose we intended. Mr. Herczeg said that was correct. [Exhibit 19 hereto at p. 9 (emphasis added)].[8]

The Retention Facility is a massive public works project. The contract for the project provides for the construction of, among other improvements, the following:

1. A new 15 feet wide by 10 feet high by approximately 1,000 feet long underground concrete sewage retention facility (SRF) which will provide approximately 1 million gallons of storage;
2. A new approximately 5 million gallons per day (MGD) Pump Station to fill the new SRF when required;
3. A new underground concrete diversion structure including bypass, gates, weirs, baffles, and other equipment and appurtenances for diverting flow from the HRSDS into the new Pump Station and for draining the new SRF by gravity back into the HRSDS; and
4. A new flushing system for flushing/cleaning a portion of the new SRF and pump station with provisions for future expansion of the flushing system if needed. [Exhibit 18 hereto at Exhibit A].

In his deposition, the City's engineer confirmed that the Retention Facility is a "major" capital improvement that will serve the City for decades:

> Q: And in the whole scheme of things, around ten million dollars is a major expenditure of the water and sewer fund, correct?
> A: In my mind, yes.
> Q: And the improvement itself was a major improvement, correct?
> A: Yes.
> Q: And it's going to – that retention basin is going to serve the community for decades if it performs as expected, correct?
> A: Yes [Croy Dep. (Exhibit 17 hereto) at pp. 25-26].[9]

Not only did the City cash-finance this major facility, but Mr. Croy confirmed that the

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[8] Further, the City has consistently argued, and its representatives have testified, that all of the expenses of the City's Water and Sewer Fund, including capital improvements are financed by the City's water and sewer ratepayers. For example, the City's initial disclosures contended that the City's water and sewer fund reserves were "already **earmarked** to be used for critically necessary infrastructure improvement, rehabilitation and replacement projects." *See* Exhibit 20 hereto at p. 3 (emphasis added). And, as Mr. Johnson testified in his deposition:

> As you pointed out, the enterprise funds, **everything is covered through rates**. The cash balances that are there, along with the annual rate setting, covers all of those costs. It is meant to cover all of those costs. [Johnson Dep. (Exhibit 6 hereto) at p. 58 (emphasis added)

[9] The City's financial statements confirm that the City depreciates its water and sewer infrastructure assets over 30-50 years. *See* Exhibit 21 hereto.

Retention Facility was designed and built to provide additional sewer capacity for future expansion of the system, and that, if the Facility had been built only to serve current customers, it would have cost less:

> **Q: But you do know the facility was designed to accommodate future sewer capacity for future years, correct?**
> **A: That was the goal, yes.**
> **Q: So in other words, it wasn't just serving the current users, it was designed and built to accommodate the expansion of the sewer system in the future, correct?**
> **A: Correct.**
> Q: And, in fact, haven't you expressed the opinion that it was double in size from what had been recommended in some study?
> A: Yes, there was that belief, yes.
> Q: And that was because – I guess what I'm saying is, if you were just designing and building this to serve the current water and sewer needs, it could have been a smaller facility, less capacity?
> A: Without looking to the future, yes.
> Q: **So because it was larger, it was more costly than it otherwise would have been, correct?**
> **A: Sure, yes** [Croy Dep. at pp. 26-27 (emphasis added)].

When the City Council approved the contract for the Retention Facility in June 2019, the City representatives touted the extra sewer capacity the Facility would provide for future users. Mr. Herczeg told the Council at that time:

> The size of the facility that we are building now will be **maximum buildout of the entire system**. It is designed for overflow now, but in the long term it will address any capacity limit issues that we may or may not have. [Exhibit 19 hereto at p. 8 (emphasis added)].

See also Id. (City Manager Auger stating that "This had been budgeted for a long time, and planned for a long time. It's doing exactly what Member Mutch is bringing up. **It is ensuring we can steadily grow**") (emphasis added). Indeed, the Retention Facility was designed to "serve the Municipality **and not the individual property owners** and users thereof…" *See* Exhibit 18, Contract between the City and the County (emphasis added).

In sum, the City's current water and sewer customers paid for a major infrastructure improvement that not only (1) will last for decades, but (2) will also service future customers in areas to

which the City expands the sewer system in the future and who therefore will receive the benefits of the Retention Facility without having paid for it.[10] For the reasons discussed below, because of these facts and circumstances, the Retention Facility Charges which financed the Facility constitute unlawful taxes.

III. THE CHARGES IMPOSED BY THE CITY TO FINANCE THE RETENTION FACILITY CONSTITUTE UNLAWFUL TAXES IMPOSED IN VIOLATION OF MCL 141.91.

It is now well-established that "water and sewer charges are not always user fees" and "such charges must be measured against the "relevant criteria for determining whether a charge is a fee or a tax." *Shaw v. City of Dearborn*, 329 Mich. App. 640, 944 N.W.2d 153 (2019) (Exhibit 22 hereto). Whether a disputed charge is a "user fee" or a tax is a question of law for the Court. *Gorney v. Madison Heights*, 211 Mich. App. 265, 267, 535 N.W.2d 263 (1995).[11]

For the reasons discussed below, the revenues the City has garnered from its water and sewer customers that it has used to cash-finance the Retention Facility as a matter of law constitute "taxes." Because they are not ad valorem property taxes and were first imposed after January 1, 1964, the Retention Facility Charges violate MCL 141.91.

A. *Bolt* Limits The "Capital Investment Component" That May Be Included In A Municipal Utility's Rates and Charges

As explained by our Supreme Court, "There is no bright-line test for distinguishing between a valid user fee and a tax that violates the Headlee Amendment." *Bolt,* 459 Mich at 160. In general, "a fee is exchanged for a service rendered or a benefit conferred, and some reasonable relationship exists between the amount of the fee and the value of the service or benefit. A tax, on the other hand, is

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[10] The City expected the Retention Facility to be completed by the end of June 2021. Johnson Dep. at pp. 75-76. As of February 2022, however, the Facility is not yet operating. *See* Croy Dep. at p. 26.

[11] Plaintiff moves for summary disposition under MCR 2.116(C)(10). Under that subrule, summary disposition is proper if there is no genuine issue as to any material fact and the moving party is entitled to judgment in its favor as a matter of law. In presenting a (C)(10) motion, the moving party has the initial burden of supporting its position by affidavits, depositions, admissions, or other documentary evidence. *Quinto v. Cross & Peters Co.*, 451 Mich. 358, 362; 547 N.W.2d 314 (1996). "The burden then shifts to the opposing party to establish that a genuine issue of disputed fact exists." *Id.*

designed to raise revenue." *Id.* at 161. A true user fee "confers benefits **only** upon the particular people who pay the fee, not the general public **or even a portion of the public who do not pay the fee**." *Graham v. Township of Kochville*, 236 Mich. App. 141, 151, 599 N.W.2d 793 (1999) (emphasis added).

In *Bolt,* the Court, in enforcing the Headlee Amendment, identified "three primary criteria to be considered when distinguishing between a fee and a tax":[12]

1. A user fee must serve a regulatory purpose rather than a revenue-raising purpose;
2. User fees must be proportionate to the necessary costs of the service; and
3. Payment of the fee is voluntary. [459 Mich. at pp. 161-62]

"These criteria are not to be considered in isolation, but rather in their totality, such that a weakness in one area would not necessarily mandate a finding that the charge is not a fee." *Wheeler v Shelby Charter Twp*, 265 Mich App 657, 665; 697 NW2d 180 (2005).

It is clear that municipal utility charges can constitute taxes to the extent that they exceed a municipality's actual cost of providing the utility service. In *Bolt*, this Court specifically rejected the assertion that charges for sanitary sewers are "always user fees." 459 Mich. at 162. Instead, the Court held that sewerage can properly be viewed "as a utility service for which usage-based charges are permissible, and not as a disguised tax," **only** where "the charge for … sanitary sewers reflects the actual costs of use, metered with relative precision in accordance with available technology, **including some capital investment component**." *Id* at p. 164-64 (emphasis added).[13]

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12 While *Bolt* assessed whether a stormwater charge constituted a tax or a user fee under the Headlee Amendment (and Plaintiff does not assert a Headlee Amendment claim here), there is no reasoned basis for the Court to conclude that the test for determining whether a governmental charge is a "tax" under the Headlee Amendment is different than the test for determining whether that charge is a "tax" under MCL 141.91. In fact, in formulating the three-factor test in *Bolt*, the Court relied upon pre-Headlee authorities defining the characteristics of a tax. *See* 459 Mich. at 161-62 (collecting cases).

13 And it matters not whether the disputed charge is separately itemized by a municipality or simply incorporated into the Rates charged to its customers. *See Shaw v. City of Dearborn*, COA Case No. 341701 (2019) (Exhibit 22 hereto) (after recognizing that the city there "does not impose a distinct charge or fee" corresponding to the challenged charge, "we recognize that a municipality cannot avoid the Headlee Amendment simply with bookkeeping maneuvers."

In applying the "relevant criteria," the Courts have recognized that charges which force current ratepayers to finance major infrastructure projects that will last decades and benefit future ratepayers constitute unlawful taxes. For example, in *Shaw*, the Court of Appeals observed:

> Voters approved the Headlee Amendment to ensure that local taxpayers would have ultimate control over spending on local public works. **The purpose of the amendment would be thwarted if a local authority could charge higher utility rates to raise revenue and then use some of the excess funds to finance a public-works project**. [329 Mich. App. at 643 (emphasis added)].

This pronouncement is consistent with the Supreme Court's ruling in *Bolt*. There, the city of Lansing sought to limit the polluting of local rivers that resulted when heavy storm water precipitation caused the city's combined sewer systems to overflow and discharge untreated sewage into those rivers. 459 Mich. at 154-155. To this end, the city decided to separate the remaining combined storm and sanitary sewer system, at a cost of $176 million. *Id.* at 155. To fund the costs of the sewer system separation, the City adopted an ordinance, which provided for the creation of a storm water enterprise fund "to help defray the cost of the administration, operation, maintenance, and construction of the stormwater system…" The ordinance provided that costs for the storm water share of the CSO [combined sewer overflow] program (fifty percent of total CSO costs, including administration, construction, and engineering costs) would be financed through an annual storm water service charge. This charge was imposed on each parcel of real property located in the city using a formula that attempted to roughly estimate each parcel's storm water runoff. The *Bolt* plaintiff challenged the stormwater charge under the Headlee Amendment.

With regard to the first two criteria, the *Bolt* Court concluded that the Lansing storm water service charge neither served a regulatory purpose nor was proportionate to the necessary costs of the service. Rather, the Court concluded that the service charge served a revenue-raising purpose. *Id.* at 163-167. According to the Court, "'the 'fee' is not structured to simply defray the costs of a 'regulatory' activity, but rather to fund a public improvement designed to provide a long-term benefit to the city and all its citizens.'" *Id.* at 164 (quoting *Bolt v City of Lansing,* 221 Mich. App. 79, 91; 561 N.W.2d 423

(1997) (Markman, J., dissenting).[14] The Court so concluded, in part, because:

> [i]n instituting the storm water service charge, the city of Lansing has sought to fund fifty percent of the $176 million dollar cost of implementing the CSO control program over the next thirty years. A major portion of this cost (approximately sixty-three percent) constitutes capital expenditures. **This constitutes an investment in infrastructure as opposed to a fee designed simply to defray the costs of a regulatory activity**. [*Bolt,* 459 Mich. at 163 (emphasis added).]

In *Bolt*, the fact that the City forced current property owners to finance an improvement that would last decades was critical to the Court's finding that the charges were taxes.

> No effort has been made to allocate even that portion of the capital costs that will have a useful life in excess of thirty years to the general fund. **This is an investment in infrastructure that will substantially outlast the current "mortgage" that the storm water charge requires property owners to amortize. At the end of thirty years, property owners will have fully paid for a tangible asset that will serve the city for many years thereafter.** Accordingly, the "fee" is not structured to simply defray the costs of a "regulatory" activity, but rather to fund a public improvement designed to provide a long-term benefit to the city and all its citizens. The revenue to be derived from the charge is clearly in excess of the direct and indirect costs of actually using the storm water system over the next thirty years and, being thus disproportionate to the costs of the services provided and the benefits rendered, constitutes a tax. [459 Mich. at 163-164 (emphasis added)].

While *Bolt* recognized that sewer rates could include a "capital investment component," the Court held that it was impermissible to impose charges to finance capital improvements that would "enable the city to fully recoup its investment, in a period significantly shorter than the actual useful service life of the particular public improvement." *Id.* at 164. The Court stated that "[t]his fundamental principle of basic accountancy guides public utility regulators," and "it ought to apply equally here." *Id.* In *Bolt*, the Court found that the charges did not reflect an appropriate capital investment component where the charges would be imposed over a 30-year period **in the future** but the improvements would last much longer. *Id.* ("At the end of thirty years, property owners will have fully paid for a tangible asset that will serve the city for many years thereafter"). **By paying over $11 million in cash for the**

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[14] Justice Markman's dissent in the *Bolt* Court of Appeals' decision is noted in this Motion because the Supreme Court ultimately adopted it in substantial part in the majority opinion in *Bolt.*

Retention Facility, what the City did here is much, much worse – i.e., it imposed rates to finance a major capital improvement that will serve the City for decades *in advance*, years before the improvement was even completed.

B. Applying *Bolt's* Limitations On The Financing Of Capital Improvements, the Court of Appeals Has Repeatedly Recognized That It Is Unlawful For Municipal Utilities To Impose Charges Which Force Current Customers To Create Reserves To Finance Future Capital Improvements

After *Bolt*, the Court of Appeals issued at least **four opinions** recognizing that municipalities cannot legally finance future expenses through current utility rates and has twice specifically ruled that a water or sewer-related charge that is intended to finance future repairs or improvements to water and sewer infrastructure assets constitutes an illegal tax. These rulings are based on a finding that such charges have a revenue-raising (as opposed to a regulatory) purpose and render the resulting rates disproportionate to the actual costs of providing water and/or sewer services to current ratepayers because improvements undertaken at unspecified points of time in the future will benefit future users and may not benefit the current payers at all.

First, in *Grunow v. Frankenmuth Township*, 2002 Mich. App. LEXIS 1440 (2002) (Exhibit 23 hereto), the Court found that a $7500 connection fee a township imposed on new users of the township's water system constituted an unlawful tax because the "asserted purpose of the charge was to 'establish a reserve fund to provide for the maintenance and repair of the Frankenmuth Township Water System' when the eventual need arises." *Id.* at *4. In assessing whether the fee constituted an unlawful tax, the Court concluded that the charge was not proportionate to the necessary costs of providing water service to the payers of the charge because, among other things, the reserve fund did not provide a current benefit to any of the payers:

> **In the instant case, the revenue collected does not confer a benefit on anyone because it is not used but, rather, is placed in a reserve fund that may eventually be spent on repairing any of the existing water mains within the Water System.** Further, the Water System was constructed in the early 1970s and the resolution to impose the $7,500 charge on new users was adopted in 1995. Consequently, the possible future benefits conferred by the imposition of the charge on new users of the System

> will eventually, and impermissibly, flow to users of the Water System who were not required to pay the charge. See *Bolt, supra at 164-165*. In sum, **the charge is not proportionate to the necessary costs of a regulatory service and it confers benefits on users of the System who were not required to pay the charge**. [*Id.* at *7-8 (emphasis added).]

Similarly, in *In re Foreclosure of Certain Parcels of Property*, 2014 Mich. App. LEXIS 943 (2014) (Exhibit 24 hereto), the Court held that another township's "sewer privilege fee" constituted an unlawful tax because the purpose of the fee was to create a reserve for future capital improvements to the Township's sewer system, the Court found that the fee had a revenue-raising, and not a regulatory, purpose, and further held that, because the revenues garnered by the fees would not be used until some indeterminate time in the future, the fees failed to satisfy the proportionality requirement of *Bolt*.

More recently, in *Binns v. City of Detroit*, Case No. 337609 and *Detroit Alliance Against The Rain Tax v. City of Detroit, et al.*, COA Case No. 339176 (collectively "*Binns*"), *vacated on other grounds* 506 Mich. 996; 951 N.W.2d 327 (2020) (Exhibit 25 hereto), the Court of Appeals ruled that the City of Detroit's "Drainage Charges" constituted valid "user fees" and thus were not unlawful taxes under the Headlee Amendment to the Michigan Constitution. In doing so, however, the Court recognized a clear distinction between municipal utility charges which fund the debt service on existing infrastructure improvements over time (which can be appropriate) and utility charges, like those at issue here, which are intended to create reserves to fund infrastructure improvements that will be undertaken in the future (which are not appropriate). *See* Exhibit 25, *Binns* Opinion at pp. 17-18.

Similarly, in *Gottesman v. City of Harper Woods*, COA Case No. 344568 (Mich. App. December 3, 2019), *vacated on other grounds* 2021 Mich. LEXIS 1658; 964 N.W.2d 365 (2021) (Exhibit 26 hereto), the Court relied in part upon the "past vs. future" distinction made by *Binns* in finding that stormwater charges imposed by the City of Harper Woods were unlawful taxes because a significant portion of the charges had been set aside to pay the City's portion of the debt service on a major infrastructure improvement. There, the Court stated:

> The fact that the Charge is used in part to service such debt does not by itself require the conclusion that the Storm Water Charge is a tax because the payment of debt can be part of the cost of providing service. **In *Binns*, this Court concluded that the charge was not used to fund future expenses, but to amortize present debt costs incurred.** See id. **In this case, however, defendant has admitted that it has not yet been required to make its first payment on the project. The debt service charges will not be fully implemented until the completion of the project in 2019.**

The *Gottesman* court further observed that "based on the testimony of defendant's city manager, it appears that defendant is collecting far more than is required to operate the system, particularly given that its debt repayments have not yet become due." This again confirms the Court of Appeals' distinction between charges that are intended to pay the debt associated with prior or existing capital improvements and charges that are intended to generate cash reserves that will be used, if at all, to pay for capital improvements sometime in the future.

Here, the City asserts the same argument which was rejected by the Court of Appeals in *Gottesman* – namely, "our charges are ok because we have this looming future liability and we are simply charging our current customers extra now to build up a reserve to pay that future bill when it comes due." The *Grunow*, *In re Foreclosure*, *Binns* and *Gottesman* Opinions reject this argument—collectively standing for the proposition that while it may be appropriate to impose Rates to pay for **yesterday's** infrastructure improvements **over time**, it is **NOT** appropriate to impose Rates to pay for **tomorrow's** infrastructure improvements **today**. That is what the City did here – it collected over $11 million in additional cash reserves in its Water and Sewer Fund and then spent those reserves to pay in full, up front, the total costs of the Retention Facility.

The Retention Facility Charge has a revenue raising purpose and is not proportional because it fails to confer any "particularized benefits" upon the City's current water or sewer customers who are forced to pay the Charge. Instead, the Charge is "**an attempt to raise capital for improvements based on assumptions regarding the future use of the wastewater system, and without any indication that the fees will ever be used in a manner that will provide a benefit to a fee payer.**" *In re Foreclosure.* Moreover, as in *Grunow*, because the cash reserves accumulated through the Retention

Facility Charge were accumulated over a certain time period to be spent in the future on an improvement, those reserves not only may not benefit the current payers, but also will necessarily confer benefits on future water and sewer customers who were not required to pay the Retention Facility Charge. *See also Graham v. Township of Kochville*, 236 Mich. App. 141, 151, 599 N.W.2d 793 (1999) (holding that a true user fee "confers benefits **only** upon the particular people who pay the fee, not the general public **or even a portion of the public who do not pay the fee**.") (emphasis added) (citing *Bolt,* 459 Mich. at 164-165). This is especially true given that the City constructed the Retention Facility to be twice as large as currently needed, so that the Facility could serve future customers in future developments that have not yet even been started.[15] Clearly, the Retention Facility Charge fails both of the first two *Bolt* factors.

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[15] There are at least two additional reasons the Retention Facility Charges fail to satisfy the proportionality requirement. First, one of the major functions of the Retention Facility is to prevent sewer overflows which cause harm to the environment. *See* Exhibit 19 hereto at p. 8 ("Mr. Herczeg said the sanitary sewer overflow is when the stormwater and rain event infiltrates into the sanitary system and you have a backflow up through a manhole. That is called sanitary sewer overflow. He said the idea of the rain event happening and **the storage being able to accommodate that will stop the sanitary sewer overflow**") (emphasis added). This is a benefit to the general public that extends beyond any benefit conferred upon water and sewer users who pay the Charges and was one of the reasons the *Bolt* court found that the Stormwater Charges there were not proportionate. *See, e.g., Bolt*, 459 Mich. at 166 ("[i]mproved water quality … and the avoidance of federal penalties for discharge violations are goals that benefit everyone in the city, not only property owners."). In *County of Jackson*, the Court found that the charges were not proportionate because, among other things, they financed activities which prevented sanitary sewer overflows:

> The city indicated in its original response to plaintiffs' complaints that the charge "assur[es] cleanliness and safety of the State's waters and watercourses." The city also indicated that the management charge enables the city to protect the public health and safety, to reduce the likelihood of flooding caused by excessive storm water runoff, to reduce the potential for land erosion, which can damage roads, bridges and other infrastructure and thereby endanger the public, and **to prevent sewer overflows by providing a mechanism to collect and divert rain water runoff from the sanitary sewer system. We do not doubt that a well-maintained storm water management system provides such benefits. Nevertheless, these concerns addressed by the city's ordinance, like the environmental concerns addressed by Lansing's ordinance in *Bolt*, benefit not only the property owners subject to the management charge, but also everyone in the city in roughly equal measure, as well as everyone who operates a motor vehicle on a Jackson city street or roadway or across a city bridge, everyone who uses the Grand River for recreational purposes downriver from the city, and everyone in the Grand River watershed. This lack of a correspondence between the management charge and a particularized benefit conferred to the parcels supports our conclusion that the management charge is a tax.** *Bolt, 459*

C. Payment of the Charges Was Not Voluntary

Finally, the Charges are not voluntary because, at the very least they are "effectively compulsory" in that "the property owner has no choice whether to use the service and is unable to control the extent to which the service is used." *Bolt,* 459 Mich. at 167-168 (footnote omitted).

The City requires all dwellings to be connected to the public sewer system and, by virtue of that connection, to pay the City's charges for sewer services. *See* City Ordinance Sections 34-127 and 34-155 (Exhibit 27 hereto). The Court of Appeals has held that where a person is required to connect to a public sewer, payment of sewer-related charges is not voluntary for purposes of determining whether the charges are "taxes" under the Headlee Amendment. *See, e.g., Meadows Valley, LLC v. Village of Reese*, 2013 Mich. App. LEXIS 1009 (2013) (Exhibit 28 hereto).

Further, the City's Ordinances give the City a lien on each water and sewer customer's property to secure payment of the water and sewer charges and further authorize the City to cut off the water supply of any customer who fails to promptly pay their water and sewer bill. *See* Ordinance Sections 34-21 and 34-147 (Exhibit 27 hereto). In *Jackson*, the Court found that the Charges there were not voluntary because of the enforcement remedies available to the City. There, the Court ruled:

> **[P]roperty owners have no means by which to escape the financial demands of the ordinance. Additionally, the ordinance authorizes the administrator of the**

Mich at 166. [302 Mich. App. at pp. 108-109 (emphasis added)].

Second, the Retention Facility does not confer a particularized benefit on all persons who have incurred the Retention Facility Charges. Indeed, as the City must admit, the Retention Facility was designed to "serve the Municipality **and not the individual property owners** and users thereof…" *See* Exhibit 18 (emphasis added). Moreover, the Retention Facility does not service at least 15% of the City's sewer system. *See* Exhibit 16 hereto (stating that "the retention facility will control flows only from the HRSDS District, which encompasses 85% of the city's sanitary flow"). Nonetheless, because the City's water and sewer rates are uniform throughout the City, persons who live in the areas not serviced by the Retention Facility still have contributed to the costs of constructing the Retention Facility, yet they won't receive any special benefit from the excess capacity provided by the Facility. As Judge Markman observed in his Court of Appeals dissent in *Bolt* that ultimately was adopted by the Supreme Court: "[I]t being effectively conceded that many properties in the City are already served by a bifurcated sewer system, expansion of the system to serve other properties confers no benefit on the former group …". 221 Mich. App. at p. 95 (emphasis added). Thus, as in *Bolt*, "these property owners are charged the same amount" for the Retention Facility as "the property owners who will enjoy the full benefits of the new construction." 459 Mich. at p. 165 (emphasis added).

> **storm water utility to discontinue water service to any property owner delinquent in the payment of the fee, as well as to engage in various civil remedies, including the imposition of a lien and the filing of a civil action, to collect payment of past-due charges. All of these circumstances demonstrate an absence of volition. This lack of volition lends further support for our conclusion that the management charge is a tax.** *Bolt*, 459 Mich. At 168. [302 Mich. App. at 111-112 (emphasis added).]

See also Gottesman at p. 10 ("the fact that the Storm Water Charge may be secured by placing a lien on property supports the conclusion that the Charge is a tax") (Exhibit 26 hereto); *Youmans v. Bloomfield Township*, __ Mich. App. __, __ N.W.2d __ (2021) (Exhibit 29 hereto) (payment of fixed water and sewer charges not voluntary).

Similarly, here the City's property owners "have no means by which to escape the financial demands" of the Ordinance. This is particularly true given that, like in *Youmans*, the City imposes fixed charges to recover at least some of the costs of the water and sewer system (see Exhibit 29 hereto) and the Charges constitute a lien on the charged properties which, if unpaid, are transferred to the tax rolls, and the City's ordinances further authorizes the City to cut off the water service to any property whose owner fails to pay the Charges. There is no element of volition here. At a minimum the Charges are "effectively compulsory" within the meaning of *Bolt*.

CONCLUSION

For all of the foregoing reasons, Plaintiff requests that the Court grant its Motion for Partial Summary Disposition as to Counts I and II of the Complaint and find that the Retention Facility Charges constitute taxes that have been imposed by the City in violation of MCL 141.91.

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CERTIFICATE OF SERVICE

I hereby certify that on March 10, 2022, I served the foregoing document on all counsel of record using the Court's electronic filing system.

/s/ Kim Plets
Kim Plets

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