STATE OF MICHIGAN

COURT OF APPEALS

MACKINAW AREA TOURIST BUREAU, INC., doing business as MACKINAW AREA VISITORS BUREAU, AMERICAN BOUTIQUE INN, AMERICA'S BEST VALUE, BAYMONT INN & SUITES, BAYSIDE HOTEL MACKINAC, BEACHCOMBER MOTEL, BEST WESTERN DOCKSIDE, BRIDGE VISTA BEACH HOTEL, BRIGADOON BED & BREAKFAST, BUDGET INN MACKINAW, CABINS OF MACKINAC, CAPRI MOTEL, CLARION HOTEL BEACHFRONT, COMFORT INN–LAKESIDE, COURT PLAZA INN & SUITES, CROWN CHOICE INN & SUITES, DAYS INN–LAKEVIEW, ECONO LODGE BAYVIEW, FAIRVIEW BEACHFRONT INN, GREAT LAKES INN, HAMILTON INN SELECT, KNIGHTS INN, LAMPLIGHTER MOTEL, LIGHTHOUSE VIEW MOTEL, MACKINAW BEACH & BAY MOTEL, PARKSIDE INN–BRIDGEVIEW, QUALITY INN & SUITES, RAINBOW MOTEL, RAMADA INN WATERFRONT, STARLITE BUDGET INN, SUPER 8–BEACHFRONT MOTEL, SUPER 8–BRIDGEVIEW MOTEL, THUNDERBIRD INN MACKINAW, TRAILSEND MOTEL, VINDEL MOTEL, WATERFRONT INN, WELCOME INN, MACKINAC BAY TRADING COMPANY, MACKINAW CROSSINGS, MACKINAW COFFEE, INC., FRANK & STUFF, INC., DIXIE SALOON, INC., RUM RUNNERS ISLAND, INC., ANNA LIEGHIO, INC., MACKINAC BAY WATER, INC., MACKINAC BAY WATER PARK, INC., TBWC RESTAURANT, INC., and MACKINAW DEPOT, INC.,

Plaintiffs-Appellees/Cross-Appellants,

v

FOR PUBLICATION
May 23, 2024

No. 361625

Cheboygan Circuit Court
VILLAGE OF MACKINAW CITY, LC No. 19-008746-CZ

Defendant-Appellant/Cross-Appellee.

Before: O'BRIEN, P.J., and K. F. KELLY and M. J. KELLY, JJ.

K. F. KELLY, J. (*dissenting*).

I respectfully dissent. In 2018, the Village of Mackinaw City (the "Village") passed a resolution that raised water and sewer rates for all users of the Village's water and sanitary sewer services. The rates developed in the resolution were in response to numerous assessments performed by the Michigan Department of Environmental Quality ("DEQ") after DEQ, the Michigan Finance Authority, and the Village entered into a grant agreement in 2014. It is undisputed that part of the increased revenue obtained from the rate increases was to be used for constructing a new water tower to increase the Village's water capacity.

In plaintiffs' lawsuit challenging the legality of the rates under the Headlee Amendment, Const 1963, art 9, § 31, the trial court determined that defendant's rate structure for water use fees contained a hidden tax levied without voter approval, contrary to Headlee. Relying on *Shaw v Dearborn*, 329 Mich App 640; 944 NW2d 153 (2019), the court granted summary disposition in favor of plaintiffs because the Village violated the "admonition that a fee may not be used to raise revenue to finance a public works project." Because I agree that the trial court correctly granted summary disposition in plaintiffs' favor, I would affirm the trial court's order.

I. APPLICABLE LAW

The Headlee Amendment, Const 1963, art 9, § 31, in relevant part, states:

> Units of Local Government are hereby prohibited from levying any tax not authorized by law or charter when this section is ratified or from increasing the rate of an existing tax above that rate authorized by law or charter when this section is ratified, without the approval of a majority of the qualified electors of that unit of Local Government voting thereon.

The Amendment was "proposed as part of a nationwide 'taxpayer revolt' in which taxpayers were attempting to limit legislative expansion of requirements placed on local government, to put a freeze on what they perceived was excessive government spending, and to lower their taxes both at the local and the state level." *Youmans v Bloomfield Twp*, 336 Mich App 161, 225; 969 NW2d 570 (2021); see also *Shaw*, 329 Mich App at 652 ("The ultimate purpose [of the Headlee Amendment] was to place public spending under direct popular control.") (quotation marks and citation omitted; alteration in original). The application of § 31 is triggered by the levying of a tax, *Bolt v Lansing*, 459 Mich 152, 158; 587 NW2d 264 (1998), and the Amendment "prohibits units of local government from levying any new tax or increasing any existing tax above authorized rates without the approval of the unit's electorate . . . ." *Bate v St Clair Shores*, ___ Mich App ___, ___; ___ NW3d ___ (2023) (Docket Nos. 364536 & 364537), slip op at 4

(quotation marks and citation omitted). Charges by the government that are properly considered user fees, however, are not "taxes" affected by the Headlee Amendment. *Bolt*, 459 Mich at 159.

"There is no bright-line test for distinguishing between a valid user fee and a tax that violates the Headlee Amendment." *Id*. at 160. "Generally, 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 designed to raise revenue." *Id*. at 161 (quotation marks and citation omitted). Thus, when analyzing whether a particular charge is a fee or tax for purposes of the Headlee Amendment, our courts have looked to three factors, which are whether the charge: (1) serves a regulatory purpose; (2) is proportionate to the costs of the service; and (3) is voluntary. *Id*. at 161-162; see also *Jackson Co v Jackson*, 302 Mich App 90, 101; 836 NW2d 903 (2013). "Although the levying of a new tax without voter approval violates the Headlee Amendment, a charge that constitutes a user fee does not, and the party challenging a given municipal utility charge under § 31 bears the burden of establishing the unconstitutionality of the charge at issue." *Youmans*, 336 Mich App at 226 (quotation marks and citation omitted).

Under the first *Bolt* factor, the charge "must serve a regulatory purpose rather than a revenue-raising purpose" to be considered a valid fee under the Headlee Amendment. *Bolt*, 459 Mich at 161. Thus, a charge may validly raise money and retain its identity as a fee so long as the money supports the underlying purpose. *Merrelli v St Clair Shores*, 355 Mich 575, 583; 96 NW2d 144 (1959). Moreover, a "regulatory fee may confer a benefit on both the general public and the particular individuals who pay the fee and still maintain its regulatory character . . . ." *Jackson Co*, 302 Mich App at 108.

The second *Bolt* factor requires analysis of whether the charge "serve[s] a regulatory purpose rather than a revenue-raising purpose." *Bolt*, 459 Mich at 161. "The determination of 'reasonableness' is generally considered by courts to be a question of fact." *Trahey v Inkster*, 311 Mich App 582, 594; 876 NW2d 582 (2015) (quotation marks and citation omitted). "[M]athematic precision is not required," *id*. at 597, and "the fee need not generate an amount equal to that required to support the services the ordinance regulates in order to survive scrutiny . . . ." *Jackson Co*, 302 Mich App at 109. "[H]owever, where the revenue generated by the 'fee' exceeds the cost of regulation, the 'fee' is actually a tax in disguise." *Id*.

The third *Bolt* factor considers voluntariness, i.e., the idea that "fees generally are voluntary, while taxes are not." *Bolt*, 459 Mich at 162. In other words, "[i]f a charge is 'effectively compulsory,' it is not voluntary" and is a tax. *Youmans*, 336 Mich App at 232. For example, in circumstances where users have "no choice whether to use the service" and are "unable to control the extent to which the service is used," courts will view such circumstances as indicating a compulsory tax. See *Bolt*, 459 Mich at 167-168.

In *Jackson Co*, 302 Mich App at 93, the Court addressed a city council ordinance that "created a storm water utility and imposed a storm water management charge on all property owners within the city to generate revenue to pay for the services provided by the utility, which include, among others, street sweeping, catch basin cleaning, and leaf pickup and mulching." The resulting charge was computed by use of a formula that would estimate the amount of storm water runoff from each parcel. *Id*. at 95. Under the first *Bolt* factor, the Court concluded the storm water

charge served dual purposes. *Id*. at 105. A regulatory purpose was furthered by financing the protection of local waterways from solid pollutants carried in storm water discharged from properties, and a general revenue-raising purpose was served by shifting the funding of preexisting government activities from declining general and street fund revenues to a storm water charge. *Id*. The Court concluded that "the minimal regulatory purpose served by the ordinance and the related management charge is convincingly outweighed by the revenue-raising purpose of the ordinance." *Id*. The ordinance "contain[ed] few provisions of regulation and no provisions that truly regulate the discharge of storm and surface water runoff, with the exception of the provision that allows for credits against the management charge for the use of city-approved storm water best management practices." *Id*. The ordinance "fail[ed] to require either the city or the property owner to identify, monitor, and treat contaminated storm and surface water runoff and allow[ed] untreated storm water to be discharged into the Grand River." *Id*.

The Court also noted that "the lack of a correspondence between the charge imposed and any particularized benefit conferred by the charge supports a conclusion that the charge is a tax and not a utility user fee." *Id*. at 108. The defendant stated that the storm water charge helped to protect public health and safety, but ameliorating such concerns "benefit[s] not only the property owners subject to the management charge, but also everyone in the city in roughly equal measure . . . ." *Id*. at 109. "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." *Id*.

Turning to the proportionality of the charge, the Court noted that "residential parcels measuring two acres or less are charged a flat rate based on the average EHA of all single family parcels, and not on the individual measurements of each parcel's impervious and pervious areas." *Id*. at 110. Single-family parcels comprised over 80% of the parcels within the city. *Id*. By contrast, residential parcels in excess of two acres, as well as commercial, industrial, and institutional parcels of all sizes, were charged on the basis of individual measurements of each parcel's area. *Id*. The Court stated:

> This method of apportioning the management charges among all urban properties emphasizes administrative convenience and ease of measurement and, thereby, suggests an absence of a close proportional relationship between the amount of runoff attributable to a particular parcel and the management charge, as does the fact that the method of calculating the charge fails to consider property characteristics relevant to runoff generation, such as a parcel's location in reference to storm gutters and drains and soil grade. This lack of proportionality is further demonstrated by the fact that the charge generates sufficient revenue to allow the city to maintain a working capital reserve of 25 to 30 percent of the storm water utility's total expenses. Although maintaining a capital reserve is a common practice amongst rate-based public utilities that provides a degree of fiscal stability to utilities, those reserves are funded by true user fees closely calibrated to the actual use of the service or a price paid for a commodity. The management charge at issue in these cases is not such a fee. For these reasons, the actual use of the storm water sewer system by each parcel is not accounted for with the requisite level of precision necessary to support a conclusion that the charge is proportionate to the costs of the services provided. [*Id*. at 110-111 (citation omitted).]

Lastly, the Court concluded that the defendant's storm water charge was compulsory. *Id*. at 111. Although credits were available if property owners reduced runoff, allowing a full credit for all property owners would have undermined the purpose of the storm water charge, to generate funding for the water management system. *Id*. Failure to pay the charge had the possibility of resulting in discontinuation of water service, and the defendant could collect past-due charges through liens and civil actions, further demonstrating the lack of voluntariness and supporting the conclusion the charge was a tax. *Id*. at 112.

In contrast, in *Shaw*, 329 Mich at 648, the Court considered the plaintiff's challenge to the defendant's water and sewer rates that the plaintiff claimed contained "hidden charges that qualified as unlawful taxes because they were imposed without authorization." The project at issue involved mandatory sewer separation-work combined with other ancillary sewer maintenance work, for which the defendant used money generated from sewer rates to fund. *Id*. at 646-647. Although the Court concluded that the plaintiff failed to demonstrate that there was a hidden capital charge in the sewer and water rates, it was "undisputed that a portion of the city's utility rates is used to fund operation and maintenance of the caissons," triggering application of *Bolt*. *Shaw*, 329 Mich App at 665.

Addressing the first factor, the Court held that the rates comprised a valid fee "because the rates serve the regulatory purpose of providing water and sewer service to the city's residents." *Id*. at 666. The Court found there to be a "significant regulatory component" missing in *Jackson Co*, namely that of "the treatment of combined sewage, comprised of storm water and wastewater, in conformance with regulatory requirements." *Id*. The Court explained:

> [T]he alleged CSO-O&M charge, i.e., the cost of operating and maintaining the caissons, is part of the cost of providing sewer service to the city's ratepayers. Dearborn must provide sewer service in conformance with state and federal regulatory requirements, and keeping the caissons functional helps ensure that sewage is properly treated before it is released into the environment. [*Id*.]

Considering the second *Bolt* factor, the Court reasoned that the disputed water and sewer rates

> constitute[d] a valid user fee because users pa[id] their proportionate share of the expenses associated with the operation and maintenance of the water and sewer systems. Mathematic precision is not required when reviewing the reasonable proportionality of a utility fee. Where the charge for either storm or sanitary sewers reflects the actual costs of use, metered with relative precision in accordance with available technology, including some capital investment component, sewerage may properly be viewed as a utility service for which usage-based charges are permissible, and not as a disguised tax. [*Shaw*, 329 Mich App at 666-667 (quotation marks and citation omitted).]

Lastly, under the third factor, the Court found the charge to be a valid fee because it had voluntary characteristics. The Court explained that "[e]ach individual user decides the amount and frequency of usage, i.e., each user decides how much water to draw from the tap." *Id*. at 669.

Thus, because the users could "control how much water they use," the charges were "voluntary." *Id*.

II. ANALYSIS

Although I acknowledge that this case presents a close question, the trial court did not err when it granted plaintiffs' motion for summary disposition. While the Village's water rates serve a regulatory purpose, the rates are also designed to raise revenue for the construction of a new water tower, and the purpose of the new water tower is to increase the water storage capacity for the Village as a whole, not to simply replace the existing water tower. In *Shaw*, 329 Mich App at 666, the Court held that the defendant's water and sewer rates were regulatory in nature because they "serve[d] the regulatory purpose of providing water and sewer service to the city's residents." But as the Court recognized in *Jackson Co*, 302 Mich App at 105, when a charge serves a dual purpose, as most do, the Court must look closer at the respective purposes.

The Village's new rates were estimated to use $50,000 of the $363,000 yearly revenues from the disputed fees to directly fund the construction of the second water tower. Defendant also estimated that it will use approximately $200,000 from the fees to pay for the Village's contribution to a block grant provided that is intended to assist with funding the project. According to defendant, after five years of collecting the fees, the Village will no longer need to use them to fund the water tower's construction. Once funding for the new water tower is complete, defendant claims that it will use the revenue generated by the fees to fund other capital improvements and that the increased rate will otherwise remain.

There is no question that the Village's water and sewer rates serve some regulatory purpose. See *Youmans*, 336 Mich App at 228 ("[T]he contested rates are assessed to fund the operational and capital expenses of the Township's water and sewer system, which serves the primary function of providing water and sewer services to the Township's ratepayers."). However, the overriding purpose for the imposition of the new rates was the determination by DEQ that the Village's water capacity was insufficient and the Village needed to obtain increased revenue to fund the construction of a new water tower. "The purpose of [Headlee] 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," *Shaw*, 329 Mich App at 643; but that is precisely, in my view, what has occurred here. The Village was tasked with increasing its water capacity and building a new tower, and did so by incorporating those capital construction costs into the rate structure for water in the Village. Moreover, like *Jackson Co*, the Village's resolution had little to do with the nuts and bolts of regulation and more to do with raising revenue.

The majority determined that the trial court misinterpreted *Shaw* when it concluded that water rates could never be used to fund new construction projects, and that the overriding precedent permits local municipalities to use revenue from its rates to fund new projects. Referring to *Shaw*, the trial court stated:

> Moreover, in other areas of Dearborn, the city constructed retention facilities, called caissons, to store the combined sewage to avoid overflow events during heavy storms. *Id*. at 645. The manner of financing this project is noteworthy here. The panel in *Shaw* described it as follows: "Although the city funded the

> construction of the caissons through the millage, it currently pays the cost of operating and maintaining the caissons with revenue generated by sewer rates charged to the city's sewer customers. *In other words, taxpayers built the four caissons, ratepayers operate and maintain them.*" *Id*. at 645 (emphasis added). This suggests that the initial construction of the new infrastructure, *even when performed in response to regulatory requirements*, could not be funded through increased rates to taxpayers. Rather, the funding of such new constructions involves taxes. In Dearborn's case, they submitted a millage proposal to the voters to approve the city to incur debt and use the increased millage rate to service the debt. *Id*. at 644-645. Such an option was available and open to defendant in this case. Instead, defendant is funding new construction through increased rates.

The majority is correct insofar as the Court in *Shaw* did not reach the issue of whether the defendant's rates unlawfully included the capital infrastructure costs of separating its sewer system, because the plaintiff did not present any evidence that funds obtained from water and sewer rates were used to pay for the sewer separation. In this case, however, plaintiffs did present evidence, which is undisputed, that the Village intended to use a portion of the revenue from its water and sewer rates to fund the construction of the water tower. Putting *Shaw* aside, *Bolt*, 459 Mich at 163, instructs that where a significant portion of a particular fee or charge is used for "investment in infrastructure as opposed to a fee designed simply to defray the costs of a regulatory activity," such a fee or charge violates the Headlee Amendment. Here, approximately $50,000 of the $360,000 collected annually will be used for capital construction costs. This is "significant," and therefore, in my view, the trial court did not err when it concluded that the Village's rates were not predominately regulatory in nature and served to support a finding that the rates violated the Headlee Amendment.

Concerning whether the rates in question were proportional to the costs of the service, the trial court, for its part, stated its analysis yielded "mixed results" but ultimately determined that because the water tower was itself impermissible, and because the Village could not explain how the tiered-rate structure was proportional, the balance tipped in favor of finding the charge to be a violation of Headlee. I agree. Since 2015, the Village was in communication and discussion with DEQ regarding its view that the Village's water storage capacity was insufficient. In 2017, DEQ sent a letter to the Village specifically noting that the Village "needs to expand upon its current water storage capacity," and the "Village council will need to *increase revenue* to address the water storage capacity deficiency." (Emphasis added.) In response to DEQ's demands, the Village conducted a rate study that ended with the rates in question. Thus, any suggestion that addressing the Village's water storage issues was not the primary purpose of the rate increase is not supported by the record.

While it is true that courts are not to use mathematical precision when analyzing the proportionality of a particular rate, and rates are presumed proportional and, therefore, legal, *Trahey*, 311 Mich App at 594, 597, the Village failed to justify why a 50% increase in rates for the high-use owners was proportional to the increased demands those users have on the overall system. Similar to *Jackson Co*, 302 Mich App at 110, in which the defendant charged property owners a flat rate for parcels under two acres and a variable rate for larger parcels, the lack of proportionality reveals that the Village's fees are a disguised tax. In addition, it is undisputed that after the water tower is constructed, the Village intends to continue to collect the same rates and use the revenue

for future projects. If the rate increase for high-volume users was predicated on their disproportionate need for more water than the average user, the continued increase in rates for unknown future capital projects cannot be similarly justified. See *Bolt*, 459 Mich at 164 ("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.") (quotation marks and citation omitted).

Finally, the third *Bolt* factor requires examination of the voluntariness of the Village's rates because "fees generally are voluntary, while taxes are not." *Bolt*, 459 Mich at 162. The trial court concluded that the Village's water and sewer rates were voluntary because users could decide whether and how much water they used. Indeed, such rates have generally been held to be voluntary for the very fact that users can decide "the amount and frequency of usage." *Shaw*, 329 Mich App at 669. Although plaintiffs contend that the rate structure will alter their use habits and therefore deprive them of their property rights, citing *Bolt*, I agree with the majority that the rates are voluntary. The issue in *Bolt* involved fees for storm water runoff, which was justified, in part, by the defendant arguing that such a fee would be voluntary because property owners could choose not to build on the property, thereby reducing the costs. *Bolt*, 459 Mich at 168. Incentivizing users to conserve water is different from incentivizing them to refrain from constructing buildings or paving property.

However, the fact that the charges are voluntary does not save the Village. As explained above, the primary purpose of the new rates was to raise revenue to construct a second water tower. While the purpose of the water tower itself undoubtedly had regulatory features, such a fact cannot save the Village's rates. The rates were not proportionate in that there was no justification for why high-volume users needed to pay 50% more, and why they needed to do so even after the new water tower was constructed. Thus, I would conclude that the trial court did not err when it granted summary disposition in plaintiffs' favor.

/s/ Kirsten Frank Kelly