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Senate Bill 442 (Substitute S-1 as passed by the Senate)
Senate Bill 443 (Substitute S-2 as passed by the Senate)
Sponsor: Senator Jim Marleau
Committee: Education

Date Completed: 11-19-13

RATIONALE

Under the Revised School Code and the Revised Judicature Act, collection on a judgment against a school district is obtained through an assessment on the school district property tax rolls, and not directly from the school district. Concerns about this issue arose after a \$7.8 million judgment against the Pontiac School District led to a millage increase in the municipalities within the district (discussed below). Some people believe that increasing taxes to pay a judgment against a school district for damages regarding school operations is unfair to the taxpayers in that district. Therefore, it has been suggested that statutory amendments should prevent such a judgment against a school district from being collected through the tax rolls.

CONTENT

Senate Bills 442 (S-1) and 443 (S-2) would amend the Revised School Code and the Revised Judicature Act, respectively, to prevent the enforcement of a judgment for damages in a contract action against a school district or an intermediate school district (ISD) that specifically related to school operations.

Senate Bill 442 (S-1) is tie-barred to Senate Bill 443.

Senate Bill 442 (S-1)

Part 28 of the Revised School Code governs actions and judgments against school districts and intermediate school districts (ISDs). Under this part, a claimant may not bring an action to enforce a judgment against a school district or an ISD, and a person can collect on a judgment against a school district or an ISD only as prescribed in Part 28 (i.e., through tax roll adjustments). The bill would delete this language.

The bill specifies that a judgment for damages against a school district or an ISD would not be enforceable, and would not be subject to collection, except as provided under Section 6094 of the Revised Judicature Act (the section that Senate Bill 443 (S-2) would amend).

The bill also would repeal Sections 1643 and 1644, in Part 28, which prescribe the method of collecting on a judgment against a district through the tax roll. (The provisions in those sections are virtually identical to the current provisions in Section 6094 of the Revised Judicature Act.)

Senate Bill 443 (S-2)

Section 6094 of the Revised Judicature Act establishes the method of recovery with regard to a judgment against a school district. Essentially, the judgment must be certified to the township supervisor, and the supervisor must assess the amount of the judgment against the taxable property in the district.

Under the bill, Section 6094 would not apply to a judgment for damages that resulted from an action to enforce a contract to which the school district or ISD was a party and that specifically related to school operations, including, but not limited to, a collective bargaining agreement, a contract relating to employment, a construction contract, or a procurement contract.

Specifically, under Section 6094, if a final judgment is issued against a school district, the school district treasurer must certify the judgment to both the township supervisor and the director of the school district. If the treasurer fails to certify the judgment, the party obtaining it may file with the supervisor a certificate of the clerk of the court that entered the judgment. If the judgment applies to a school district that lies in two or more townships, the supervisor for each township must certify the judgment.

A supervisor who receives a certificate of a judgment must assess the amount of the judgment on the taxable property of the district, placing it on the next township assessment roll in the column for school taxes. The amount must include interest from the date of the judgment to the time that the warrant for the collection of the judgment will expire. The amount of the judgment must be collected and returned in the same manner as other district taxes.

In addition to providing that Section 6094 would not apply to a judgment for damages as discussed above, the bill would revise several terms in the section. The bill would include references to an intermediate school district, as well as a school district; and would refer to a municipality, as well as a township. In addition to "supervisor", the bill would refer to "assessing officer"; and in addition to "director" of a school district, the bill would refer to "secretary".

MCL 380.1642 (S.B. 442)
600.6094 (S.B. 443)

BACKGROUND

After a judgment for approximately \$7.8 million was entered against the Pontiac School District, the Oakland County Circuit Court in June 2013 ordered a tax levy against the property in the district. As a result, municipalities within the school district are subject to a 3.071 millage increase spread over the next 10 years. The district includes portions of Auburn Hills, Bloomfield Township, Lake Angelus, Orion Township, Pontiac, Sylvan Lake, Waterford Township, and West Bloomfield Township. Each community's share of the judgment is based on the size of the tax base that is within the school district. According to the Mayor of Pontiac, Pontiac residents will pay \$2.1 million of the judgment, and the remainder will be spread throughout the remaining municipalities in the school district. Reportedly, Auburn Hills will pay the largest share, which amounts to approximately \$4.9 million.

The judgment resulted from a lawsuit by the Michigan Education Special Services Association (MESSA) against Pontiac Schools for 18 months of accumulated debt related to unpaid health coverage services for teachers.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Liability for school operations should not be shouldered by taxpayers, yet the current law allowed a \$7.8 million judgment to be assessed against taxpayers of multiple townships and cities when the Pontiac School District failed to meet its contractual obligations to MESSA for 18 months.

The law should be changed to prevent assessments like this in the future, as there is a threat of cases similar to the Pontiac Schools case. According to a memo from the Governor's Office dated August 6, 2013, Pontiac Schools was in a state of financial emergency, had a general fund deficit of \$37.7 million, was \$3.73 million behind in its payments to MESSA (in addition to the \$7.8 million judgment), and had approximately \$33.0 million in unpaid bills due to various vendors.

Many other Michigan school districts also are financially stressed. For example, Detroit Public Schools has been under emergency management since 2011, and Buena Vista Schools and Inkster Schools were recently dissolved due to severe financial problems. According to the State Superintendent's quarterly report to the Legislature on deficit districts, as of September 12, 2013, 46 school districts were projected to end the 2012-13 fiscal year with a deficit. If the law is not changed, taxpayers of many districts, in addition to those within the Pontiac School District, could see judgments rolled into their property taxes as a result of actions against school districts.

Allowing judgments for school operations to be levied against the taxpayers of a school district conflicts with the goals of Proposal A and the Headlee Amendment, approved by the voters in 1994 and 1978, respectively. Arguably, one purpose of Proposal A, the school finance reform measure, was to shift some of the burden of school operational costs from local taxpayers to the State. In addition to other limitations, the Headlee Amendment includes a provision that generally prevents a unit of local government from levying a tax increase without the approval of its voters. Nonetheless, current law allows levying a judgment in the form of a tax millage increase when a school district otherwise would have to get voter approval for the increase.

This practice also may encourage a school district to accumulate massive debt for services that it contracted for, yet could not afford. Rather than having to seek voter approval for a millage increase to provide more services, a district can simply contract for a new service, not pay the bill, and see the liability passed on to taxpayers in the form of a millage increase. As a result, school districts have little accountability for irresponsible fiscal practices. Effectively, they are free to ignore budgetary constraints and avoid contractual obligations to pay for school operations, to the detriment of local taxpayers. Some people believe this is what led to the nearly \$8.0 million judgment against Pontiac Schools.

Passing judgment liability on to taxpayers also may serve to encourage bad business practices by vendors. Some people believe that if a contract vendor is owed payment from a school district, that vendor should stop providing services in a timely manner, rather than let unpaid bills accumulate. In the Pontiac Schools case, MESSA allowed the district's unpaid debt to accumulate for 18 months. Some have suggested that MESSA may have relied on the fact that a judgment against a school district is assessed against the tax rolls, which effectively guaranteed payment to MESSA for services that it otherwise might have cancelled due to nonpayment.

Unexpected tax increases due to the assessment of judgments on property tax rolls are not business friendly and may discourage business growth and investment in the State. Auburn Hills is home to many businesses, including Chrysler, and comprises a large portion of the Pontiac School District tax base. According to various business representatives, predictability in tax obligations is important to planning investments and encouraging growth. Including judgments in the tax rolls disrupts predictability and stability, and may serve as a disincentive to firms considering locating or expanding business operations in Michigan.

Opposing Argument

The bills would not include an alternative form of recovery, effectively granting immunity to school districts with regard to contract damages. Although this immunity would be limited to judgments for contracts specifically related to "school operations", that is a very broad term, and the bills could affect virtually all contract suits against schools.

Unlike Proposal A, which shifted some responsibility for operating costs from local taxpayers to the State, the bills would not provide a similar shift of responsibility, and would deprive an unpaid vendor of any meaningful legal recourse. A school vendor would be responsible for the school district's failure or refusal to pay on a contract, even if the district had acted in bad faith. This would be unfair to a party that contracted in good faith and fulfilled its obligations.

As a result, vendors could refuse to enter into contracts with school districts due to the risks involved, or charge higher fees to school districts to offset the risks. Since many districts are struggling, the risk of nonpayment combined with the inability to collect on a judgment against a district could dissuade potential contractors from dealing with school districts altogether. School

districts in financial stress particularly could face difficulty in finding willing vendors. If a struggling school district could not obtain services or had to pay relatively higher fees for a service, the district likely would face additional financial stress.

Opposing Argument

Judgments against a school district for contract damages are the local taxpayers' responsibility, and a school board is accountable to them. Local taxpayers elect the school board. The board makes decisions on the behalf of the taxpayers, including decisions regarding the selection of vendors and services, and whether to pay on a contract. Barring the enforcement of judgments would remove taxpayers' accountability for the actions of their elected school board, and would reduce taxpayers' incentive to ensure that a school board was operating in a fiscally responsible manner. Placing the liability with taxpayers via the tax rolls helps to ensure that local taxpayers hold their school boards accountable through the elective process.

Opposing Argument

The bills would prevent school employees from enforcing their right to compensation. The bar on enforcing judgments would apply to employees, not just creditors and vendors. Employment contracts are fundamental to school operations.

Opposing Argument

The bills could unconstitutionally impair contract rights. Under Article 1, Section 10 of the Michigan Constitution, and Article 1, Section 10 of the U.S. Constitution, a law may not retroactively impair contract rights. Arguably, barring a vendor from enforcing a judgment that stemmed from damages relating to a school district's failure to fulfill a contractual obligation would be an impairment of the vendor's rights under the contract. If a contract existed before the bills became effective, and were subject to the provisions in the bills, the impairment would be retroactive.

Legislative Analyst: Glenn Steffens

FISCAL IMPACT

The bills could have a positive fiscal impact on school districts and ISDs. If plaintiffs were barred from collecting on a successful judgment against a district, that district could realize cost savings in two principal ways. First, the difficulties of a would-be plaintiff to collect on a successful judgment in a contract suit could deter that party from filing suit to begin with, thus saving the district the cost of litigation. Second, in the event of a judgment against a district, that district would experience cost savings for the entire amount of the judgment it would no longer be required to remit to the plaintiff under the bills.

Fiscal Analyst: Kathryn Summers

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.