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Senate Bills 442 and 443 (as enacted)  
Sponsor: Senator Jim Marleau  
Senate Committee: Education  
House Committee: Financial Liability Reform

**PUBLIC ACTS 184 & 185 of 2013**

Date Completed: 7-16-14

**RATIONALE**

Under the Revised School Code and the Revised Judicature Act, if a person is awarded monetary damages in a lawsuit against a school district, collection on the judgment is obtained through an assessment on the school district property tax rolls, and not directly from the school district. This means that the taxpayers in the district ultimately pay the damages. 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 is unfair to the taxpayers in that district, and it was suggested that this practice should not be allowed in certain situations.

**CONTENT**

**Senate Bills 442 and 443 amended 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 if 1) the district was not authorized to enter into the contract; or 2) the judgment requires the payment of money to someone other than the State, a public employee retirement system established by the State, or a State university, and a) the district is subject to a consent agreement under the Local Financial Stability Act that does not require the State Treasurer's approval for the district treasurer to certify a judgment, or b) the required payments total more than \$100,000 and the person failed to notify the district or to discontinue providing goods or services within a certain time frame after the district defaulted.**

The bills took effect on December 13, 2013.

**Senate Bill 442**

Part 28 of the Revised School Code governs actions and judgments against school districts and intermediate school districts (ISDs). Previously, a claimant could not bring an action to enforce a judgment against a school district or an ISD, and a person could 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 deleted this language.

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

The bill also repealed Sections 1643 and 1644, in Part 28, which prescribed the method of collecting on a judgment against a district through the tax roll.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

### **Senate Bill 443**

Section 6094 of the Revised Judicature Act establishes the method of recovery with regard to a judgment against a school district. Specifically, if a final judgment is issued against a school district or an intermediate school district, the district treasurer must certify the judgment to both the township supervisor and the secretary of the school district. The treasurer also must certify the judgment to the assessing officer of the township or municipality in which the district is located. If the treasurer fails to certify the judgment, the party obtaining it may file a certificate of the clerk of the court that entered the judgment. If the judgment applies to a district that lies in two or more townships or municipalities, a certificate must be delivered to the supervisor of each township and the assessing officer of each township or municipality.

An assessing officer 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 taxes of the district.

(This description of the process reflects several changes made by the bill, such as the inclusion of intermediate school districts, and the requirement that the district treasurer certify the judgment to the township or municipal assessing officer.)

Under the bill, Section 6094 does not apply to any of the situations described below.

Unauthorized Contract. Section 6094 does not apply to a judgment entered in an action to enforce a contract that the school district or ISD was not authorized to enter into under the laws of the State.

Payment Not to the State; Consent Judgment. Section 6094 does not apply to a judgment entered in an action to enforce a contract to which the school district or ISD is a party that provides for payment of money to a person other than the State, a public employee retirement system established by the State, or a State university, if both of the following apply:

- The school district or ISD is subject to a consent agreement under the Local Financial Stability and Choice Act.
- The consent agreement does not require the district to obtain the approval of the State Treasurer before the district treasurer certifies a judgment under Section 6094.

(Under that Act, if a financial emergency is found to exist within a local government (including a school district), the local government must choose among several options, which include entering into a consent agreement with the State Treasurer. In the case of a school district, the consent agreement also must be signed by the Superintendent of Public Instruction. The consent agreement must provide for necessary remedial measures, and may grant local officials the powers that an emergency manager would have.)

Payments over \$100,000 Not to the State. Section 6094 does not apply to a judgment entered in an action to enforce a contract to which the school district or ISD is a party that provides for one or more payments of money to a person other than the State, a public employee retirement system established by the State, or a State university, if all of the following apply:

- The total amount of payments by the district required under the contract is more than \$100,000.
- The district failed to make a payment required under the contract to the person within 90 days after the date required under the contract.
- Either 1) within the 90-day period, the person entitled to the payment did not provide written notice to the board and superintendent of the district and the State Treasurer of the district's failure to make the required payment and the person's intent to stop providing goods or services under the contract; or 2) after sending such a notice, the person did not stop

providing goods or services under the contract at the earliest time allowable under the contract.

The State Treasurer must send an electronic copy of each notice received under item 1) to the chairpersons of the Senate and House Education Committees, and the Senate and House Appropriations subcommittees on school aid. Also, the State Treasurer and the district must post an electronic copy of the notice on the internet website of the Department of Treasury and of the district, respectively.

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 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**

Taxpayers should not have to shoulder liability for a school district's breach of contract, yet the 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.

Changing the law will prevent assessments like this in the future, in situations 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 owed approximately \$33.0 million 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 dissolved in 2013 due to severe financial problems. According to the State Superintendent's quarterly report to the Legislature on deficit districts, dated June 6, 2014, a total of 48 districts and public school academies ended the 2012-13 fiscal year in a deficit position.

Allowing monetary awards against school districts to be levied against the taxpayers of the districts 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, the Revised School Code has allowed 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 could encourage a school district to accumulate massive debt for services that it contracts, yet cannot afford. Rather than having to seek voter approval for a millage increase to provide more services, a district could 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.

Passing judgment liability on to taxpayers also could encourage bad business practices by vendors. If a contract vendor is owed payment from a school district, that vendor should stop providing services in a timely manner, rather than letting 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 might have relied on the fact that a judgment against a school district would be assessed against the tax rolls, which effectively guaranteed payment to MESSA for services that it otherwise might have cancelled because of nonpayment.

Furthermore, 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. Predictability in tax obligations is important to planning investments and encouraging growth, and including judgments in the tax rolls undermines predictability and stability.

**Response:** A district that is in a financial emergency will still be able to avoid its accountability if the district enters into a consent agreement that allows it to certify a judgment without the State Treasurer's approval.

### **Opposing Argument**

For situations in which a judgment against a school district cannot be enforced under the bills, the legislation does not include an alternative form of recovery, effectively granting immunity to school districts with regard to contract damages.

Unlike Proposal A, which shifted some responsibility for operating costs from local taxpayers to the State, the bills will deprive an unpaid vendor of any meaningful legal recourse. A school vendor will be responsible for the school district's failure or refusal to pay on a contract, even if the district acted in bad faith. This will be unfair to a party that contracts in good faith and fulfills its obligations.

As a result, vendors might 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 might dissuade potential contractors from dealing with school districts altogether. School districts in financial distress particularly may face difficulty in finding willing vendors. If a struggling school district cannot obtain services or has to pay relatively higher fees for a service, the district likely will face an additional financial burden.

**Response:** Unless the other exceptions apply, a vendor will be unable to collect on a judgment only if the total payments required exceed \$100,000 and the vendor failed to notify the district within 90 days after a payment was not made, or continued to provide goods or services after sending a notice. In other words, a vendor will have to reasonable steps to mitigate its damages in order to enforce a judgment through a levy on the taxpayers.

### **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. By barring the enforcement of judgments under certain circumstances, the bills remove taxpayers' accountability for the actions of their elected school board, and reduce taxpayers' incentive to ensure that a school board is 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**

If any of the exceptions to Section 6094 applies, the bills will prevent school employees from enforcing their right to compensation. If there is a bar against enforcing a judgment, the bar will apply employees as well as creditors and vendors.

### **Opposing Argument**

The bills may 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, if a vendor is barred from enforcing a judgment that stemmed from damages related to a school district's failure to fulfill a contractual obligation, the vendor's rights under the contract will be impaired. If a contract existed before the bills became effective, and is subject to the provisions in the bills, the impairment will be retroactive.

Legislative Analyst: Suzanne Lowe

### **FISCAL IMPACT**

The bills may have a positive fiscal impact on school districts and ISDs. If plaintiffs are barred from collecting on a successful judgment against a district as outlined in Senate Bill 443, that district may 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 might 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 for a contract in excess of \$100,000, that district will experience cost savings for the entire amount of the judgment it will no longer be required to remit to the plaintiff under the bill, if the required conditions are met.

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.