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STATE OF MICHIGAN

IN THE SUPREME COURT

DETROIT ALLIANCE AGAINST THE RAIN TAX, a voluntary unincorporated association, and **DETROIT IRON AND METAL CO., AMERICAN IRON & METAL CO., MCNICHOLS SCRAP IRON & METAL CO., MONIER KHALIL LIVING TRUST,** and **BAGLEY PROPERTIES, LLC**, individually and on behalf of similarly situated persons,

Plaintiffs/Appellants,

v.

CITY OF DETROIT, a municipal corporation, the **DETROIT WATER AND SEWERAGE DEPARTMENT**, and the **DETROIT BOARD OF WATER COMMISSIONERS,**
Defendants/Appellees.

Case No. 158852

Court of Appeals Case No. 339176

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DEFENDANTS/APPELLEES CITY OF DETROIT, DETROIT WATER AND SEWERAGE DEPARTMENT, AND DETROIT BOARD OF WATER COMMISSIONERS' COURT-ORDERED SUPPLEMENTAL BRIEF

ORAL ARGUMENT ON THE APPLICATION GRANTED

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COUNTER-STATEMENT OF QUESTION PRESENTED

The Court of Appeals, after comprehensive review of an extensive record, concluded that the City's combined sewer system, and its related drainage charge, are regulatory and not revenue-raising because (1) the City provides end-of-pipe treatment and disposal services to both sanitary sewage and storm water, (2) the drainage charge only recovers the costs to operate, administer and maintain its combined sewer system (which provides these treatment and disposal services to those who use the system), (3) the City has always relied on rate, not tax, revenue to fund its combined sewer system costs, and (4) the charge is not being used to predominantly pay for large-scale infrastructure that has no regulatory purpose. Given this analysis, did the Court of Appeals err in concluding that *Bolt v City of Lansing*, 459 Mich 152, 164 (1998), is distinguishable from this case on the basis that Detroit's sewer system is a combined system rather than a separate storm and sanitary sewer system?

Plaintiffs/Appellants Answer: Yes

Defendants/Appellees Answer: No

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INTRODUCTION

The Court of Appeals held that the City of Detroit's drainage charge is a fee, not a rain tax, under *Bolt v City of Lansing*, 459 Mich 152, 164; 587 NW2d 264 (1998).[1] This is because the drainage charge, which is assessed for services provided by a combined sewer system, is patently distinguishable from the charge in *Bolt*. In a combined sewer system, sanitary waste is commingled with storm water. Thus, both the sanitary waste and the storm water contain sewage that must be treated and properly disposed. Although Plaintiffs regard the City's treatment of sewage as an immaterial fact, the Court of Appeals correctly recognized that the presence of sewage renders the operation of the City's combined sewer system a regulatory activity. The City treats and properly disposes of not only sanitary sewage, but also the storm water-component of its combined sewage. The Lansing storm water charge in *Bolt* did not pay for any treatment of sewage or storm water, and did not pay for any disposal of sewage. The City's treatment and disposal of both sanitary waste and polluted storm water is a service being provided by the City's combined sewer system – a service that was absent in *Bolt*. It is this treatment and disposal of sewage-infested water that, in part, differentiates the City's drainage charge from the storm water charge at issue in *Bolt* and renders the City's drainage charge a valid user fee.

This Court has asked the parties to provide supplemental briefing as to whether the Court of Appeals erred in concluding that *Bolt* is distinguishable from this matter based on the fact that the City operates a combined sewer system as opposed to separated storm water and sanitary sewer systems. However, the Court of Appeals' opinion that the drainage charge is distinguishable from the facts in *Bolt* is not based solely on the fact that the City operates a "combined sewer system." The Court of Appeals issued a 22-page, single-spaced opinion in which it discussed many factual

[1] The City of Detroit includes Defendants City of Detroit, the Detroit Water and Sewerage Department and the Detroit Board of Water Commissioners and all three are collectively referred to herein as either the "City" or "DWSD."

aspects of the City's drainage charge that differ from the charge in *Bolt*, ultimately concluding that based on these differences, the City's drainage charge is both regulatory and proportional.

Moreover, the Court of Appeals' finding that the drainage charge is regulatory because the City maintains a combined sewer system, App 1 at 015b-017b, is by no means the only basis upon which the Court of Appeals concluded that the City's drainage charge is regulatory (and ultimately, a fee). The Court of Appeals also found that there is an adequate correspondence between the charges imposed and benefits provided insofar as the charge is being imposed only upon on those parcel owners who contribute polluted storm water to the combined sewer system. (*Id.* at 017b.) And, the Court of Appeals concluded that the City's treatment and disposal of combined sewage was never supported by the City's general fund (nor could it be given the federal prohibition on assessing an ad valorem tax to recover these costs).[2] (*Id.* at 017b-018b.) Finally, notwithstanding Plaintiffs' distortion of the record to the contrary, the Court of Appeals concluded the drainage charge was regulatory because it did not reflect an enormous investment in a large-scale infrastructure project as did the storm water charge in *Bolt*. There, the City of Lansing's storm water charge – 63% of which was dedicated to recouping approximately $130 million in capital costs – was assessed upon all residents even though the capital project only benefitted 25% of them. (*Id.* at 018b-019b.) Here, as (1) the affidavits from DWSD's CFO, (2) the City's June 30, 2016 Audited Sewer System Financial Report, and (3) the City's Capital Improvement Plan all reveal (App 2, 3, 4), the City's drainage charge covers the necessary costs of owning, running and maintaining a combined sewer system. While some of these underlying costs relate to debt associated with the construction of the system or relate to the repair and maintenance of the system (and thus reflect an investment in capital), these costs are not only acceptable to include in a rate per *Bolt*, but also a required rate component under the Michigan Revenue Bond Act. In short, the Court of Appeals'

[2] See *infra* at 16-18.

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analysis of the regulatory aspect of the City's drainage charge was broad and extensive and it did not rely exclusively on the fact that the City operates a combined sewer system. That being said, none of these other facts is necessary to find that the City's drainage charge is regulatory. The fact that the drainage charge recoups the costs of operating, administering and maintaining a combined sewer system is basis enough to hold that the charge is a valid user fee.[3]

STATEMENT OF MATERIAL FACTS

The City is mindful of the Court's directive to not submit a mere restatement of its Answer to Plaintiffs' Application and thus, it includes in this supplemental brief the most salient points regarding its combined sewer system. These facts demonstrate that this matter is nothing like *Bolt* and illustrate why the Court of Appeals correctly concluded that the City's drainage charge is a valid user fee and not an unlawful tax.[4]

---

[3] There are two class actions pending before this Court on applications for leave to appeal that also involve combined sewer systems, although both are factually distinct from this matter. See *Shaw v City of Dearborn*, ____ NW2d ____, 2019 WL 4548372, at *9 (Mich App Sep 19, 2019) (holding that all sewer ratepayers benefit from 12 retention facilities that store combined sewage even though the facilities are used for sewage discharged by only some users of the city-wide combined sewer system and the related sewer charges are user fees); *Gottesman v Harper Woods*, Case No 344568, 2019 WL 6519142, at *5 (Mich App Dec 3, 2019) (holding that a storm water charge assessed to pay for future improvements to a combined sewer system is a tax). Plaintiffs repeatedly compare this matter to *Gottesman*. (Pls' Supp Br at 1-4.) Setting aside whether the Court of Appeals' decision in *Gottesman* was proper, Plaintiffs' comparisons between this case and *Gottesman* are inapt. *Gottesman* involves a storm water charge that was not estimated on a per parcel basis (as opposed to the City's uniform rate, which is applied to the individually-measured impervious acreage of only those parcels who contribute storm water to the City's combined sewer system). *Gottesman*, 2019 WL 6519142 at *1. Also, unlike the City, Harper Woods previously paid for these costs with its general fund revenue before it began assessing its storm water charge. *Id.* at *5.

[4] In their supplemental brief, Plaintiffs raised issues that go beyond the scope of this Court's January 24, 2020 briefing order. The City cannot let Plaintiffs' arguments stand unrebutted because they misconstrue the underlying record supporting the validity of the City's drainage charge, including but not limited to, record evidence regarding the City's sewage disposal fund, the City's combined sewer system costs, the allocation of these costs and the City's rate-setting process. See App 5. Given the breadth of Plaintiffs' supplemental brief, the City's also includes in this brief those facts that are critical to rebutting Plaintiffs' arguments.

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The Different Public Sewer Options

In a 2004 Report to Congress, the Environmental Protection Agency ("EPA") recognized that "two types of public sewer systems predominate" in the United States: sanitary sewer systems and combined sewer systems. (App 6 at 167b.)[5] Both sanitary sewer and combined sewer systems convey domestic, commercial and industrial waste (which consists of sewage and other sanitary waste) through a single pipe system to publicly-owned treatment works facilities. The difference between the two systems is that a combined sewer system also carries polluted storm water runoff to that same treatment works facility.[6] (*Id.*)

The construction of municipal sewer systems (including combined sewer systems) did not begin in earnest until the late 1880s. (*Id.* at 172b.) Before then, human waste was disposed of in privy vaults or cesspools and storm water ran into the streets. (*Id.* at 171b-172b.) Still, even with municipal sewers, untreated water was being discharged directly into adjacent rivers and streams, resulting in outbreaks of cholera and typhoid. (*Id.* at 173b.) These illnesses prompted municipalities to start treating their wastewater at wastewater treatment plants. (*Id.*) Wastewater treatment plants nationwide (including the City's, see *infra* at 6-8), provide both primary treatment (i.e., separating solids and floating debris from wastewater prior to discharge) and secondary treatment (which reduces the concentration levels of certain key parameters (see *infra* at 10-11)). These plants are now integral components of combined sewer systems. The vast majority of combined sewer systems are

---

[5] This Court may take judicial notice of official government documents including government reports. See *People ex rel Blair v Michigan Cent R Co*, 145 Mich 140, 149; 108 NW 772 (1906) (acknowledging that case law generally supports courts taking judicial notice of public documents); *US ex rel Dingle v BioPort Corp,* 270 FSupp2d 968 (WD Mich 2003) (interpreting federal equivalent of Michigan Rule of Evidence 201 to conclude that court could take judicial notice of government documents including congressional reports).

[6] A combined sewer system contains more than storm water and also includes drain water, irrigation runoff, snow melt, and other surface runoff. For ease of reference the City uses the term "storm water" as a catch-all phrase to include all of these flows of non-sanitary sewage to the combined sewer system.

concentrated in the Northeast and Great Lakes regions. (*Id.* at 174b.) As of 2004, there were more than 20,000 sanitary and combined sewer systems in operation in the United States. (*Id.* at 171b.) Both sanitary and combined sewer systems differ from the separated storm water system at issue in *Bolt v City of Lansing*. A separated storm water system includes storm water and no sewage.

The City's Combined Sewer System

For over 140 years, the City has provided services to users of the City's combined sewer system (which receives both sanitary sewage and polluted storm water).[7] (App 7 at 364b, 367b.) Once storm water enters the City's sewer system and commingles with sewage, the two flows become one. The merged flows now contain raw sanitary waste – i.e., the waste that goes down sinks, showers, tubs, and toilet drains. This is why the system is a "combined sewer system" and why the flow is called "combined sewage." Clearly, sanitary sewage needs to be treated before disposal. But in a combined system like the City's, storm water also requires treatment because it, too, contains raw sewage. Moreover, the storm water that flows from various parcels is not pure "rain water" or pollution free when it enters the combined sewer system. Instead, it contains, among other things, "particulate matter from the atmosphere, nitrogen oxides from car exhaust, rubber particles from tires, debris from brake systems, phospates from residential and agricultural fertilizers . . ." along with other hydrocarbons, bacterial contamination, oil and greases, chlorine and

[7] In January 2016, the Great Lakes Water Authority ("GLWA") assumed responsibility for servicing regional wholesale sewer customers. The Authority also assumed responsibility for operating the City's regionally-based combined sewer system under the terms of a lease agreement between the City and the Authority. (App 8; App 2 at 041b.) The City is one of several communities served by the regional system. A majority of the costs relating to the City's combined sewer system are allocated by GLWA to the City's retail customers as a whole, who are now collectively customers of GLWA. The allocation reflects what GLWA has decided are those costs allocable to the City's customers. (App 8.) Despite the leasing arrangement, the City is responsible for establishing a rate structure for its customers' share of the costs of operating and maintaining the regional system, as well as the local system that the City operates. The references throughout this brief to the City's combined sewer system and related facilities reflect that obligation.

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metals. (App 6 at 195b-201b (see also Tables 4.1-4.6); App 18 at 795b; App 28 at 912b; App 30 at 937b.)

The City's combined sewer system includes various sewer lines, 98% of which carry both sanitary sewage and storm water flow in the same pipes. (App 7 at 364b.) Thousands of miles of "public" (main or trunk) and lateral sewers serve nine major drainage districts within the City, including the Rouge River, Southfield, Hubbell, Oakwood, Baby Creek, Conner Creek, Fox Creek, East Jefferson, and Central drainage districts. (*Id.* at 364b, 368b-371b.) The City's combined sanitary and storm water flow is transported to a wastewater treatment plant ("WWTP") by three interceptors within the City: the Detroit River Interceptor, the Oakwood-Northwest Interceptor and the North Interceptor-East Arm. (*Id.* at 372b.)

The decision to treat combined sewer discharges at wastewater treatment plants created unforeseen challenges for communities with combined sewer systems:

> As the need to provide wastewater treatment was recognized, the major design difference between CSSs [combined sewer systems] and SSSs [sanitary sewer systems] became apparent. Although combined sewers offered an efficient means of collecting and conveying storm water and wastewater, they made treatment more difficult due to large variation in flows between dry and wet weather conditions.

(App 6 at 173b.) Wet weather conditions may result in combined sanitary and storm flows that are too much for a treatment plant to handle at once. When this happens in the City, the excess flows are either held in storage until they can be treated by the WWTP, or routed to one of the City's other facilities designed to treat and dispose of this excess combined sewage. These excess flows are referred to as "combined sewage overflows" ("CSOs"). (App 7 at 408b-463b; App 6 at 173b.)

Services Provided by the Wastewater Treatment Plant to Users' Combined Sewage

The WWTP is one of the largest and most complex wastewater treatment systems in the country, treating on average 650 million gallons of combined sewage flows per day from both the City and other communities in the region. (App 9 at 578b.) The WWTP is situated on a 123-acre

site in southwest Detroit where the Detroit and Rouge Rivers meet. (App 10 at 586b.) The WWTP provides the following disposal and treatment-related services to the City's combined sewage:

- Raw wastewater pumping at Pump Station Nos. 1 and 2, which receive flows from the three interceptors;
- Primary treatment using 12 rectangular and 6 circular clarifiers;
- Phosphorus removal using Ferric Chloride;
- Secondary treatment using 4 high-purity oxygen-activated sludge tanks and 25 secondary final clarifiers;
- Chlorination and dechlorination of the final effluent;
- Gravity thickening of the solids generated in primary and secondary treatment;
- Dewatering of the thickened solids using both centrifuges and belt filter presses
- Incineration of a portion of the dewatered solids; and
- Offloading the remainder of the dewatered solids (after lime addition) to trucks for either land application or landfill disposal.

(App 11 at 600b; see also App 10 at 586b.) Under NPDES Permit No. MI0022802, the WWTP is authorized to discharge the treated wastewater into nearby receiving waters including the Detroit River, the Rouge River, and Conner Creek. (App 12 at 617b.)

The City's Court-Ordered Compliance with the Clean Water Act

Historically, when the City's CSOs overwhelmed the WWTP, the CSOs would flow untreated into surrounding waters. In 1977, the State of Michigan and the EPA filed an action against the City, alleging that the City had not complied with the Federal Water Pollution Control Act (commonly known as the Clean Water Act ("CWA")). See *City of Detroit v State of Michigan*, 803 F2d 1411, 1413 (6th Cir 1986). Ultimately, through a consent judgment issued by the federal district court, "Detroit was required to make massive improvements to provide full secondary treatment to flows received at its [WWTP]." *Id.* at 1412-13, 1417. After meeting this requirement, the City was then required to address treatment of its wet weather flows. *See US v State of Michigan*, No 77-71100, 1989 WL 155689, at *3 (ED Mich Nov 7, 1989). At the behest of state and federal authorities, the City has already constructed "$1 billion in CSO control facilities" to treat and dispose of the City's CSOs. (App 1 at 19b, n.16; App 13 at 682b) The City financed this construction years ago,

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primarily through bonds and loans, but also through federal and state grants. (App 13 at 688b (¶24), 690b (¶11).) The City was also ordered to adopt a user charge system to charge ratepayers for treatment and management of storm water flows, *City of Detroit*, 803 F2d at 1413, because this is what federal law and regulations required. See also *infra* at 16-17. The City was under federal oversight for more than three decades in order to ensure the City's continued compliance with treatment obligations.

The City's CSO Control Program and Facilities

In 1989, the EPA published its National Combined Sewer Overflow Control Strategy to govern approximately 15,000-20,000 CSO discharge points nationwide. 54 FR 37370-02, 1989 WL 288369 (Sep 8, 1989). This strategy requires communities like the City to develop and implement combined sewer system management plans and to maintain a single, system-wide permit for all of its discharges, including overflows, from the combined system. 54 FR at 37371-72. In 1994, the EPA issued its Combined Sewer Overflow Control Policy ("EPA CSO Policy"). 59 FR 18688-01, 1994 WL 133270 (Apr 19, 1994). The EPA CSO Policy requires owners of combined sewer systems to adopt control measures for CSOs and to develop and implement long-term CSO control plans.

A key difference between the City in this case and Lansing in *Bolt* is that unlike Lansing, which decided to separate its sanitary and storm sewers to manage its CSOs (*Bolt*, 459 Mich at 171, n1), the City elected to treat its CSOs containing raw sewage. The City submitted its long term CSO control plan to MDEQ in 1996. (App 7 at 390b.) The City's CSO plan emphasized three CSO control strategies: (1) optimizing the system to maximize treatment of <u>all</u> flows at the WWTP; (2) reducing and controlling CSOs; and (3) implementing and improving end of pipe treatment systems. The City's overarching goal is to route these CSOs to the WWTP for treatment. (App 7 at 391b, 478b-479b, 483b; App 11 at 612b.) Thus, the City relies on double-leaf side gates in several areas that reduce the amount of CSOs during storm events and re-route CSOs through the

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Northwest Interceptor to the WWTP. (App 7 at 391b, 408b-409b.) The City also engages in "source" control by utilizing inflatable dams in its large diameter sewers. These dams control wet weather flows to the WWTP, creating in-system storage for holding these flows until they can be routed to the WWTP for treatment. (*Id.* at 394b, 414b-426b.) In addition to these inflatable dams, the City operates diversion dams throughout the system that help retain and/or route flows to the interceptors (*id.* at 554b), and remote-controlled system gates (or "valves") that are also used to load the interceptors. (*Id.* at 555b.) The City further controls its CSOs by minimizing them through the adoption of City-wide "green infrastructure" initiatives like bioswales and tree planting. (*Id.* at 394b; App 12 at 654b.) To supplement its control measures, the City also has three CSO screening and disinfection facilities (App 7 at 427b-434b), along with six CSO retention/treatment basins (*id.* at 442b-463b). See also *infra* at 10. The City additionally utilizes at least 11 pump stations that help route flows to the WWTP, to a screening/disinfection facility, or to one of the retention/treatment basins. (App 7 at 548b-553b.)

The City's NPDES Permit

The City's NPDES permit (Permit No. MI0022802) is issued by the Michigan Department of Environmental Quality ("MDEQ") in compliance with, among other things, the CWA.[8] (App 12.) This permit is a wastewater permit that specifically targets the City's combined sewage, which, as noted earlier, also includes storm water. The City's ability to discharge its treated wastewater under the permit is subject to the permit's extensive set of detailed conditions designed to ensure that the City maintains long-term and sustained compliance with its state and federal obligations to properly treat and dispose of its customers' combined sewage. (*Id.*; App 9 at 578b.) The City must also fulfill its obligations to treat combined sanitary and storm water flows under the permit in order to comply with the series of federal court and state agency orders issued in connection with the

[8] As the operator of the regional system, GLWA is now a party to this NPDES permit, as well.

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long-running litigation regarding the City's past periods of noncompliance with federal law and the terms of its permit. (App 11 at 610b.)

The Combined Sewage Overflow Disposal and Treatment Services Required under the City's NDPES Permit

The City's NPDES wastewater permit also applies to its CSO treatment facilities, its basins, and other combined sewer system components. CSO control and treatment are required under Section 402 of the CWA and are part of the City's CSO abatement efforts. (*Id.* at 602b-603b.) Under the permit, the City's CSO facilities and programs provide "end of pipe treatment" to overflows of combined sewage that cannot be processed by the City's WWTP because they overwhelm the system. (App 12 at 632b-636b.)

When the WWTP is overwhelmed and unable to treat CSOs in the first instance, CSO "end of pipe treatment" includes routing the CSOs through one of the City's six retention/treatment basins, which allow for the CSOs to pass through screens to eliminate raw sewage and sanitary trash and allow for the settling, skimming and disinfection of CSOs using sodium hypochlorite. (App 7 at 394b, 442b-463b.) Flows may also be routed through one of the City's three screening and disinfection facilities (*id.* at 427b), which are designed to fine screen and remove floatables, settleable solids, and sanitary trash, and to provide ten minutes of sodium hypochlorite disinfection in order to meet state water quality standards for microorganisms on combined sewage prior to discharge. (*Id.* at 395b, 427b, 433b.)

The City's NPDES Permit - Sampling and Monitoring Requirements

Unlike the storm water flowing through the separated storm water system in *Bolt*, all of the City's wastewater flows (including its combined sewage overflows) must be sampled and monitored so as not to exceed the NPDES permit's maximum limits of quantity or concentration of pollutants. The City must measure and conform to daily limits for carbonaceous biochemical oxygen demand, total suspended solids, ammonia nitrogen, total mercury, total phosphorous, available cyanide, fecal

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coliform bacteria, total residual chlorine, oil and grease, pH, and dissolved oxygen. (App 12 at 622b, 624b-625b, 626b, 629b, 632b-633b.) The permit further requires the City to sample and monitor its flows to the WWTP and CSO facilities, and to engage in other monitoring and management-related activities. (*Id.* at 623b, 636b.) The monitoring for these various materials is necessary because the City cannot discharge into its nearby receiving waters any combined sewage overflows from its WWTP or its CSO facilities that contain "turbidity, color, oil films, floating solids, foams, settleable solids or deposits." (*Id.* at 620b, 628b, 630b, 634b, 636b.) Monitoring is further necessary to ensure that the "end of pipe treatment" provided by the WWTP and CSO facilities eliminates these pollutants from any CSOs before they are released.

The City's Sewage Disposal Fund

The costs of operating and maintaining the City's combined sewer system are funded through a sewage disposal fund. (App 2 at 042b.) The costs of providing combined sewer services are recovered through sewage fees and drainage fees, both of which are deposited in the sewage disposal fund. (*Id.* at 027b (¶6).) The sewage disposal fund is an enterprise fund and can only be used for the closed purposes of the fund (i.e., providing combined sewer services). (*Id.* at 027b (¶7), 042b.) The City's sewage disposal fund absorbs all revenues and expenses relating to the combined sewer system (including but not limited to drainage-related fee revenue and costs).

For a capital-intensive system like the City's, the cash flow statement provides the best understanding of the system's receipts and payments because the income statement fails to reflect all incurred capital expenses (e.g., amortized principal payments relating to bond debt, which are reflected in the asset statement not the income statement). (*Id.* at 027b (¶8).) The cash flow statement reveals what is needed and used to operate the system on an annual basis. (*Id.* at 028b (¶10).) For the fiscal year ending June 30, 2016, the City's receipts for sewage <u>and</u> drainage services provided were approximately $379 million, its net cash payments were $475,472,066, and after

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factoring in its starting position, its ending unrestricted cash on hand was roughly $20.5 million, which is about 5.4% of total receipts.[9] (*Id.* at 027b (¶9), 040b.) This represents approximately 115 days of operating expenses versus the industry standard of 250 days. (*Id.* at 027b (¶9).) Even the City's working capital, which for fiscal year 2016 was only 14 working days, is less than standard. (App 14 at 700b (¶3).)[10] In short, the City is not using its sewer and drainage fees to generate more money than is needed to operating and maintain its combined sewer system.

The City's Allocation of Combined Sewer System Costs and Rate-Setting

Once storm water combines with sanitary waste, there is no physical way to separate the two flows again. At the end of the day – the City's combined system is still a municipal sewer system that contains sewage throughout the entire system. Sanitary flow containing sewage contributes to the amount of combined flows being treated by the City's combined sewer system. During wet weather events, however, it is the amount of storm water that dictates the volume of combined flows being treated by the system. For this reason, the City must make some attempt to separate the costs that are allocable to sanitary waste and the costs that are allocable to storm water runoff. Certainly, it would inequitable (and potentially disproportionate) for the City to charge only those who contribute sanitary waste to the combined system for system costs related to storm water based on the amount of sanitary waste they contribute. And it would be inequitable (and potentially

[9] Just as they did in their Application, Plaintiffs cast about various numbers in their Supplemental Brief in order to sow confusion and claim reversible error. (Pls' Supp Br at 14, 23-31.) But Plaintiffs rarely cite the sources for their calculations, often mischaracterize the numbers they cite, and never do the work of explaining how any of the numbers they reference are relevant to this case. In contrast, the City has produced detailed financial evidence and sworn testimony supporting the costs allocated through its drainage charge. Plaintiffs fail to provide evidence either from documents produced by the City or any of the City's other publicly-available, FOIA-eligible financial records to support their allegation that the City is collecting more in drainage fees than it costs to operate and maintain its combined system.

[10] The Government Finance Officers' Association recommends that a municipal enterprise fund's working capital be at least 45 days, and then supplemented based on a variety of considerations including collection practices, declining demand, and debt position – many of which weigh in favor of increasing the City's amount of working capital. (App 15.)

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disproportionate) for the City to charge only those who contribute storm water to the combined system for costs related to sanitary waste based on the amount of storm water they contribute.[11] Thus, the City has estimated which of its combined system costs relate to storm water and assigned these costs only to users who contribute storm water to the combined system. Likewise, the City assigns estimated sanitary waste costs only to users who contribute sanitary waste to the combined system. *City of Detroit*, 803 F2d at 1413. Regardless, the drainage charge is not a mere "storm water charge." It is, together with the City's sewer rate, a valid user fee for *combined* sewer services.

The City historically calculated its drainage fee by "first estimat[ing] the system's total cost that was attributable to storm water runoff within the City of Detroit," and then, allocating the cost among "three classes: residential water users, nonresidential users and state and county roads, based on their relative impervious acreage." *City of Detroit*, 803 F2d at 1414. Today, the calculation is basically the same except that costs are being allocated to system users by applying the drainage rate to each parcel's individually-measured impervious acreage.[12] The City's storm water (or drainage)-related costs can be broken down into three categories: volume-related costs, peak flow-related costs and base costs. (App 16 at 710b.)

More specifically, these three types of storm water-related costs reflect a percentage allocation of direct and indirect system costs, including, but not limited, to retail operational costs (e.g., customer service costs, field service costs and the City's administrative and general costs for the system) and system-wide indirect costs (e.g., costs allocated to the City by the Great Lakes Water

[11] And it would be entirely inequitable to use taxable value as a basis to allocate these costs. Under such a scenario, a two-acre, high-value parcel with low impervious acreage (e.g., .03) would end up paying more to cover these costs than a low-value parcel with higher impervious acreage (e.g., 1.4) but the same total acreage. The parcel owner that actually limited parcel development would (unfairly) bear more of the combined system's storm water costs than this owner should bear based on the burden she places on the system.

[12] The record establishes that impervious acreage is the best available method for measuring how much storm water a parcel contributes to the City's combined sewer system. (App 5 at 099b, App 18 at 790b, App 21 at 816b-817b, App 26 at 879b, App 27 at 903b.)

Authority ("GLWA"), note payments, and other payments to GLWA). (App 2 at 028b (¶11).) This percentage allocation is based on the percentage of wet weather infiltration and inflow contained in the total volume treated and disposed by the City (which consists of wet weather infiltration and inflow, dry weather infiltration and inflow, and sanitary waste flow).[13] (*Id.* (¶12).) The percentage varies based on the amount of each flow but generally has been in the range of 28-33% and is based on data collected from flow meters and other monitoring devices that support the Greater Detroit Regional Sewer System model. (*Id.*) This data consists of "flow and depth information from the GLWA sewerage meters in five minute increments and rain gauges in 15 minute increments," see https://gdrss.glwater.org/, and "has been widely used to estimate flows in the DWSD collection system under dry weather and wet weather scenarios." (App 10 at 591b.) The City's storm water costs also include a percentage of the system's bad debt expense that is attributed to unpaid drainage bills, and all of the system's direct and allocated CSO costs (because those are attributable to storm water).[14] (App 2 at 028b (¶13).)

The City's drainage revenue requirement for fiscal year 2017 was estimated to be approximately $151 million. This requirement covered approximately $59.8 million in debt service related to municipal bond issues and state revolving fund loans allocable to drainage activities. (App 13 at 688b (¶24).) This $59.8 million includes approximately $25.7 million in principal and interest payments that GLWA has allocated to the City as direct CSO costs. (*Id.* at 690b (¶11).) The City also relies on its drainage charge (and its sewer charge) to recoup the annual costs associated with the sewer system projects in the City's Capital Improvement Plan (CIP), which covers the next five

[13] As noted earlier, it is during "wet weather" events that storm water contributes most significantly to the combined system. Thus, the City uses measurements of "wet weather infiltration and inflow" to determine what percentage of system-wide costs are storm-water related treatment/disposal costs.
[14] Per a 1999 rate settlement agreement facilitated by the federal court, 83% of all CSO control costs are allocated directly to DWSD's retail customers, except for those facilities that are "Detroit Only" facilities, in which case 100% of all costs are allocated to the City. (App 10 at 590b.)

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years. (App 4.) According to the City's CIP, $275 million will be spent on capital improvements over the next five years on a combined sewer system valued at more than $1 billion. (App 4 at 077b, App 2 at 037b.) Using fiscal year 2016 cash receipts as a baseline (see *supra* at 11), the total cash receipts collected during this same five-year time period would be roughly $1.895 billion. Thus, even assuming that the City used rate revenue to fund all of these capital expenditures (which it will not (see App 4 at 076b)), the City's expected capital expenses for these five years are (at most) only 14.5% of the City's overall sewer and drainage charge revenue received over the same time period – a significantly smaller amount than was being dedicated to capital expenditures in *Bolt*.[15]

Using a detailed rate model, the City's allocated drainage costs are then spread across the billable impervious acres using the system in order to determine the effective drainage rate for any given fiscal year.[16] (App 2 at 029b (¶15).) For fiscal year 2018, the drainage rate was

[15] The City's expected capital expenses likely comprise an even smaller percentage of system receipts given anticipated increases in customer receipts due to GLWA rate increases.

[16] Plaintiffs fault the City for not charging itself for City roads by citing to unfounded estimates and analyses regarding the number of impervious acres in roads that the City is not charging. (Pls' Supp Br at 14-15.) First, there is no record evidence or testimony to support the conclusion that by exempting its own roads, the City is only charging 14% of the impervious acres in the City. The record evidence reveals that the City is charging all parcels with measurable impervious area for drainage services using the same methodology. The City assesses a drainage charge on MDOT and Wayne County roads under the terms of consent agreements entered into in 1989. (App 13 at 687b (¶20).) Second, there is a reason that the City does not charge itself for its roads. The unrebutted record evidence includes studies that show that these roads are part of the City's conveyance system. Because the roads facilitate disposal and drainage, the roads are not "using" the system; they *are* the system. See App 17 at 726b-735b (recognizing that "*streets play an important role in stormwater collection and conveyance* . . .")(emphasis added); App 19 at 798b ("The primary function of a street is to facilitate traffic movement. However, during a storm event, *streets must also collect and convey the concentrated stormwater runoff*.")(emphasis added); App 20 at 806b ("Although street inlets and storm sewers are often designed as part of the minor drainage system to pass the 2- to 5-year peak runoff discharges, *streets are in fact part of the major drainage system* and should be capable of passing the 100-year storm event under the specified design constraints.")(emphasis added). Plaintiffs have not offered any evidence to dispute the research or analyses offered by the City in this regard. Finally, the City has been adhering to a 1986 ruling from a federal appeals court that the City does not have to charge itself a drainage fee for its own roads, with the court noting there is "no legal reason why the city, which owns and operates the system, should take money from its taxpayers and, with it, pay

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$661/impervious acre/month. (*Id.* (¶16).) The drainage rate is applied to each parcel's impervious acreage in order to determine the parcel's total drainage charge. For example, the owner of a parcel containing .03 impervious acres would have paid a drainage fee of $19.83/month in fiscal year 2018.

STATEMENT OF APPLICABLE LAW

Federal Obligations to Charge for Storm Water Treatment and Disposal

The City has a duty under federal law to treat combined sewage overflows *and* to charge user rates for that treatment. In as early as 1975, the City assessed a drainage charge in accordance with its charter (which allows the City to assess a fee that covers its expenses for drainage services), although the fee was smaller than it is now. (App 13 at 683b.) The City's first consent judgment (entered in connection with the EPA litigation discussed above (*supra* at 7)) ordered the City to develop and enact a robust "user charge system" that would recoup the revenue necessary to cover the costs of providing federally-mandated treatment. *City of Detroit*, 803 F2d at 1413. This is because the improvements undertaken to provide treatment to the City's wastewater (including CSOs) were partially financed by federal grants. *Id.* at 1417. As the federal court noted:

> [t]he FWPCA, 33 U.S.C. § 1284(b)(1)(A) [the CWA], prohibits the Administrator of the EPA from approving any grant for treatment works "unless he shall first have determined that the applicant (A) has adopted or will adopt a system of charges to assure that each recipient of waste treatment services within the applicant's jurisdiction, as determined by the Administrator, will pay its proportionate share . . . of any waste treatment services provided by the applicant . . ."

City of Detroit v State of Michigan, 538 FSupp 1169, 1170 (ED Mich 1982) (quoting 33 USC §1284(b)(1)(A)). The City's obligation to adopt the user charge system is mandatory under federal law, and "[a]n important item in the EPA's complaint was the failure of DWSD to implement a proper user charge system required by Title II of the [Act]." *City of Detroit*, 538 FSupp at 1173.

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itself for the use of its own sewers. The situation is not within the rule that a public utility corporation may not render free service to a patron." *City of Detroit*, 803 F2d at 1416-17.

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The City's user charge system ensures coverage of the costs of operating and maintaining the improvements that were funded by the EPA for the purposes of regulating and bettering waste treatment. The user charge system must cover the costs of operation and maintenance for all flow including infiltration and inflow. See 40 CFR §35.929-2(d)(now 40 CFR §35.2140(e)); 40 CFR §35.929-1(a) (now 40 CFR §35.2140).[17] By definition, infiltration and inflow include surface water runoff and storm water. See 40 CFR §35.905 (now 40 CFR §35.2005)). The costs related to infiltration and/or inflow must be distributed among all users of the City's sewage system based on any combination of factors including but not limited to flow volume, land area, or number of hookups. See 40 CFR §35.929-2(d)(now 40 CFR §35.2140(e)). In addition to covering the costs of operation and maintenance for infiltration and inflow, the user charge must also produce adequate revenues for system infrastructure "replacement," which itself is categorized as an "operations and maintenance" cost under the federal law and regulations governing the charge. See 40 CFR §35.2140; 33 USC §1284(b)(1). The City's user charges must be based on actual use and cannot be ad valorem.[18] See 40 CFR §35.929-1(b) (now 40 CFR §35.2140(b)). There is nothing in *Bolt* to suggest that these regulations governed Lansing's assessment of its storm water charge.

[17] The regulations at 40 CFR § 35.929-1 previously described acceptable user charge systems. *Id.* These same user charge system requirements are now located in 40 CFR §35.2140.

[18] The City is prohibited from relying on an ad valorem tax to recover its costs because it did not have a dedicated ad valorem tax system to pay for its combined sewer system as of December 27, 1977. See 40 CFR §35.929-1(b) (now 40 CFR §35.2140(b)). Although the City had assessed a drainage charge as early as 1975, the City had no federally-acceptable user charge system in place prior to 1980, let alone one that was ad valorem. *City of Detroit*, 803 F2d at 1412. The City still has an obligation to maintain the required user charge system for the life of the system funded by the grant. See 40 CFR §35.2105. According to the EPA, "user charge system requirements continue to apply even though the Title II construction grant was awarded many years ago," and "the Title II construction grant requirements for the user charge system remain as long as the treatment works are operational." (App 22.)

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The federal district court overseeing the City's long-running EPA litigation reiterated the City's obligation to assess drainage fees in order to meet its regulatory obligations in a December 15, 2015 Order:

> The Board of Water Commissioners shall continue to exercise its existing authority under the City Charter to assess drainage fees, charges or assessments to the users of the City's local water and combined sewer and drainage infrastructure because these charges are necessary and critical to ensure that the City is able to continue to comply with (i) its regulatory requirements under NPDES Permit No. MI0022802 to treat and dispose of the City's combined sewage overflows and (ii) its obligations under the Clean Water Act.

(App 21 at 816b-817b (¶2(e)).)[19]

Michigan's Regulatory Framework Underlying the Operation of Combined Sewer Systems and Related Fees for Service

The Michigan Revenue Bond Act ("RBA") authorizes all public corporations like the City to own, operate and maintain public improvements, including, but not limited to, combined sewer systems and storm water systems.[20] MCL 141.103(a) (defining public corporation to include a "city"); MCL 141.103(b) (defining public improvement to include "sewage disposal systems, including sanitary sewers, combined sanitary and storm sewers, plants, works, instrumentalities and properties used or useful in connection with the collection, treatment or disposal of sewage or industrial wastes," and "storm water systems, including storm sewers, plants, works, instrumentalities, and properties used or useful in connection with the collection, treatment, or disposal of storm water . . ."). The RBA grants public corporations the authority to operate a

[19] In the Court of Appeals, the City argued that conflict preemption barred the Plaintiffs' state law claims given the federal law requiring the City to assess a user fee for drainage. If this Court concludes that the City's drainage charge is an unlawful tax, it would be appropriate to remand this matter to the Court of Appeals so that the lower court can further consider the City's preemption defense, along with the City's pre-Headlee authorization defense under its charter and the Michigan Revenue Bond Act.

[20] Similar authority is embedded in the Home Rule City Act. See MCL 171.4f(d) (providing for "the acquiring, establishment, operation, extension, and maintenance of sewage disposal systems, sewers, and plants, either within or outside the corporate limits of the city, as a utility, . . . including the fixing and collecting of charges exclusively for service covering the cost of service.").

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combined sewer system irrespective of whether the municipality has issued bonds. MCL 141.104 ("[t]he powers in this act granted may be exercised notwithstanding that no bonds are issued hereunder."). Upon embarking on the operation of a sewer system, a municipality is then obligated to comply with its authorizing statute.

The RBA mandates that municipalities that operate sewer and other utility systems establish service rates that sufficiently recoup all expenses incurred to administer, operate and maintain the system as necessary to preserve the system in good repair and working order. MCL 141.121(1)(a) (stating that "[r]ates for services furnished by a public improvement "shall be fixed" and "shall be sufficient" to provide for payment of certain expenses). Through the RBA, the Michigan Legislature has also mandated that any public corporation that operates a public improvement such as a combined sewer system include in its rates for services "[t]he payment of interest on and the principal of bonds payable from the public improvements when the bonds become due and payable," and "[o]ther expenditures and funds for the public improvement as the [bond] ordinance may require." MCL 141.121(1)(b),(d). Thus, the Michigan Legislature has decided that the municipality should determine the necessary expenses for public improvements like water and sewer systems (including those needed to operate, administer, and maintain these systems in good repair and working order). According to the Michigan Legislature, these are the exact type of costs to recover through a user fee. These costs include "capital expenses" because an investment in capital is warranted to maintain a system in good repair and working order. Thus, a charge is not (and cannot be) per se unlawful simply because it seeks to recover capital costs – whether they be principal and interest payments on bonds used to finance capital investment or an estimate of what a municipality expects to spend in repair and replacement costs in the next 5-10 years. Those who burden or use a utility system are contributing to its wear and tear and drive the need to invest in

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capital. The Michigan Legislature recognized this and through the RBA, mandated that municipal utilities recover these capital costs through a rate assessed upon users of a system.

That these costs are properly borne by system users is further supported by the Municipal Water Liens Act, through which the Michigan Legislature has granted municipalities who operate sewage systems[21] an automatic lien upon any premises, parcels or lots upon which sewage system services are supplied. This statutory lien becomes effective immediately upon distribution of the service to the premises or property being supplied. MCL 123.162. Thus, the lien rights that exist here are not like those in *Bolt*, which Lansing unilaterally afforded itself. *Bolt v City of Lansing*, 221 Mich App 79, 84; 561 NW2d 423 (1997) (noting that Ordinance 925 provides for the creation of a lien against property). Instead, the rights in this case exist because, as a matter of policy, the Michigan Legislature has decided that the collection of rates and charges from system users in exchange for water and sewer services (including combined sewer services) is critical to the continued provision of these services statewide. It is an acknowledgment that the City is owed money for services rendered. As this Court held, a lien for unpaid water (and by extension, sewer) fees, "although enforced the same way as a lien for taxes, is really a lien for indebtedness . . . ." *Jones v Detroit Water Com'rs*, 34 Mich 273, 275 (1876).

The Headlee Amendment and the Blue Ribbon Commission Report

Any rates for services rendered by a public improvement (like the City's combined sewer system) must also comply with *Bolt's* three-factor test. The test is designed to further the purposes of the Headlee Amendment (Const 1963, art 9, §31) – i.e., to ensure "specific limitations on state and local revenues," and "to place public spending under direct control." *Bolt v City of Lansing*, 459

[21] Under the Municipal Water Liens Act, "sewage system" refers to a "sewage disposal system, including sanitary sewers, combined sanitary and storm sewers, plants, works, instrumentalities, and properties used or useful in connection with the collection, treatment, or disposal of sewage or industrial wastes." MCL 123.61(c).

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Mich at 160. The Drafters' Notes to the Headlee Amendment acknowledge that "[t]he spirit of the times from which this proposal grew was the 'tax revolt' and it was the drafters' clear intent that the Tax Limitation Amendment be so interpreted." *Drafters' Notes – Tax Limitation Amendment*, Taxpayers United Research Institute (February 15, 1979). (App 23 at 827b.)

The Headlee Blue Ribbon Commission was empaneled in 1993 to "conduct[] a scholarly review of issues and practices that have arisen since [Headlee's] enactment." (App 24 at 852b.) Before this Court's decision in *Bolt*, the Commission argued that the imposition of mandatory "user fees" by local governments would render Section 31 obsolete. (App 25 at 859b.) In particular, the Commission was concerned about "user fees" assessed as a specific amount per household, with local ordinances then requiring these unpaid fees to become tax liens that are effectively added to a property owner's tax bill. (*Id.*) Ultimately, the Commission concluded that a true "user fee is a payment made for the voluntary receipt of a measured service, in which the revenue from fees are used only for the service provided." (*Id.* at 862b.) The Commission drew this and several other distinctions between user fees and taxes that now form the basis for *Bolt's* three-factor test. The Commission also offered examples of charges that would, necessarily, constitute a "fee," *noting that one example of a quintessential "fee for service" is a "municipal sewer charge*[]." (*Id.* (emphasis added).)

In its Report, the Headlee Blue Ribbon Commission did not consider the intersection between the Headlee Amendment and the constitutional directive that Headlee be construed in favor of a municipality. See Const 1963, art 7, § 34 ("The provisions of this constitution and law concerning counties, townships, cities and villages shall be liberally construed in their favor. . ."). Moreover, §§ 22 and 24 of the Michigan Constitution grant cities power to frame their own charter, adopt their own resolutions and ordinances, and to operate public service facilities like sewer systems. Collectively, this Court has construed these provisions as suggesting that municipalities have the right to govern their own affairs. See *Associated Builders and Contractors v City of Lansing*, 499

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Mich 177, 186-87; 880 NW2d 765 (2016) ("[G]iven the newly added [constitutional] language that expresses the people's will to give municipalities even greater latitude to conduct their business . . . , there is simply no room for doubt about the expanded scope of authority of Michigan's cities and villages."). Thus, while courts rely on *Bolt* to review municipal rates in order to ensure that the "spirit" of Headlee is not violated, they must also be mindful that municipalities are entitled to some deference and that "it is not the role of [the courts] to second-guess the premises of a regulatory system devised by local representatives."[22] *Bolt*, 221 Mich App at 100 (dissenting opinion).

The "Regulatory" Factor under Bolt v City of Lansing

Under *Bolt*, a user fee must be regulatory – meaning it should be designed to defray the costs of a regulatory activity. *Bolt*, 459 Mich at 162-63. Regulatory measures control and/or supervise the public's conduct through a means of rules and regulations and regulatory charges further the goals and aims of these regulatory measures. If there is an absence of a "significant element of regulation," then the charge is designed to raise revenue and more akin to a tax. *Id.* at 166.

A regulatory activity reflects a valid exercise of police power. Per *Merrelli v St Clair Shores*, 355 Mich 575, 582; 96 NW2d 144 (1959) – a case relied upon by *Bolt*, 459 Mich at 161, and the Headlee Blue Ribbon Commission, App 25 at 861b, n9, to illustrate the differences between the "municipal power of taxation," and the "police power of the community" – regulatory measures

[22] Plaintiffs claim that if this Court lets the Court of Appeals' decision stand, it will gut the Headlee Amendment. That is hardly the case. Headlee was never intended to upend the day-to-day operation and finances of municipal utilities. On its face, Headlee was intended to preclude local governments from assessing taxes that had no legislative authority supporting their assessment. The Blue Ribbon Commission Report ushered in the idea that the Headlee Amendment intended to challenge municipal fees in order to limit a local government's ability to assess mandatory flat rate charges under the guise of a user fee (despite the fact that cases such as *Merrelli v St Clair Shores*, 355 Mich 575, 582; 96 NW2d 144 (1959) already precluded such subterfuge). Even under the Commission's interpretation of Headlee (which does not necessarily comport with Article 7, Section 34), the City's drainage charge is a far cry from the fees the Blue Ribbon Commission intended to challenge. Holding that the drainage charge is a fee will not stop courts from evaluating other municipal fees using the *Bolt*-three factor test, or from continuing to find that in certain cases, a fee is an unlawful tax.

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(and related fees) involve "the public health, morals, or welfare." *Merrelli*, 355 Mich at 582. Monies obtained in connection with the exercise of a municipality's police power are "incidental to the accomplishment of the primary purpose of guarding the public." *Id.* at 583.

"Except as limited by the Constitution or by statute, the police power of the City of Detroit as a home rule city is of the same general scope and nature as that of the State." *People v Sell*, 310 Mich 305, 316; 17 NW2d 193 (1945). This Court has acknowledged that a municipality's police power varies with circumstances and conditions:

> The 'police power' is said to be a power or organization of a system of regulations tending to the health, order, convenience, and comfort of the people and to the prevention and punishment of injuries and offenses to the public. It is the expression of an instinct of self-preservation and characteristic of every living creature, an inherent faculty and function of life, attributed to all self-governing bodies as indispensable to their healthy existence and to the public welfare. It embraces all rules and regulations for the protection of life and the security of property. . . . It has for its object the improvement of social and economic conditions affecting the community at large and collectively with a view to bring about the greatest good of the greatest number. Courts have consistently and wisely declined to set any fixed limitations upon subject calling for the exercise of this power. It is elastic and is exercised from time to time as varying social conditions demand correction.

Id. at 315–16 (citations omitted). One constant, however, over the past century is that "[t]he establishment and maintenance of a sewer system by a municipality is usually regarded as an exercise of its police power. . . . *The drainage of a city in the interest of public health and welfare is one of the most important purposes for which police power can be exercised.*" *Drain Com'r of Oakland County v City of Royal Oak*, 306 Mich 124, 141; 10 NW2d 435 (1943) (emphasis added).[23]

[23] Controlling sewage is a proper exercise of a municipality's police power because it is inextricably linked with the public's health and welfare. See *Holland v Heavlin*, 299 Mich 465, 472; 300 NW 777 (1941) (holding that the construction of a sewer system was a project of public health and safety, and thus, constitutional, without requiring a vote of the City's electors); *Ripperger v City of Grand Rapids*, 338 Mich 682, 687; 62 NW2d 585 (1954) ("[T]he disposal of sewage into the streams of this state is a matter of importance to the public health . . . and is so essential that, if the people of a city fail to meet their responsibility by bond issue, drastic steps may be taken.").

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When a municipality is engaged in a public purpose (such as the treatment and disposal of polluted water), courts are typically required to refrain from second-guessing the municipality's decisions. See *City of North Muskegon v Bolema Const Co*, 335 Mich 520, 526; 56 NW2d 371 (1953) ("Where a municipality has the power to engage in an activity for a public purpose, the courts will not interfere with the discretionary acts of its municipal officials.") This does not mean that the courts have no oversight over municipal charges; rather, that oversight is limited. Historically, for a court to intervene in municipal affairs, "there must be some malicious intent, capricious action, or corrupt conduct, something which shows the action of the body whose acts are complained of did not arise from an exercise of judgment and discretion vested by law in them." *Id.* Moreover, "the rate lawfully established by the [municipality] is assumed to be reasonable in absence of a showing to the contrary or a showing of fraud or bad faith or that it is capricious, arbitrary or unreasonable, and the burden of proof is on the [ratepayer] to show that the rate is unreasonable. . . ." *City of Detroit v City of Highland Park*, 326 Mich 78, 99-101, 104; 39 NW2d 325 (1949) (holding that "[t]he city of Detroit is entitled to charge for use of its sewage disposal system by suburban municipalities as well as all other users . . . ") (citations omitted).

This deference is afforded to rate-setting because "[c]ourts of law are ill-equipped to deal with the complex, technical processes required to evaluate the various cost factors and various methods of weighing those facts required in rate--making." *City of Novi v City of Detroit*, 433 Mich 414, 428-430; 446 NW2d 118 (1989) (acknowledging that Michigan courts "have stressed a policy of judicial noninterference where the Legislature has authorized governmental bodies to set rates," and chiding a decision that "superimpose[d] Michigan courts as ultimate rate-making authorities despite the absence of any express statutory language or legislative history that would support such a role in the rate-making process.").

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ARGUMENT

A charge assessed in connection with the provision of sewage treatment and disposal services is a fee. This has been the law in this state for more than 65 years. *See Ripperger v City of Grand Rapids*, 338 Mich 682, 686; 62 NW2d 585 (1954) (holding that sewage charges are not a tax). The City's drainage charge is imposed to provide treatment and disposal services to storm water flows tainted with sewage and other pollutants. *Even the Plaintiff in Bolt conceded that "charges for storm water collection, detention and treatment . . . when combined with sewage disposal" are "properly subject to a fee and not a tax."* *Bolt*, 221 Mich App at 87 (emphasis added). Thus, the City's drainage charge is a valid user fee.

In *Bolt*, this Court distinguished Lansing's storm water charge from the sewage charge in *Ripperger* because the Court believed no service was being rendered by Lansing in exchange for the charge. Instead, Lansing assessed the charge upon all its residents to pay for the construction of large scale infrastructure that only 25% of its residents would use. *Bolt*, 459 Mich at 163-65. Lansing's disproportionate assessment of a charge to pay for the construction of a separated storm water system and the City's uniform imposition of a charge to pay for the operation, administration and maintenance of a combined sewer system that is riddled with sewage are patently two different activities. As such, the Court of Appeals correctly concluded this case is nothing like *Bolt*.

I. THE CITY'S COMBINED SEWAGE TREATMENT AND DISPOSAL SERVICES ARE A REGULATORY ACTIVITY FOR WHICH A CHARGE MUST BE ASSESSED.

No activity is inherently more regulatory than a municipal effort to rein in the volume of sewage-laden water entering the nation's navigable waters. It is not the mere presence of a NPDES permit (or the obligation to comply with it) that renders the City's operation of a combined sewer system and associated charges a "regulatory" activity (and the Court of Appeals never claimed as

such).[24] It is what the City is accomplishing by operating the system and assessing a related drainage charge. Here, the Court of Appeals properly concluded that the City operates its combined sewer system for the very purpose of accepting the polluted sanitary and storm water generated by residents in the City, treating the effluent at both its WWTP and/or its CSO facilities so that it no longer contains harmful toxins, and disposing of it in an orderly and methodical fashion post-treatment. (App 1 at 015b-017b.) The evidence reveals that the City's drainage charge is used to fund these treatment and disposal operations and is merely a reflection of the costs to operate and maintain the combined sewer system allocated on a per user basis. The charge reflects the costs of regulation – nothing more and nothing less.

A. The City's Drainage Charge Regulates the Contribution of Storm Water to the City's Combined Sewage System.

The City's drainage charge is different from the storm water charge in *Bolt*, which was being used to fund $130 million in ongoing capital construction. *Bolt*, 459 Mich at 163, n13. Only 37% of Lansing's costs underlying the charge related to non-capital expenses. *Id.* As such, this Court stated that it was hard-pressed to find how a fee that was primarily being used to fund this large-scale construction was controlling or regulating behavior. Here, the City assesses its drainage charge to regulate the contribution of storm water to an existing combined sewer system. The drainage charge is designed to give the City a modicum of control over the flows that are burdening its combined

[24] True, as Plaintiffs contend, Lansing also operated a combined sewer system and was also grappling with how to control its CSOs when it elected to separate its combined sanitary and storm sewers. *Bolt*, 459 Mich at 171, n.1. Thus, both the City and Lansing were engaging in a regulatory activity by complying with governmental directives to manage their untreated CSOs. (Pls' Supp Br at 7-8; 16-17.) However, by electing to manage untreated CSO releases through treatment and not system separation, the City diverged from Lansing regarding the "regulatory" nature of the activities it actually undertook to manage its CSOs – a fact that the *Bolt* court noted when it remarked that Lansing's storm water charge failed to reflect costs for "end-of-pipe" treatment and thus, lacked "a significant element of regulation." *Bolt*, 459 Mich at 166-67. Nonetheless, the City agrees that the effort to comply with an obligation to manage untreated CSOs – regardless of how – is per se "regulatory" along with any charge assessed to accomplish that "regulatory" activity – even the construction of a separated storm water system. *Id.* at 170-178 (dissenting opinion).

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system. This drainage fee is similar to the City' sewer fee – a fee that also provides the City control over the sanitary sewage that enters its combined system. When the City and other municipalities treat sewage, they generally do not measure the amount and type of sanitary waste or sewage each household or business contributes to the system because there is limited technological means to do this. But, system users understand and accept that like hundreds of other municipalities across the nation, the City measures the amount of sewage burdening the system by using the amount of domestic water (MCF or 1,000 cubic feet of water) purchased by each user as a proxy for the amount of sewage.

Because CSOs containing runoff commingled with sewage are essentially no different than sanitary sewage, the treatment of these runoff waters should not be viewed as any less regulatory. The only difference is that CSOs contain sanitary waste mixed with sewage <u>and</u> storm water containing other contaminants. The City is utilizing fundamentally the same approach to determine the amount of contaminated storm water contributed to a system as it uses to gauge the amount of sewage contributed to the system: i.e., it relies on a proxy to measure what is entering its system, using impervious acreage instead of MCF. As with its sewage treatment costs, the City attempts to estimate, and then allocate, the costs associated with storm water treatment and disposal to those persons who burden the system with polluted storm water through the development of their parcels.

This Court has already held that controlling drainage is a proper regulatory function of a municipality. See *supra* at 23. In this case, the City's drainage necessarily contains sewage because of the City's combined sewer system. The City must exact some control over the amount of CSOs in the system because it faces liability for any discharges of raw sewage from within its boundaries into state waters. MCL 324.3109(2) ("The discharge of any raw sewage of human origin, directly or indirectly, into any of the waters of the state shall be considered prima facie evidence of a violation of this part by the municipality in which the discharge originate . . ."); see also *Department of*

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Environmental Quality v Worth Tp, 491 Mich 227, 247-48; 814 NW2d 646 (2012). But, drainage could also be polluted storm water that the City screens and treats *sans* sewage or other sanitary waste. And although the City is not presumptively responsible for such discharges if they do not contain raw sewage, by screening for storm water for pollutants, the City does provide a service to people who might otherwise be responsible for such discharges to navigable water under the law.[25] In the City's case, "treatment" is a regulatory act that does not merely abate sewage. It also abates pollutants in the storm water by screening floatables and settleables (which removes, e.g., foods, oil, grease, animal waste, dirt) and treating the storm water with sodium hypochlorite (which disinfects the water by, among other things, inactivating pathogens, and oxidizes metals in the water). (App 6 at 195b-201b; App 7 at 390b-477b; App 12.)

B. A Parcel Owner's Right to Develop Property Should Not Usurp the City's Right to Regulate Combined Sewage.

Users who contribute storm water to the combined sewer system should not be insulated from paying for the burdens they impose. Some would read *Bolt* to hold that land owners are free to develop their parcels without impediment and irrespective of the burdens they place on the City's combined sewer system. This is because this Court concluded that Lansing's storm water charge (based on a predetermined number of equivalent hydraulic area (EHA) units) was "tantamount to requiring property owners to relinquish their rights of ownership to their property by declining to build on their property." *Bolt*, 459 Mich at 167-68. But, the law does not allow unfettered property development. Landowners who develop their parcels routinely need to mitigate the burden that development places on a municipality and its infrastructure. Owners who develop their parcels incur costs tied to development, some isolated and some repeating, all under the authority that

[25] See, e.g., MCL 324.8901 *et seq.* (prohibiting persons from dumping or depositing litter – which includes rubbish, refuse, waste material, garbage, trash, debris, or other foreign substances – in the water and imposing penalties for littering in water).

municipalities have to regulate development.[26] Thus, property owners are required to mitigate traffic caused by their development through the provision of deceleration and acceleration lanes, traffic lights, medians, and pedestrian crossings. Or, they may be called upon to manage the burden they place on the electrical grid by paying for necessary improvements, including utility poles. Point being, parcel owners cannot develop their property however they wish if there are corresponding burdens imposed on the municipality in which that property is situated.

This Court has recognized that it is only through its police power that a municipality can place some constraints on, and exercise some control over, these burdens:

> The constantly increasing density of our urban population, the multiplying forms of industry, and the growing complexity of our civilization, make it necessary for the state, either directly or through some public agency by its sanction, to limit individual activities to a greater extent than formerly. With the growth and development of the state the police power necessarily develops, within reasonable bounds, to meet the changing conditions.

Cady v City of Detroit, 289 Mich 499, 511, 514; 286 NW 805 (1939). How a parcel owner develops its property undoubtedly affects the corresponding burden that this parcel places on the City's combined sewer system, with higher impervious-acreage parcels contributing more storm water to the system. (App 18 at 790b, App 21 at 816b-817b, App 26 at 879b, App 27 at 903b.) Parcel development increases the costs that the City incurs to treat and dispose of all CSOs. It additionally places strain on an aging system. Without the drainage charge, the City will be left with no way to recover the costs it incurs to protect the public health by eliminating sewage and other pollutants from its CSO discharges. That the City's drainage charge may incidentally limit property

[26]See, e.g. MCL 125.3201(1) ("A local unit of government may provide by zoning ordinance for the regulation of land development . . . to ensure that use of the land is situated in appropriate locations and relationships, to limit the inappropriate overcrowding of land and congestion of population, transportation systems, and other public facilities, to facilitate adequate and efficient provision for transportation systems, sewage disposal, water, energy, education, recreation, and other public service and facility requirements, and to promote public health, safety, and welfare.").

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development is not a legitimate basis upon which to repudiate the charge as a lawful way to regulate and control the volume of combined sewage entering rivers adjacent to the City.

C. The City's Storm Water Operations Are an Integral and Indivisible Component of a Combined Sewer System and As Such, Are Inherently Regulatory.

The central and implicit tenet of Plaintiffs' appeal is that the storm water that flows from their parcels into the City's combined sewer system is clean rainwater that does not merit treatment. Thus, Plaintiffs imply that the City is not providing a service to any landowner who contributes storm water to the system. They argue that absent a service, the City is effectively charging Plaintiffs for "nothing" and merely seeking to raise revenue. Even if the City did not already have a finding from the United States Sixth Circuit Court of Appeals that the treatment and disposal of storm water runoff is a "service rendered" for which rates may be assessed (see *City of Detroit v Michigan*, 803 F2d 1411, 1417 (6th Cir 1986)),[27] the facts in this case illustrate that the City is providing a utility-based service in exchange for the drainage charge it assesses. Were this Court to conclude otherwise, it would be carving out an integrated function of a combined sewer system and holding that systems like this across the state have an obligation to examine each line-item cost to determine what relates to "sewage" and what relates to "storm water."

This outcome is untenable. First, this type of exacting judicial scrutiny over rate-setting is not conferred through the Headlee Amendment and runs afoul of other laws in this state. See *supra* at 18-20, 22-24. Second, engaging in this systematic categorization of costs provides, at best, only a rough approximation of allocable costs given that some costs relate to treating both sewage and storm water (e.g., costs of primary treatment). Any separated system would be allowed to pass all

[27] Again, Plaintiffs argue that the City claims that the Sixth Circuit's decision in *City of Detroit* insulates its drainage charge from a *Bolt* review. (Pls' Supp Br at 18-21.) To the contrary, the City relies on *City of Detroit* only to illustrate that a court has already held that the City provides a service to those who contribute storm water to the system, not to show that the City's drainage charge is *Bolt* compliant.

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those costs on to a user through a sewer rate. But, older, larger communities operating combined sewer systems would be penalized and forced to recover costs that are being incurred for a service (i.e., the treatment of sewage) and assess those through an ad-valorem tax (something that the City cannot even legally do under federal law). This is an incongruous result that discriminates against aging systems in urban areas by arbitrarily stripping them of a legally-viable method for recouping costs incurred for a regulatory activity. It cannot be that the people who ratified the Headlee Amendment intended to invalidate a charge for treating combined sewage when even the Blue Ribbon Commission acknowledged that a municipal sewer charge is a valid "fee." As this Court recently stated: "A constitution is made for the people and by the people. The interpretation that should be given it is that which reasonable minds, the great mass of people themselves would give it. . . . [I]t is not to be supposed that they have looked for any dark or abstruse meaning in the words employed, but rather that they have accepted them in the sense most obvious to the common understanding . . . ." *Michigan Association of Home Builders v City of Troy*, 504 Mich 204, 213; 934 NW2d 713 (2019). Common sense suggests that the City's combined sewer services and the related drainage charges are both regulatory and thus, distinguishable from the separated storm water system and storm water fee at issue in *Bolt*.

II. THE COURT OF APPEALS' REMAINING ANALYSIS REGARDING THE REGULATORY NATURE OF THE CITY'S DRAINAGE CHARGE WAS PROPER ALBEIT UNNECESSARY.

Although the Court of Appeals could have based its decision that the City's drainage charge is a fee and not a tax solely on the fact that the City is charging for the operation, administration and maintenance of a combined sewer system, it did not. It analyzed several attendant factors that this Court used in *Bolt*. Based on those factors, the Court of Appeals concluded that the City's drainage charge differs from Lansing's storm water charge and is, in fact, regulatory, and not merely revenue-raising. As did the Court of Appeals in this case, lower courts home in on these ancillary concerns

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and are losing sight of the fact that the overall character of a charge should dictate whether something is a fee or a tax. These issues were merely incidental in *Bolt*, and are incidental here, and should not dictate whether a charge is a tax or a fee.

A. Correspondence Between Charges And Benefits Conferred.

1. The City's drainage charge reflects benefits conferred upon individual ratepayers.

The Court of Appeals reviewed the City's unrebutted evidence and found a correspondence between the drainage charges assessed and the benefits conferred to ratepayers. It noted that the City's drainage charge merely seeks to recover the costs it incurs to operate, administer and maintain its combined sewer system. (App 1 at 17b.) Designed only to recover storm-water related costs of the combined sewer system, the City's drainage charges correspond to the benefits conferred to individual customers. These are not simply "generalized benefits" that the community-at-large receives from having improved water quality in nearby rivers. See *Bolt*, 459 Mich at 166. Rather, the City's charges are for the costs attributable to the storm water pollution and treatment services provided by the City's combined sewer system (which includes, among other things, its mains, pipes, WWTP, gates, inflatable dams, retention basins, and CSO disinfection/screening facilities). See *supra* at 5-9.

As it relates to the regulatory validity of the drainage charge, the question this Court should be asking under *Bolt* is not (as Plaintiffs contend) whether the goal of treatment and disposal benefits everyone. (Pls' Supp Br at 15.) It does. The City does not dispute that there are generalized benefits from combined sewage treatment and disposal to everyone in the City: i.e., improved public health and welfare through the reduced risk of water-borne diseases and improved water quality in neighboring rivers. *See Bolt*, 459 Mich at 166. Rather, under *Bolt*, the proper question for this Court to ask is whether an additional benefit is provided to "the particular person on whom [the charge] is

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imposed." *Bolt*, 459 Mich at 165. In *Bolt*, the answer was "no" because 100% of the residents were paying for the construction of infrastructure that would only benefit 25% of them. *Id.*

Here, the answer is "yes" because the parcel owners who contribute storm water to the combined sewer system for treatment and disposal only pay for their individually measured use of the system – i.e., that portion of system services that benefit them directly. The City provides primary and secondary treatment to the sanitary sewage and storm water that enters the system. The City does not ask drainage charge customers to pay for any costs related to sanitary sewage treatment and disposal unless they also happen to contribute sewage to the system and are thus, independently "sewer customers." Based on the best available technology for measuring storm water contribution (i.e., impervious acreage), the City can estimate the amount of storm water flow a parcel owner is contributing to the system relative to other customers.[28] The City uses that estimate to allocate only the direct and indirect costs of this storm water treatment and disposal to each parcel owner that contributes storm water to the system. (App 2 at 027b-29b (¶¶ 6, 10-15).) No parcel owners in this case are paying for a service that they do not individually receive.

2. *Bolt's* emphasis on proving corresponding benefits to individual or "particular" ratepayers effectively creates a "new burden of proof" that undercuts existing Michigan law.

Although individuals are directly benefited by the City's drainage charge, requiring absolute correspondence between an *individual* rate and the benefit to an *individual* rate payer undermines existing Michigan law.

[28] In its answer to Plaintiffs' application, the City cited numerous studies concluding that impervious acreage (1) increases the amount of storm water entering the City's combined sewer system (App 5 at 100b; App 28 at 913b; App 29 at 922b; App 30 at 931b; App 32 at 992b-993b), and (2) is the best available method to measure storm water. (App 5 at 099b; App 18 at 790b-791b; App 26 at 879b; App 27 at 903). The City also explained how it measures, calculates, and adjusts the individual impervious acreage for each parcel that contributes storm water to the system. (App 5 at 100b-103b; App 32-37.)

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A municipality has the legal authority and discretion to set rates for utility operations. MCL 141.103(b); MCL 141.121(a). Moreover, these rates are also presumed reasonable. See *City of Novi v City of Detroit*, 433 Mich 414, 428; 446 NW2d 118 (1989) ("Michigan courts, as well as those in other jurisdictions, have recognized the longstanding principle of presumptive reasonableness of municipal utility rates."). As noted earlier, Michigan courts refrain from reviewing rates in situations where the Legislature has authorized governmental bodies to set them instead. *Id.* Yet *Bolt* appears to allow plaintiffs to second-guess a utility's services, rate structure, and allocation of costs along with the associated utility charge – all under the theory that the rate in question fails to correspond to the individual benefit received by each ratepayer.

Nothing illustrates this point more than Plaintiffs' attempt to challenge the City's plan to phase-in the uniform assessment of its drainage charge. (Pls' Supp Br at 23-29.) By way of background, prior to October 2016, the City allocated it drainage charge across different groups. It assessed certain residential and non-residential customers a "meter-based" drainage charge, and other non-residential customers an "impervious acreage" drainage charge based on five different classes. (App 5 at 101b, n.19; App 13 at 683b-685b; App 38; App 39 at 1076b (¶ 14).) The City was also not charging thousands of parcels that were contributing polluted storm water to the system.[29] The City updated its drainage charge methodology to ensure a correspondence between the charge and the services provided to each user of the system. But the City determined that implementing this uniform charge immediately upon all ratepayers would have resulted in "rate shock." (App 40 at 1086b (¶5).) Thus, it decided to phase-in the uniform charge. (App 39 at 1079b (¶27); App 40 at 1086b (¶5); App 41.) The Court of Appeals upheld the phase-in as a proper rate-setting technique.

[29] This was the basis of the claims in *Michigan Warehousing et al v City of Detroit* – a now-settled Headlee class action lawsuit that was brought on behalf of approximately 9,900 non-residential parcel owners who believed they were subsidizing other non-residential and residential parcel owners who either were not paying the charge or paying less than they were. They argued that the benefits they received did not correspond with the higher charges they paid. (App 38.)

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(App 1 at 020b-021b.) Plaintiffs now contend that this temporary phase-in, which has allowed some customers to gradually pay the uniform charge, results in rates that do not correspond with the benefits received by individual customers. (Pls' Supp Br at 23-30.) Plaintiffs rely on *Bolt* to challenge a rate-mitigation technique that the City has the authority to employ to manage its rates. They also use *Bolt* to attack the amount of the rates associated with rate mitigation, even though these rates are presumed reasonable. In short, Plaintiffs rely upon the "individual correspondence" test in *Bolt* to divest the City of not only its legally-conferred discretion, but also the benefit of a long-standing legal presumption.

Under *Bolt* and its "individual correspondence" test, ratepayers can arguably prevail on their claims without having to show fraud, bad faith, deceit or subterfuge, or arbitrariness, and without overcoming the presumption of reasonableness. Plaintiffs would contend that this is exactly what the Headlee Amendment intended. But, this construction of Headlee ignores this state's long-standing common and statutory law recognizing municipal authority over local concerns (such as rates). It also thwarts the constitutional directive to construe all laws concerning cities, counties and townships liberally in their favor. Plaintiffs' construction of Headlee swallows this existing precedent whole, creating a new, higher burden of proof for defending Headlee claims that is at odds with the discretion and the well-established presumption of reasonableness afforded to municipal utilities. It invites rampant micro-level challenges to municipal utility fees.

The absence of a "correspondence" between a charge and the benefit conferred *upon a particular person* should not render a charge a "tax." If this were truly the case, then every utility rate is essentially a tax. This is because utilities do not operate in segments or parts; they physically and financially function as a whole unit to provide maximum benefits to all users. In any utility system, there are components or legitimate system costs that do not tangibly confer a benefit on the ratepayer individually, but are a necessary cost of operating a utility. There are rate-setting

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mechanisms that may appear inequitable to some ratepayers in the short-run, but actually ensure that all users continue to enjoy long-term benefits from a viable and self-sustaining utility. Rate-setting does not always achieve a correspondence between the rate assessed and the benefits provided on an individual level because the realities of a utility system make this next-to-impossible to achieve. The failure to achieve such individual correspondence, however, is not fatal and does not mean a charge is not a valid user fee.[30]

B. Prior Sources of Funding For Services Rendered.

In upholding the City's drainage charge as a valid user fee, the Court of Appeals also determined that (1) the City's costs to operate, administer and maintain the combined sewer system have always been recouped through rates as opposed to taxes, and (2) there was an absence of any evidence to suggest that the drainage charge (or any revisions to it) reflected a motivation to recoup lost revenue. (App 1 at 017b-018b.) Unlike Lansing, which had been using its general fund to historically finance its storm water infrastructure (*Bolt*, 221 Mich App at 97), DWSD has never relied on the City's general fund to cover the costs of the combined sewer system. Thus, the Court found no "significant revenue-generating purpose that outweighs a regulatory purpose." (App 1 at 018b.)

[30] The City knows that there are many low-income residents that struggle with the affordability of the City's charges and are subject to liens (indeed, the *Binns* Plaintiffs criticize the drainage charge because of the risk of water shutoffs and foreclosures from failing to pay it, thereby implicitly faulting the City for employing a rate that is "too high" for some). (Binns Amicus Br at 9-10.) Many municipalities such as the City are reluctant to charge an income-based rate because some ratepayers will twist *Bolt* to argue that such a rate must reflect the "benefit [to] the particular person on whom it is imposed." *Bolt*, 459 Mich at 165. If the City charges Ratepayer X, who receives the same level of service as Ratepayer Y, a lower rate than it charges Ratepayer Y based on Ratepayer X's lower income, Ratepayer Y may argue that under *Bolt*, the difference between the two rates is now an "unlawful tax" that should be refunded to him (and all those similarly situated) because his higher rate is subsidizing Ratepayer X's lower rate. According to Ratepayer Y, his rate is disproportionately higher, does not reflect the actual costs of use incurred by him, and does not correspond to the benefits that he directly receives. The risk that a court will agree with Ratepayer Y and interpret *Bolt* to preclude an income-based rate is the precise reason that many municipalities across the state struggle with the issue of affordability. As it stands, any municipal utility that does tie its rates to income level is inviting a Headlee class action lawsuit even if it believes that the lawsuit has no merit and believes income-based rates would be more protective of public health.

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The record lacks any evidence that the City has been assessing a drainage charge to supplement revenue for items that are unrelated to the provision of combined sewer services – which includes the treatment and disposal of both sewage and storm water. Plaintiffs made the same argument to the Court of Appeals that they lodge here: i.e., the City, in October 2016, started charging parcels that were never previously charged the drainage charge because it wanted to recover wholesale revenue that it lost due to the creation of GLWA. (Pls' Supp Br at 30-32.) But, there is no shortfall in the City's revenue for this alleged reason. GLWA does receive revenue for wholesale operations provided by the regional system (previously operated by the City), but it also assumes responsibility for the costs of those operations, as well. The entire wholesale budget – both revenues and expenses – moved to GLWA. (App 3 at 072b-73b (¶¶6-8).) GLWA's expenses are allocated to the various communities served by the regional system – including the City. The expenses that the City passes on through its drainage rate reflect its costs to operate the retail system plus whatever costs have been allocated to it by GLWA. (App 2 at 028b (¶11).) As the Court of Appeals concluded, Plaintiffs' contention that the City brought on new customers to replace lost revenue is speculative and "Plaintiffs have presented no evidence to support such a hypothesis."[31] (App 1 at 018b.) Therefore, there is no basis to conclude that the City's drainage charge is merely revenue-raising, and not regulatory, simply because it is now being assessed on system users

[31] Plaintiffs also point to the class-based impervious acreage rate that existed before October 2016 to argue that the drainage charge must be revenue-raising because the City had enough revenue to cover system costs before it started charging parcels that were receiving combined sewer services but not paying for them. (Pls' Supp Br at 26-28.) This overlooks the fact that some parcel owners paid more than others under the class-based impervious acreage rate system, and that by folding in all parcels that burden the system, the City was able to reduce the so-called "$852 impervious acreage charge" that was being assessed on limited parcels to $661 in 2017. (App 2 at 029b (¶16).) The phase-in has enabled the City to ensure that all parcels burdening the system will be charged the same rate-per-impervious acre over a period of time. That rate, however, cannot be construed in a vacuum because system costs continue to increase as result of normal inflationary pressures, demand continues to fluctuate, and system maintenance continues to be necessary to preserve the system and keep it in good working order. Thus, while the rate is currently $602/impervious acre, the rate may continue to increase (or decrease) in the years to come depending on a variety of factors.

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previously not charged. Moreover, the City's CFO from 2015 to 2017 averred that the City "has never used general fund expenses to pay for the costs of its combined sewer system treatment and disposal services."[32] (App 2 at 027b (¶¶6-7).) For these reasons, the City's drainage charge is distinguishable from Lansing's charge in *Bolt*.

Nonetheless, the notion that a municipal utility can never recover through a rate or fee costs that were previously paid through the general fund is far too sweeping. Under this rubric, if, for example, a municipality decided that rather than raise utility rates on ratepayers during a recession, it would be economically more prudent to cover system shortfalls or costs through the general fund, the utility would never be able to use rate revenue to reimburse its general fund for helping out in a pinch or to cover those system costs that were previously absorbed by the general fund. Most sewage disposal systems like the City's operate through an enterprise fund (App 2 at 42b), meaning they are only funded through rate revenue, statutorily-permitted debt – which must be repaid through a rate per MCL 141.121(1)(b)[33] – or loans from the municipality's general fund.[34] Costs that are incurred by a public utility to supply services do not (and should not) lose their character as proper utility costs that must be recovered through a rate per the RBA simply because they were once supported by the general fund. Although this "factor" suggested that the *Bolt* storm water charge was a revenue-raising tax, relying on it as a bellwether in other cases is problematic because it will lead courts to erroneously conclude that true user fees are "taxes" simply because the

[32] Plaintiffs essentially contend that the Hudson affidavits (App 2, 3) are disingenuous. (Pls' Supp Br at 33-34.) These affidavits are averred to under oath. Moreover, Plaintiffs were free to submit documents and affidavits rebutting the Hudson affidavits. They did not. Instead, they misconstrue and mischaracterize the evidence submitted by the City and then contend that the City's evidence is not good enough. The burden to prove that the City's drainage charge is a tax does not lie with the City. It lies with Plaintiffs and as the Court of Appeals concluded, it has not been met.

[33] MCL 141.121(1)(b) requires that "rates for services furnished by a public improvement . . . shall be sufficient to provide for . . . [t]he payment of the interest on and the principal of bonds payable from the public improvements when the bonds become due and payable."

[34] Generally speaking, municipal tax revenue may be used to pay for all municipal activities.

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general fund was previously used to pay certain costs that categorically relate to providing services to users. This alleged indicator of a tax, although absent in this case, is simply not reliable.

C. Investment in Capital.

Perhaps the biggest takeaway from *Bolt* is the (mistaken) belief that municipal utilities cannot use rate dollars to finance capital improvement. In *Bolt*, Lansing's storm water charge was targeted to fund $205 million in costs, approximately 63% of which were dedicated to capital expenses. *Bolt*, 459 Mich at 163, n13. This Court held that use of a fee to fund this capital infrastructure was "an investment in infrastructure as opposed to a fee designed simply to defray the costs of a regulatory activity." *Bolt*, 459 Mich at 163. The Court of Appeals appropriately distinguished this matter and the nature of capital expenditures covered by the City's drainage charge from those in *Bolt* by recognizing that the City was recovering through its rate the funds necessary to pay $59.8 million in debt service costs – i.e., principal and interest payments on municipal bonds and state revolving fund loans. Noting that this Court concluded it was appropriate for a rate to include "some capital investment component," and recognizing that by using debt, the City was amortizing its capital expenses and enabling rates and capital expenses to coincide, the Court of Appeals concluded that the City's drainage charge did not represent an "investment" in infrastructure. (App 1 at 018b-019b (citing *Bolt*, 459 Mich at 164, and *Ass'n of Businesses Advocating Tariff Equity v Pub Serv Comm*, 208 Mich App 248, 261; 527 NW2d 533 (1994)).)

Plaintiffs contend that the City's drainage charge represents an excessive investment in capital because of (1) the amount of debt service recovered through the charge, (2) the amount of capital investment that is being financed through the rate, and (3) the possibility that future infrastructure – gray and/or green - may be financed through the charge. (Pls' Supp Br at 32-34.) But, none of these claims turns the drainage charge into a revenue-raising mechanism that fails to serve a regulatory purpose. First, as the Court of Appeals recognized, *Bolt* explicitly states that a rate

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can include "some capital investment component." *Bolt*, 459 Mich at 164-65. Second, the debt service recovered through the drainage charge is appropriately recovered through a utility fee. As noted earlier, the RBA mandates the payment of principal and interest due on bonds issued to fund a public improvement.[35] MCL 141.121(1)(b). Third, rate revenue may also be appropriately used to finance future capital improvements.[36] That a utility rate may never fund capital is contrary to common practice. Municipal utilities across the country rely on rate revenue to fund capital improvements. This is so common that the State of Michigan expects and provides uniform account numbers for all municipalities to use for designating their "capital funds."[37] (App 42.) For years, the Court has been aware that the two primary rate-setting methods – cash basis and utility basis – each account for using rates to fund future capital expenditures. See *City of Plymouth v City of Detroit*, 423 Mich 106, 115; 377 NW2d 689 (1985) (noting that the "cash basis" method incorporates costs needed "to make capital improvements as would not require bond financing, *e.g.*, limited new

[35] The RBA also explicitly provides public improvements like water, sewer, and storm water systems with the authority to also include in its rates whatever "[o]ther expenditures and funds" are required for the system per the municipality's bond ordinance." MCL 141.121(d). Through the RBA, the Michigan Legislature has concluded that a municipality is in the best position to determine the type of expenses the community wants to fund through rates and has conferred upon it the authority to self-govern in this area – even if what it seeks to fund is "capital."

[36] A portion of DWSD's capital expenses will be financed by rate revenue. See *supra* at 14-15. But, at most, these costs are approximately 14.5% of revenue over the next five years, and much of that capital will be funded through debt service. (App 4 at 076b.) The $1 billion in "gray infrastructure" improvements cited by Plaintiffs (Pls' Supp Br at 33) is a possible future cost *if* green infrastructure initiatives to reduce storm water runoff are not successful. (Pls' App J at 53.) There is no evidence that the City of Detroit has incurred these costs, let alone paid for these costs through the current drainage charge. There is also no evidence that it will pay for such a significant outlay of capital relying solely on rate revenue and that it will not rely on debt to fund these particular expenses should they become necessary. In short, Plaintiffs' argument is speculative and not based on actual conduct. Thus, Plaintiffs fail to show that the City's drainage charge is revenue-raising because it seeks to fund an inordinate amount of capital.

[37] The Michigan Department of Treasury states that "Capital Project Funds are used to account for the acquisition or construction of major capital facilities by a governmental unit that is not accounted for by proprietary funds and trust funds. . . . Capital Projects and Debt Service directly related to an Enterprise Fund may be accounted for in the related Enterprise Fund." (App 42 at 1107b.)

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plant construction, plus recurring replacements, renovation and extensions of existing plant" and the "utility-basis" method relies on depreciation expense and a rate-of-return to fund future capital). See also App 6 at 323b (noting that self-financing includes the use of fees and bonds).

Municipalities require the flexibility to rely on rate revenue to fund capital improvements because there may be times where it is cheaper for a community (and its ratepayers) to use rate revenue to finance a capital project as opposed to relying on debt. To say that a municipal utility cannot use rate dollars to pay for capital costs that will occur in the future (and must only finance these projects through debt, which allows for amortization) is as equally overreaching as saying utility costs must never be paid by the general fund. Such a restrictive ruling would hamstring municipalities from being able to use their discretion to decide which financing mechanism is in the best interest of the municipality and its ratepayers.[38] Debt may allow for "amortization" of expenses but it is not always the most economical way to fund a project. Although the use of debt may ensure that each individual ratepayer is only paying for "current" expenses through amortization, it may ironically force all ratepayers to pay more for a project through increased debt service over time.[39] Furthermore, utility infrastructure is often subject to depreciation periods of 40 to 50 years –

[38] Pending before this Court are applications for leave to appeal two class action lawsuits in which plaintiffs are challenging the use of rate revenue to fund reserves that are earmarked to fund upcoming repair and replacement projects in the coming years. See *Bohn et al v City of Taylor*, No 339306, 2019 WL 360730 (Mich App Jan 29, 2019); *Deerhurst Condominium Owners Ass'n, Inc et al v City of Westland*, No 339143, 2019 WL 360725 (Mich App Jan 29, 2019). These lawsuits allege that under *Bolt*, rate revenue cannot be used to pay for repair and replacement projects that are too far in the future and can only address short-term capital needs. These plaintiffs effectively argue that a court should determine how far ahead and to what extent a municipal utility can save for future capital repair and replacement (even though a municipality is much-better suited to make this decision).

[39] Both the Court of Appeals and this Court in *Bolt* relied on *Ass'n of Businesses Advocating Tariff Equity v Pub Serv Comm*, 208 Mich App 248, 261; 527 NW2d 533 (1994) to state that amortized construction costs are current expenses. Notably, the Court of Appeals in *Tariff Equity* was analyzing whether the Michigan Public Services Commission had engaged in "retroactive ratemaking" by including construction costs for an abandoned plant in its current rate. The Court of Appeals concluded that it had not because rates coincided with amortized expenses. *Id.* At no point did the Court of Appeals conclude that a rate cannot be used to fund capital. Indeed, the Court of Appeals rejected

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timeframes that are much longer than the standard 20-to-30 year amortization schedules accompanying debt. Thus, when using debt, it is next to impossible for a municipality to spread the costs of its capital investment over the useful life of the capital asset. The idea that a rate can only fund a current capital expense is stifling from a planning perspective, especially when the development and construction of a utility project can take years – not months. *Bolt* should not be able to deprive municipalities of the ability to use or even save rate revenue to pay for capital expenses over a multi-year horizon, especially when local legislators have decided that this is the most financially-sound way to fund a utility improvement. Such a proscriptive reading of *Bolt* could punish responsible communities who opt to save a fraction of utility rate revenue over time to cover future capital projects for the utility as part of their long-term financial planning.

Simply put, a rate does not become an "unlawful tax" because it seeks to recover from system users all capital costs that benefit these users. While the City's drainage charge is a valid user fee under *Bolt* because it seeks to recover construction costs financed mostly, but not exclusively,

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the argument that the MPSC was engaging in "retroactive rate making" by unlawfully charging ratepayers for a past capital loss (i.e., an abandoned plant). Instead, it expressly upheld a rate that recovered costs for an unsuccessful plant investment – an investment no one benefitted from. At issue in *Tariff Equity* was whether charging for unsuccessful plant investment was the same thing as using a rate to charge current customers for past losses because prior rates were set too low. *Id.* at 262; *see also Detroit Edison Co v Michigan Pub Serv Comm'n*, 82 Mich App 59, 67; 266 NW2d 665 (1978), *aff'd*, 416 Mich 510; 331 NW.2d 159 (1982) ("The PSC cannot, however, set a future rate so as to recover for a loss suffered in the past."). No construction of *Tariff Equity* – a case that deals with the MPSC's regulatory authority to set rates only for non-municipal, privately owned utilities – stands for the proposition that a municipal utility rate cannot recover costs incurred to construct capital. Even if this were a proper construction of *Tariff Equity* (which it is not), it would not (and should not) apply to municipal utilities, which enjoy the authority afforded to municipalities under Article 7, Sections 22, 24 and 34 of the Michigan Constitution, the Home Rule Cities Act and the Revenue Bond Act, and are exempt from the MPSC's power and jurisdiction. See MCL 460.6(1).

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through debt, the charge would be no less valid if it were instead used to finance all capital expenses related to the combined sewer system.[40]

CONCLUSION AND RELIEF REQUESTED

The City cannot stop treating and disposing of its users' combined sewage. Providing these treatment and disposal services is mandatory under state and federal law, and assessing a charge for these services is mandatory under federal law and the RBA. The City's legal obligation to treat and properly dispose of its CSOs is the only reason the drainage charge exists. Although it was Plaintiffs' burden to prove that the drainage fee charged in exchange for these services is a tax under *Bolt*, Plaintiffs presented no reliable evidence to controvert the extensive evidence produced by the City supporting the validity of its federally-mandated charge under the principles set forth in *Bolt*. The evidence presented to the Court of Appeals (and described throughout this brief) demonstrates that the City's drainage charge is nothing like the "storm water" fee at issue in *Bolt*. To the contrary, the City's updated drainage charge is a testament to *Bolt*. It was systematically revised and refined with the express purpose of addressing the concerns this Court had about assessing a charge that reflected no act of regulation, failed to correspond individually to the value of a service rendered to a ratepayer, lacked proportionality, and offered no ability to control use of the service. The City's drainage fee is so distinct from the fee in *Bolt*, and so clearly adheres to the constraints articulated there, that if this charge were ruled a "tax," then very likely no "storm water" fee could ever be valid

[40] The City's modest green infrastructure expenses of $2-3 million per year from 2013 until approximately 2029 (App 12 at 654b-655b) are exactly the type of future capital expenses that can and must be supported by fee revenue because they relate to the operation, administration and maintenance of the existing combined sewer system. Moreover, while these green infrastructure projects are targeted for particular areas of the City, they lessen the burden on and improve the efficiency of the entire combined sewer system. (*Id.* at 655b ("[T]he performance goal is that . . . the permittee have in place in these sewersheds GI practices that *cumulatively* have the capacity to reduce flows in the sewer system in a 2-year – 24 hour storm event by at least 2,800,000 gallons . . .").) Thus, contrary to Plaintiffs' argument (Pls' Supp Br at 32), they are not projects that only benefit a subset of customers. Reducing flows increases system capacity which improves system performance and benefits everyone using the system.

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in Michigan. Such a ruling would close a door that this Court expressly left open for cases like this one. See *Bolt*, 459 Mich at 164.

The City cannot realistically use general fund (i.e., tax) revenue to support an unexpected shortfall of hundreds of millions of dollars of mandatory costs. The City's budget is largely predetermined as a result of the strictures imposed by the bankruptcy's plan of adjustment and the various settlements reflected in the related Grand Bargain Legislation. As the bankruptcy court acknowledged when it reviewed the City's plan of adjustment:

> There is no more money available for creditors in the City's already tight budget projections. Every dollar is accounted for in providing necessary services, in implementing the necessary RRIs, and in meeting plan obligations. All of those cash uses are essential to the City's future.

In re City of Detroit, 524 BR 147, 219 (Bankr ED Mich 2014). Any surplus in the City budget is intended to meet the City's plan obligations to its creditors from FY 2014 – FY 2023. *Id.* at 225. The plan of adjustment contains no place in the budget for a new line item in excess of $150 million annually, and the plan projections "do not leave much room for error." *Id.* at 230-31. These obligations are now further strained by COVID-19 impacts to the City and its population. Moreover, if the City were unable to assess the drainage charge, it would be forced to divert millions of tax dollars needed to provide core safety services, such as police, fire, and public lighting, to cover the mandatory costs of treating and disposing of its customers' combined sewage.[41] Alternatively,

[41] Plaintiffs' assumptions about the financial impact of this lawsuit are incorrect. (Pls' Supp Br at 12.) Any refund of the drainage charge would be financially devastating to the City. A refund would cover almost three years of charges for all parcel owners that were *not* among the 9,900 parcel owners in the *Michigan Warehousing* class: i.e., all opt-outs *and* all residential parcels, all non-residential parcel owners who were previously charged on a per-meter basis, and all 22,000+ parcels that were contributing storm water to the system but never paying system costs. Thus, the class of approximately 330,000 parcels in this case is significantly larger than just the fraction of parcels that opted out of the *Warehousing* lawsuit. See App 13 at 684b (¶ 2) (noting the presence of 380,000 parcels in the City); App 31 at 955b (¶ 5) (noting 37,000 parcels are not charged); App 38 at 1055b (noting that 9960 parcels are in the *Warehousing* class). A three-year refund to all of the parcels in this class (approximately 86% of all City parcels) is not insubstantial. Charges for each year in dispute

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the elimination of the charge could result in the collapse of the City's CSO systems, thereby increasing the volumes of polluted, sewage-ridden discharge into navigable waters and the amounts of polluted waters flooding the City's streets and residential basements. This would bring the City straight back to where it was in 1977 - a time when the City's system was woefully noncompliant with prevailing federal sewage treatment and disposal standards – and potentially create a health debacle on the scale of the Flint Water Crisis.

Through its drainage charge, the City is able to recover the costs it must expend so that it does not revert to the conditions of 1977. As repeatedly noted throughout this brief, the City's disposal of its storm water is crucial to ensuring public health, and thus regulatory, given the combined nature of the flow. But, the disposal of storm water *sans* sewage or other sanitary waste is equally important to ensuring the public health and welfare of residents. As the evidence presented in this case reveals, individual parcel development compounds the flooding caused by storm water and increases the burdens placed on both combined sewer and separated storm water systems. (App 28 at 913b; App 29 at 922b; App 30 at 931b-933b.) A fee to cover the costs of disposal of storm water would be no less regulatory if the City's storm water did not contain sewage (which it does) or if the City's costs did not reflect end-of-pipe treatment (which they do). The City provides inherent value simply by managing the volume of storm water contributed to its system through parcel development. The dissent in *Bolt* aptly recognized that a storm water service charge "does not lose its status as a user fee simply because the sewage and storm water flow through one pipe, but are eventually separated into two individual sewage pipes." *Bolt*, 459 Mich at 186-87.

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are in excess of $150 million. A refund of this size would have dire consequences for the City. And because neither DWSD nor the City-proper has hundreds of millions in extra cash on hand, the City must fund any judgment in this matter under the judgement levy statute, which will ultimately place the City's taxpayers on the hook for funding these refunds to themselves and others.

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The *Bolt* dissent also correctly prophesized that *Bolt*'s holding would subject cities "to future legal challenges and wreak havoc with the state's water and sewage disposal systems." *Id.* The City, alone, has faced or (is facing) seven lawsuits (four of which are class actions) challenging its drainage fee as an "unlawful" tax under *Bolt*. Neither the City's federal obligation to pay the drainage charge nor the City's painstaking efforts to ensure that the charge is regulatory, proportional and voluntary have had any effect on the proliferation of cost-prohibitive *Bolt* litigation against the City. And, the City is not alone in this predicament. Pending before this Court are at least four other class action lawsuits claiming that water, sewer, and/or storm water rates are unlawful taxes under *Bolt*. This does not account for the myriad other rate challenges that are before the trial courts and the Court of Appeals. The burden of defending against these claims is compounded by the fact that some of the purported requirements of *Bolt* – e.g., individual correspondence, limits on capital expenses, the prohibition on using fees to recover costs previously paid for through taxes – undermine, and potentially, vitiate a municipal utility's rights and obligations under other applicable and valid Michigan law. On a practical level, *Bolt* is often difficult to reconcile with the day-to-day reality of operating, administering and maintaining a municipal utility – be it water, sewer or storm water.

Nonetheless, in this matter, the City *has* complied with *Bolt* and the Court of Appeals rightly so concluded. The Court of Appeals recognized that the drainage charge covers the costs of regulatory services provided by the City. It correctly applied this Court's precedent to concrete evidence to conclude that the City's drainage charge is a valid user fee under the principles of *Bolt*. Plaintiffs have not offered any material, let alone persuasive, evidence to prove otherwise. They have not and cannot explain why treating storm water that contains sewage is not a regulatory activity. They have not advanced a cogent explanation for why the City's drainage charge should not be allowed to recover capital-related, combined sewer system costs that patently relate to the provision of a regulatory activity that benefits all system users. They have not offered another more

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precise or more technologically-advanced method by which the City should apportion its combined sewage costs. And, they have not pointed to any clear error by the Court of Appeals that would require this Court to revisit the merits of this matter.

For these reasons and those set forth in this brief and its Answer to Plaintiffs' Application for Leave to Appeal, the City respectfully requests that this Court deny Plaintiffs/Appellants' Application for Leave to Appeal. Alternatively, the City respectfully requests that the Court uphold the City's drainage charge as a valid user fee under *Bolt* and/or the long-standing constitutional, statutory and common law that recognizes a municipality's authority and discretion over utility rates. And, in the event the Court concludes that the City's drainage charge is a tax, the City respectfully requests that the Court remand this matter to the Court of Appeals so that it may review and consider the issues of pre-Headlee authorization and federal preemption.

Respectfully submitted,

MILLER, CANFIELD, PADDOCK AND STONE, P.L.C.

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Dated: June 8, 2020

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CERTIFICATE OF SERVICE

I hereby certify that on June 8, 2020, I electronically filed **Defendants/Appellees City of Detroit, Detroit Water and Sewerage Department, and Detroit Board of Water Commissioners' Court-Ordered Supplemental Brief** and **Appendix 1-42** thereto with the Clerk of the Court using the electronic filing system, which will send notification of such filing to all counsel of record.

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STATE OF MICHIGAN

IN THE SUPREME COURT

DETROIT ALLIANCE AGAINST THE RAIN TAX, a voluntary unincorporated association, and **DETROIT IRON AND METAL CO., AMERICAN IRON & METAL CO., MCNICHOLS SCRAP IRON & METAL CO., MONIER KHALIL LIVING TRUST,** and **BAGLEY PROPERTIES, LLC**, individually and on behalf of similarly situated persons,

Plaintiffs/Appellants,

v.

CITY OF DETROIT, a municipal corporation, the **DETROIT WATER AND SEWERAGE DEPARTMENT**, and the **DETROIT BOARD OF WATER COMMISSIONERS,**
Defendants/Appellees.

Case No. 158852

Court of Appeals Case No. 339176

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DEFENDANTS/APPELLEES' APPENDIX IN SUPPORT OF SUPPLEMENTAL BRIEF

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