STATE OF MICHIGAN
IN THE BERRIEN COUNTY TRIAL COURT- CIVIL DIVISION
811 Port Street, St. Joseph, MI 49085 (269) 983-7111

THE CHARTER TOWNSHIP OF NILES,
N & B ENTERPRISES, DNS DESIGN, INC.,
LAUBACH INCORPORATED,
and JAMES T. LAUBACH,
Plaintiffs,

Case No.: 2015-0224-CB

v.

HON. JOHN M. DONAHUE

CITY OF NILES
Defendants.

Ronald M. Redick (P61122)
MIKA MEYERS, PLC
Attorneys for Plaintiffs
900 Monroe NW
Grand Rapids, MI 49503
Tel: (616) 632-8000
rredick@mikameyers.com

William K. Fahey (P27745)
Christopher S. Patterson (P74350)
FAHEY SCHULTZ BURZYCH
RHODES PLC
4151 Okemos Rd
Okemos, MI 48864
Tel: (517) 381-3150
wfahey@fsbrlaw.com
cpatterson@fsrblaw.com

Robert L. Landgraf, Jr. (P23000)
Niles City Attorney
19 S 3rd St, PO Box 1310
Niles, MI 49120-8310
Tel: (269) 683-8300
rlandgraf@hlldlaw.com

At a session of the Berrien County Trial Court, held
On the ____ day of July, 2016, in the City of
St. Joseph, Berrien County, Michigan,

Opinion on Plaintiffs' Motion for Partial Summary Disposition on Count I, and for Complete Summary Disposition on Count II

I. Factual Background

The City of Niles ("the City") provides wastewater collection, treatment and disposal services to the Charter Township of Niles ("the Township") pursuant to the "2008 Sanitary

Sewage Disposal Agreement Between the City of Niles and the Charter Township of Niles" ("the Sewer Agreement"). Additionally, the City provides public water supply services to certain areas of the township pursuant to the "2012 Water Supply Agreement Between the City of Niles and the Charter Township of Niles" ("the Water Agreement"). In August of 2013, the City Council considered and approved a 10 percent payment in lieu of taxes ("PILOT") to be charged to each of its utility funds including the Water and Wastewater Funds.

II. Analysis

On October 6, 2015, the Township filed a three count Complaint. In Count I, the Township alleges that (1) that the City breached the Sewer Agreement by transferring PILOT monies from the Wastewater Fund to the City's General Fund and using those monies for purposes not related to the Sewer System and (2) the City breached the Sewer Agreement by establishing rates that include a component attributable to the PILOT transfers. In Count II, the Township alleges that (1) the City breached the Water Agreement by transferring PILOT monies from the Water Fund to the General Fund and by using those monies for purposes not related to the Water System and (2) the City breached the Water Agreement by establishing water rates that include a component attributable to the PILOT Transfers. In Count III, the Township alleges that the PILOT charges are an illegal tax under the Headlee Amendment to the Michigan Constitution.

On March 28, 2016, the Township moved, pursuant to MCR 2.116(C)(10) for partial summary disposition of Count I of their Complaint seeking a ruling that the City breached the Sewer Agreement by authorizing PILOT charges and using the PILOT charges for purposes not related to the Sewer System. The Township also moved for complete summary disposition of Count II seeking a ruling that the City breached the Water Agreement by authorizing PILOT

charges, using PILOT charges for purposes not related to the Water System, and by establishing water rates that include a component attributable to the PILOT transfers. In response to the Township's Motion, the City requested summary disposition to be entered in its favor pursuant to MCR 2.116(I)(2) arguing that (1) PILOT charges are allowable under the Sewer and Water Agreements and Michigan law, (2) the Township has failed to prove that the City's public utility rates are unreasonable, and (3) the Township has failed to show that their rates ever funded a PILOT.

On May 23, 2016, a hearing was held on Township's Motion, and this Court took the Township's Motion under advisement. On June 21, 2016, the Township submitted a Post-Hearing Supplemental Brief in support of its Motion for Summary Disposition in which it informed the Court of recent discovery events. In addressing the Motion, this Court will primarily focus on two issues: (1) are PILOT transfers authorized under the Agreements and if so (2) is the amount of the PILOT transfers reasonable?

1. Are PILOT transfers allowable under the Agreements?

The Township largely bases its arguments on Paragraph 7e of the Sewer Agreement and Paragraph 10e of the Water Agreement. The two paragraphs are nearly identical and the relevant language is presented below:

> **System Revenues**. The proceeds of all rates and charges established by the City in accordance with this Agreement shall be deposited to the City's Water Division [or the City's Wastewater Division as written in the Sewer Agreement] enterprise fund and used for legally permitted purposes related to the City System.

The Township argues that the only exception to these paragraphs are found in Paragraph 7a(7) of the Sewer Agreement and Paragraph 10a(5) of the Water agreement; the relevant language provides that the City is permitted to

> [t]ake into account the allocation of City administrative expenses to the City's Wastewater Division enterprise fund, with 25% of such allocation, in turn allocated to the City System, in accordance with the methodology set forth in [Exhibit E of the Sewer Agreement and Appendix 4 of the Water Agreement].

Exhibit E of the Sewer Agreement and Appendix 4 of the Water Agreement both indicate the same shared expenses of several non-utility personnel.[1]

The Township argues, citing *Grinnell Bros v Brown*, 205 Mich 134, 137; 171 NW 399 (1919), that the maxims *expressio unius est exclusion alterius* and *expressum facit cessare tacitum* – the expression of one thing is the exclusion of another and a thing expressed puts an end to any tacit implication – compel the conclusion that the above contractual provisions represent the sole means for the City to be reimbursed for the indirect costs of providing sewer and water services. However, such a conclusion fails to look to the Agreements as a whole, and "[w]hen a court interprets a contract, the entire contract must be read and construed as a whole." *Smith v Smith*, 292 Mich App 699, 702; 823 NW2d 114, 116 (2011).

As the City points out in its brief, Paragraph 10 of the Water Agreement[2] also contains the below provisions:

> **a. Retail Rates**. The retail rates to be charged to the customers of the City System located in the Township Retail Service Area are comprised of the Readiness to Serve Fee and the Commodity Fee (together, the 'Retail Rates'). As required by MCL 123.141, the Retail Rates to be paid by customers of the City System located within the Township Retail Service Area shall be established in accordance with the ***utility basis of rate-making methodology*** described in this subparagraph. *** In addition to the foregoing, the wholesale rates established ***in accordance with Exhibit B*** shall:
>
> (1) Be ***fair and reasonable***

[1] The City Administrator, Human Resources, IT- Computer Support, Finance Director, Senior Accountant, Payroll Clerk, and the Accounts Payable Clerk.

[2] Paragraph 7 of the Sewer Agreement contains nearly identical terms. Exhibit B of the Sewer Agreement specifically states that the rates were made having given "consideration to the requirements of Michigan law which are applicable to the establishment of utility commodity rates, customer service charges and connection charges." Sewer Agreement, Exhibit B, p. 3.

> (2) Include a ***reasonable rate of return*** to the City on that portion of the City's equity in that portion of the City System allocated to serving the Township

Exhibit B of the Water Agreement further provides that

> [t]he utility basis of rate making includes recovery of operation and maintenance expenses, administrative costs, water production costs, customer service & billing expenses, depreciation expense, rate of return, working capital reserve requirements, inventory and **all costs either direct or indirect** to provide water services to customers. [Water Agreement, Exhibit B, p. 2 (emphasis added).]

Ultimately, if the Court were to read either Agreement in a way that limited the City's ability to recover indirect expenses solely to those non-utility personnel, such a construction would render the majority of Exhibit B surplusage and nugatory. See, e.g., *Klapp v United Ins Group Agency, Inc*, 468 Mich 459, 468; 663 NW2d 447, 453 (2003). Therefore, considering that Exhibit B of the Water Agreement provides that the retail rates are to be established by the utility basis of rate making and that Exhibit B of the Sewer Agreement provides that the rates were made with consideration of Michigan law[3], this Court finds that both the Sewer and Water Agreements allow for PILOT transfers.

2. Is the Amount of the PILOT transfers reasonable?

The Township in its Motion requested that in the event the Court finds that PILOT transfers are allowable under both Agreements that it find that the amount of the PILOT transfers was unreasonable. In order to answer this question, it is therefore necessary to review Michigan law concerning ratemaking.

First, under MCL 123.141, "[a] municipal corporation . . . [is] authorized by law to sell water outside of its territorial limits, [and] may contract for the sale of water with a city, village,

[3] PILOT charges are allowable under Michigan law and as an expense under the utility of basis of ratemaking. See *Oakland Co v Detroit*, 81 Mich App 308, 312-13; 265 NW2d 130, 132 (1978).

township, or authority authorized to provide a water supply for its inhabitants." Additionally, under MCL 117.4f(4), a Home Rule City is authorized to extend its sewer service beyond city limits, collect charges for the costs of the services, and to recover a "return on the fair value of the property devoted to the service." In *Atlas Valley Golf & Country Club, Inc v Village of Goodrich*, 227 Mich App 14, 24; 575 NW2d 56, 61 (1997), the Court of Appeals found that "a unit of local government that operates a sewer system may charge nonresident users higher rates, as long as the difference represents the indirect costs that its residents pay." However, the *Atlas Valley* Court cautioned that "[t]he local government may not charge nonresidents higher fees merely to subsidize its residents' use of the system." *Id.*

Michigan has long recognized the principle that municipal utility rates are presumptively reasonable as "[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 factors required in rate-making." *City of Novi v City of Detroit*, 433 Mich 414, 430; 446 NW2d 118, 125-26 (1989). Furthermore, "the fixing of such rates is a legislative matter with which the courts will not interfere unless the [the party challenging the rate demonstrates] that the rate determination was arbitrary, capricious or unreasonable." *City of Plymouth v City of Detroit*, 423 Mich 106, 133; 377 NW2d 689, 701 (1985), citing *City of Detroit v City of Highland Park*, 326 Mich 78, 92; 39 NW2d 325, 330 (1949). The Michigan Supreme Court has stated that "arbitrary" and "capricious" have generally accepted meanings and wrote that

> Arbitrary is: [W]ithout adequate determining principle * * * [f]ixed or arrived at through an exercise of will or by caprice, without consideration or adjustment with reference to principles, circumstances, or significance, * * * decisive but unreasoned.
>
> Capricious is: [A]pt to change suddenly; freakish; whimsical; humorsome. [*Goolsby v City of Detroit*, 419 Mich 651, 678; 358 NW2d 856, 870 (1984)

> (internal quotations omitted), citing *United States v Carmack*, 329 US 230, 246 n 14; 67 S Ct 252, 260; 91 L Ed 209 (1946).]

Additionally, Black's Law Dictionary defines arbitrary as "[d]epending on individual discretion; of, relating to, or involving a determination made without consideration of or regard for facts, circumstances, fixed rules, or procedure" and "capricious" as "contrary to the evidence or established rules of law." ARBITRARY, Black's Law Dictionary (10th ed. 2014); CAPRICIOUS, Black's Law Dictionary (10th ed. 2014).

Again, the presumption of reasonableness can be "overcome by a proper showing of evidence, [but] the burden of proof is on the [party challenging the rate] to show that any given rate or ratemaking process is unreasonable." *Trahey v City of Inkster,* 311 Mich App 582, 594; 876 NW2d 582, 589 (2015). It should also be noted that the burden placed on the party challenging the rate is a "heavy burden." *City of Novi*, 433 Mich at 429, citing *Federal Power Comm'n v Nat'l Gas Pipeline Co*, 315 US 575, 62 S Ct 736, 86 L Ed 1037 (1942). Ultimately, "[a]bsent clear evidence of illegal or improper expenses included in a municipal utility's rates, a court has no authority to disregard the presumption that the rate is reasonable", and "[t]he determination of 'reasonableness' is generally considered . . . a question of fact." *Id.* at 595; *City of Novi*, 433 Mich at 431.

Here, the Township relies on statements made by Richard Huff, the City Administrator. The Township in particular relies on the below portions of Mr. Huff's deposition testimony:

> *Q*. [W]as a principal reason for looking at the PILOT's a way to increase general fund revenue?
>
> *A*. Yes.
>
> *Q*. And the idea was that those PILOT revenues would offset anticipated and . . . corresponding budget shortfalls in the general fund, correct?
>
> *A*. Yes.

***

Q. [T]he city council was directing you to come up with enough general fund revenue to offset the anticipated shortfalls, and so ten percent was the figure that would make up those anticipated shortfalls, correct?

A. That would be correct.

***

Q. Now, in developing the PILOT figure of ten percent in 2013, did you consider at that time whether the PILOT revenue would correlate with property tax revenue that the city's utility property would generate if it weren't exempt from taxation?

A. No.

Q. Did you consider whether the anticipated PILOT revenue would correlate with the . . . incremental cost of providing police and fire service for the utility systems?

A. No.

Q. Did you do any measure of the relationship of the PILOT revenues to insurances the city might spend on its utilities?

A. No. [Huff Deposition, p. 11, 13, 23].

Additionally, the Township cited to an email sent from the City's Mayor to the City Council in which the Mayor discussed a $2,000,000 surplus in the Wastewater Fund and wrote that he had "discussed with [Mr. Huff] using some of that surplus to fund projects in the community" including "increasing the funding to cover the cost of installation of a complete new roof for the Street Department" and "utilizing funds to demo the 5 or 10 worst houses in the City that should be demolished but for lack of resources." Plaintiff's Brief, Exhibit 8.[4]

[4] In the Township's Supplemental Brief, it further states that the City has calculated the true cash value and taxable value of its in-City water and wastewater system assets and that the City has also calculated the annual tax revenues that would be generated if they were taxed subject to the City's millage rate. The Township states that the City calculated the taxable value of the City Water System assets within the City's taxing jurisdiction would generate $36,516.50 annually,

The Court does recognize, as described in *City of Novi* and *Trahey*, that the burden a party carries in challenging a rate is a heavy one and that courts are generally ill-equipped to deal with such issues. However, the Township here has carried its burden, and the evidence presented by the Township in support of its argument is not overly technical or complicated. The Court of Appeals in *Coates v Bastian Bros, Inc*, 276 Mich App 498, 502-03; 741 NW2d 539, 543 (2007) held that a motion for a directed verdict is properly granted "if, viewing the evidence in a light most favorable to the nonmoving party, reasonable minds cannot differ," and given Mr. Huff's testimony, it is clear that reasonable minds could not find that the 10 percent PILOT charge is fair or reasonable.[5]

The City argues that "Plaintiffs have produced no evidence to carry their burden that the PILOT is unreasonable" and that "[t]he City has no duty to provide a precise mathematical computation to justify the amount of the PILOT." Defendant's Brief, p. 11. However, Mr. Huff's deposition testimony and the Mayor's email illustrate a clear fact which the City does not dispute; the 10 percent PILOT charges have nothing to do with the indirect costs that the City's residents pay in supporting the water and wastewater systems. Paragraph 10a(1) of the Water Agreement and 7a(1) of the Sewer Agreement require that the rates be fair and reasonable. As

---

and that the taxable value of the City Wastewater System assets would generate $71,031.52. The Township then states that the water PILOT transfers generated $211,292.64 annually (579 percent higher than the actual taxable value) and the wastewater PILOT transfers generated $263,454.96 (371 percent higher). The Township uses these facts to further support their argument that the 10 percent PILOT charges are not reasonable.

[5] Once again, the City Administrator testified that the PILOT was not designed to either correlate with the loss of property tax revenue or with the indirect costs of providing police and fire services. Huff Deposition at 23. Rather, Mr. Huff testified that he was directed to come up with enough general fund revenue to offset anticipated shortfalls. *Id*. at 23. It is lawful for a local unit of government to charge nonresident users higher rates for sewer and water services "as long as the difference represents the indirect costs that its residents pay." *Atlas Valley*, 227 Mich App at 24. Here, reasonable minds could not disagree that the 10 percent PILOT charge is designed to increase General Fund Revenue and does not represent the indirect costs that City residents pay.

Plaintiffs' counsel argued at the hearing, "that which has zero relationship to lawful factors cannot have a reasonable relationship to lawful factors," and the City Administrator's testimony clearly indicates that the driving purpose of the PILOT transfers was to increase the General Fund revenue.

The City further argued at the hearing that there is a question of material fact as to the reasonableness of the rates, and that it would be improper for the Court to arbitrarily say that 10 percent is too much. While the Court is aware that generally, the reasonableness of rates is a question of fact, see *City of Novi*, 433 Mich at 431, the Court nonetheless finds that the Township has carried its burden in demonstrating that the PILOT is arbitrary, capricious, and unreasonable.[6] This Court further finds that the Township has demonstrated that the PILOT at issue (1) has no reasonable relationship to lawful factors,[7] (2) was designed to increase revenue to the City's General Fund, and that (3) the Township residents as a result are subsidizing general City services that the City provides to City residents contrary to *Chocolay Twp v City of Marquette*, 138 Mich App 79, 84-85; 358 NW2d 636, 638 (1984).[8]

---

[6] The PILOT is arbitrary because it was established without regard to basic principles of ratemaking or specific circumstances. See *Goolsby*, 419 Mich at 678. The PILOT is capricious because it was established contrary to rules of law. See CAPRICIOUS, Black's Law Dictionary (10th ed. 2014). And again, the PILOT is unreasonable because no reasonable mind could find that the PILOT was established in accordance with Michigan law. See *Atlas Valley*, 227 Mich App at 24; *Coates*, 276 Mich App at 502-03.

[7] Lawful factors include, for example, "the fact that the property of the utility is not taxed and that other services furnished by the city, such as fire and police protections, are furnished without charge." *Chocolay Twp v City of Marquette*, 138 Mich App 79, 84; 358 NW2d 636, 638 (1984).

[8] The Court of Appeals wrote that payments in lieu of taxes made by a municipally-owned utility may be a reasonable expenditure when calculated to pay for the cost of municipal services provided to the utility. *Chocolay*, 138 Mich at 84-85. The *Chocolay* Court found, however, that the City of Marquette collects "taxes" for services it does not render and which, in fact, other entities must render . . . thereby subsidizing [City] rate payers" and ultimately upheld the trial court's finding that the rates were arbitrary and capricious. *Id*. at 85.

III. Conclusion

In Conclusion, this Court finds that (1) both the Water Agreement and the Sewer Agreement authorizes the use of PILOT transfers and (2) the 10 percent PILOT at issue was arbitrary and capricious and unreasonable, in violation of *City of Plymouth*, 423 Mich at 133, and also in violation of Paragraph 10a(1) of the Water Agreement and 7a(1) of the Sewer Agreement. Counsel for Plaintiff shall submit an Order in conformity with this Court's Opinion.

DATE: /s/

____

HON. JOHN M. DONAHUE (P38669)
Berrien County Trial Court

PROOF OF SERVICE
The undersigned certifies that a copy of the foregoing document was served upon attorneys and/or parties of record to the above cause by mailing the same to them at their respective address as disclosed by the file, with postage fully prepaid on _________________________.

____
Denise Lane, Deputy Clerk