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Lent Upson, First Director of the Citizens Research Council

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Michigan Appellate Court Ruling Upholds Stormwater Utilities

In a Nutshell

- Stormwater utility fees can provide reliable dedicated revenue to fund construction and maintenance of a community's storm sewers and stormwater infrastructure.
- There has been some unwillingness to embrace this funding mechanism because it is often unclear if a stormwater utility fee should be considered a permitted service fee or a tax subject to a required vote for adoption as provided by the Headlee Amendment to the Michigan Constitution.
- A recent ruling from the Michigan Court of Appeals has upheld the legal status of stormwater utilities. While this should give municipalities some confidence in adopting stormwater utility fees, care must be taken to ensure that such fees are proportionate with the services provided to the ratepayers.

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When Michiganders consider public infrastructure, we most often think of roads and bridges. Many of us drive nearly every day, so potholed roads and crumbling bridges are readily apparent. However, other infrastructure systems also require attention. Perhaps the most often forgotten is stormwater infrastructure – the systems that manage runoff from wet weather events (rain and snow-melt).

A stormwater system that is outdated or in disrepair can persist for months or years without causing any obvious problems. It is only when big storms come that the condition of stormwater infrastructure becomes obvious. The consequences of inadequate stormwater infrastructure can be disastrous, resulting in widespread flooding and damage to roads, properties, homes, and businesses. Additionally, poorly functioning stormwater systems can wash untreated pollution into rivers, lakes, and streams, degrading the quality of Michigan's natural environment and water resources.

Most Michigan communities finance stormwater infrastructure as part of their general operating budgets, public works funds, or even roads budgets. In such cases, stormwater funding must compete for finite resources with many other public services and often receives little attention.

A few Michigan communities have adopted a fee dedicated to the maintenance of stormwater infrastructure. Such fees have faced legal challenges. Yet, a recent ruling from the Michigan Court of Appeals has upheld the use of such fees, providing support and guidance for the expanded use of stormwater utility fees.

An Infrastructure Funding Solution: Stormwater Utility Fees

Ten Michigan cities have adopted a solution to fund stormwater infrastructure called a stormwater utility (SWU). These cities impose a SWU fee on property owners related to the amount of runoff from their properties that cannot drain into the ground. This largely reflects the area of impervious surfaces (typically built structures and pavements).

Other states have been much more willing to adopt SWUs. For example, over 200 Minnesota municipalities have adopted a SWU.

SWUs remain relatively rare in Michigan in part because of provisions in the state constitution commonly referred to as the Headlee Amendment. Article IX, Section 31 of the Michigan Constitution requires voter approval before local governments can levy new or increase existing taxes. This restriction applies to taxes, but not fees for public services. It is often unclear if a stormwater utility fee should be considered a permitted service fee or a tax subject to a required vote for adoption as provided by the Headlee Amendment.

A few Michigan cities, including Lansing, Jackson, and Royal Oak have repealed and refunded stormwater utility fees in the face of legal challenges. The Lansing case set a precedent for determining if a SWU is a legal fee or a tax. This became known as the Bolt test.

The Bolt Test: Distinguishing User Fees from Taxes

In Bolt v. City of Lansing (1998), the Michigan Supreme Court determined that "there is no bright line test" to distinguish between a user fee and a tax. However, the Court laid out three criteria to establish the differences:

1. User fees must serve a regulatory purpose rather than a revenue-raising purpose

2. User fees must be proportionate to the necessary costs of the service

3. User fees are voluntary in nature; property owners are able to refuse or limit their use of the service

Under the Bolt criteria, Lansing's SWU was a tax, and because it had not been voted on by Lansing residents it was considered an illegal tax. This precedent has also been used to successfully challenge SWUs in the cities of Jackson and Royal Oak, each of which was forced to repeal and refund their SWU fees. While other Michigan SWUs have withstood challenges, the uncertainty about the legal status of SWUs has created a "chilling effect;" municipalities are hesitant to adopt such fees without additional clarity of what is permitted under Headlee.

Meanwhile, a recent ruling from the Michigan Court of Appeals has affirmed the legality of Ann Arbor's SWU. This ruling can provide confidence and guidance for more Michigan municipalities to adopt a SWU, providing a reliable and dedicated source of funding for stormwater infrastructure.

Platt v. City of Ann Arbor (2024): Upholding Legality of Stormwater Utility Fees

In 2021, Platt Convenience Inc., owner of a gas station, filed suit against the City of Ann Arbor. The lawsuit argued Ann Arbor's SWU fee constitutes a tax that was not authorized by voters and thus in violation of state law.

The Michigan Court of Appeals ruled in favor of the city, upholding the legality of Ann Arbor's Stormwater Utility Fee.

Notably, the Court denied the plaintiff's motion for class certification. Platt motioned to certify all Ann Arbor SWU ratepayers as a class, creating a class action lawsuit that could potentially have resulted in the city being forced to refund SWUs as well as repeal the fee. The Court found that such a class certification would not represent or safeguard the interests of the proposed class, noting that most of the SWU ratepayers would be

damaged by a finding that the SWU fee is an unlawful tax. Most (residential) property owners in the city would either pay more through property taxes or suffer the consequences of failing stormwater infrastructure.

Also notable, the Court determined that Ann Arbor's SWU meets only two conditions of the three-pronged Bolt test. This is allowed for in the Bolt ruling; the Michigan Supreme Court determined that the Bolt criteria "are not to be considered in isolation, but rather in their totality, such that a weakness in one area would not necessarily mandate the finding that the charge is not a fee." But ideally, a SWU should meet all three Bolt requirements.

Specific findings of the Platt ruling related to the Bolt test are discussed below.

1) A user fee must serve a regulatory purpose rather than a revenue-raising purpose.

It is not disputed that Ann Arbor's SWU fee raises revenue for the city. However, the Court found that SWU revenues serve a direct regulatory purpose. Central to this finding is the National Pollution Discharge Elimination System (NPDES) under the federal Clean Water Act. Under these regulations, Ann Arbor must obtain an NPDES permit and ensure that the stormwater system is compliant with the conditions of this permit. The court noted that NPDES violations can carry both civil and criminal penalties, and that, "the ultimate responsibility for complying with such federal requirements cannot be avoided via state laws that prevent a municipality from raising the requisite revenue."

Citing precedent, the Court stated that, "categorically, obligations arising out of administrative agency regulations serve a regulatory purpose. … A court may not hold a civil defendant liable under state law for conduct federal law requires."

The Platt decision clearly established that SWU fees serve a regulatory purpose by their very nature. This is significant.

2) User fees must be proportionate to the necessary costs of the service.

A user fee must be reasonably proportionate to the actual costs of providing a service. In Platt, the Court did not actually determine that Ann Arbor's SWU fee is proportionate. However, in lawsuits that challenge municipal fees under Headlee, it is presumed that such fees are constitutional and proportionate. It is the burden of the plaintiff to provide "sufficient substantively admissible evidence to rebut the applicable presumption of proportionality."

The Court determined that the plaintiff in Platt, "failed to carry its burden of production in those regards, at least with regard to the instant proportionality inquiry. … [The] plaintiff has presented no expert-opinion evidence to support its allegations that, after due consideration of existing capital reserves, anticipated future capital expenses, and both the direct and indirect expenses associated with the storm-sewer system, the disputed charges are disproportionate to the direct and indirect costs of providing the storm-sewer services."

Thus, the Platt decision did not affirm that Ann Arbor's SWU meets Bolt requirements of proportionality, but determined that the plaintiff did not provide an argument to effectively rebut the presumption of proportionality. Given this, the Court concluded that "the second Bolt factor necessarily favors [the] defendant city here."

3) A user fee is voluntary in that users are "able to refuse or limit their use of the commodity or service."

If a user fee cannot be reduced or refused, the third component of the Bolt test implies that it may be considered an illegal tax in violation of Headlee. In Platt, Ann Arbor argued that its SWU complies with this requirement because the fee is based on total area of impervious surfaces (typically built structures and pavements). Thus a property owner could avoid the fee by having no impervious surfaces. Further, the city offers opportunities to reduce the fee by taking certain steps to reduce the runoff from the property (such as installing a rain

barrel or rain garden).

The Court was not swayed by these arguments. While the Court recognized that a landowner could technically avoid the SWU fee by removing impervious surfaces or leaving the parcel undeveloped, this "effectively forces property owners to choose between paying the [SWU fee] or relinquishing their rights of property ownership."

To the extent that the SWU fee could be reduced by installing stormwater mitigation features, the Court concluded that this policy "mandates that property owners pay the charge assessed or spend their own funds on improvements to their respective properties. … In other words, property owners have no means by which to escape the financial demands of the ordinance."

Thus, Ann Arbor's SWU was found to be "effectively compulsory" and "an improper tax under Headlee." However, the Court cited precedent stating that "the lack of volition does not render a charge a tax, particularly where the other criteria indicate a challenged charge is a user fee."

As the Court found in favor of Ann Arbor on two of the three Bolt criteria, it was decided that, "on balance … defendant City is entitled to judgment as a matter of law based on binding precedent."

Discussion and Lessons for Municipalities in Adoption of Stormwater Utilities

In the Platt decision, the Michigan Court of Appeals provided clear legal support for SWU fees. Critically, the ruling established that SWU fees are regulatory in nature to the extent that they are used to comply with federal Clean Water Act requirements and NPDES permitting.

However, this ruling does not preclude future legal challenges to SWUs. The Bolt criteria are not a "bright line test." Compliance with Headlee is open to interpretation. When adopting a SWU, municipalities should consider the Bolt criteria of proportionality and voluntariness, and structure fees that reasonably meet these criteria.

The Court found that Ann Arbor's fee is "effectively compulsory," and not voluntary. It is true that an undeveloped parcel with no structures or pavements would pay no fee. However, restricting development to avoid the fee is considered by the Court to be an infringement of property rights. Further, it is not in a city's interest to adopt a policy that would discourage investment and development.

Homeowners in Ann Arbor can reduce their fees by installing stormwater mitigation features (such as rain gardens), and receive a credit of up to $8.10 per quarter. This is at most an 18 percent reduction in the fee and in most cases will be much lower – practically trivial. Commercial parcels can implement measures to reduce runoff and receive fee reductions of up to 29 percent.

The Court found that Ann Arbor's fee is "effectively compulsory."

Owners of developed parcels have no options to further reduce or fully eliminate the fee. It is possible to conceive of a parcel to be developed in such a way that produces no runoff or even acts as a net sink of stormwater from adjacent parcels. Even in these cases, the property owner would be subject to a SWU fee, implying that it fails the Bolt test of voluntariness.

This also has implications for the Bolt test of proportionality. A legal fee under Headlee should be proportional to the services received. This applies collectively to the program, as well as to individual ratepayers.

In Platt, the plaintiff argued that Ann Arbor's SWU was not collectively proportional, stating that the sum of all fees collected is in excess of those required for stormwater management. This argument was based on an undisputed finding that the city's stormwater reserve fund stood at 150 percent of annual expenses, while a deposition from the city's CFO stated the reserve is "supposed to be" 25 percent of expenses. Additionally, the plaintiff stated that the city's capital improvement plan does not dedicate this reserve to identified projects and thus this should be considered revenue rather than a fee for service.

The Court determined that the plaintiff's evidence was not sufficient to establish that the fee is too high. Indeed, it may be beneficial for the city to hold these reserve funds to account for unanticipated costs, such as those caused by construction cost inflation, natural disasters, or simply unplanned repairs due to system failures.

The plaintiff further argued that Ann Arbor's SWU fee is individually disproportionate – i.e., the fee schedule often does not represent the costs imposed to the stormwater system by an individual ratepayer. For evidence, the plaintiff simply provided Ann Arbor's tiered fee schedule for residential properties.

Table 1

Ann Arbor Residential Stormwater Fees (2024)

Single-Family and Two-Family Residential			
Tier #	Measured impervious area	Representative Impervious Area Midpoint of Tier listed on the Water Utilities Bill	Quarterly Charge*
Tier 1	Up to 2,187 square feet	0.03706 acres	$36.92
Tier 2	> 2,187 to 4,175 square feet	0.06486 acres	$64.59
Tier 3	> 4,175 to 7,110 square feet	0.11117 acres	$110.71
Tier 4	> 7,110 square feet	0.19456 acres	$193.78

*Plus a $4.49 customer service charge per quarter

The plaintiff considered the disproportionality of this fee schedule to be self-evident. The judges stated that the "plaintiff effectively asks this court to independently review the cited financial documents–without the aid of any expert assistance–and make unilateral findings regarding proportionality." Without such additional evidence, the Court determined that the plaintiff failed to show Ann Arbor's SWU fee is not proportionate.

Ann Arbor may be fortunate that the plaintiff in Platt did not provide expert testimony on the proportionality of the tiered fee schedule. The 2021 Western Kentucky University Stormwater Utility Survey noted that "tier systems can be made relatively fair, but usually are not." On their face, it does not appear that Ann Arbor's tiered fees are proportionate.

This can be easily demonstrated. Take, for example, a homeowner with 2,100 square feet of impervious surface. This property would be in Tier 1, with the homeowner paying $41.41 per quarter ($36.92 plus a $4.49 service charge). Imagine that the homeowner installs a 4-foot wide, 25-foot long gravel garden path. This would make essentially no difference in runoff from this site, especially as stormwater can percolate through gravel. Yet, the City of Ann Arbor defines gravel and crushed stone as impervious surfaces, and would now place the property in Tier 2, charging the homeowner $69.44 per quarter. This homeowner would have incurred $112 per year in additional stormwater fees just for installing a little garden path.

Now imagine that same homeowner – now in Tier 2 with 2,200 square feet of impervious surface – then builds

a 1,800 square foot addition to their house. They would then have 4,000 square feet of impervious surface (and removed 1,800 square feet of pervious surface). These changes almost certainly create more runoff than previously, but the property remains in Tier 2 and the homeowner doesn't pay a dime more.

The Court determined that the plaintiff failed to show Ann Arbor's SWU fee is not proportionate. Yet, it does not appear that Ann Arbor's tiered fees are proportionate.

Multiple other factors make Ann Arbor's SWU fee disproportionate to the amount of runoff created by the property. Certainly, the city cannot be expected to perform a detailed hydrological study for each parcel. However, the city could make easy changes to improve the fee schedule. For example, the city already estimates the actual impervious surface on each lot. The city could simply apply the rate to the actual square footage of impervious surfaces rather than dividing residential properties into tiers; in fact, this is already done for commercial properties.

A SWU fee that is directly related to the amount of impervious surfaces would be more likely to withstand the proportionality requirement of the Bolt test.

Moreover, such a fee would better support the regulatory objectives of a SWU, to the extent that the structure of the fee would be designed to reflect the actual costs of managing the runoff produced by the property.

I can use myself as an example. I own a home in Ann Arbor. A previous owner installed a 900 square-foot asphalt basketball court in the backyard. The asphalt pad is now decades old, in disrepair and unused. I've considered removing it, but that would cost money. If I were charged a stormwater utility fee based directly on impervious surface area, this may incentivize me to remove it. This would likely meaningfully reduce the amount of runoff created by my property. However, removing 900 square feet of asphalt would not move me into a lower tier. I would be paying the same amount in SWU fees. So the pad is still there.

A more proportionate and rational SWU fee schedule would be more likely to withstand legal challenges and better serve the city's regulatory charge of reducing and treating runoff.

The illogic of Ann Arbor's SWU extends to the credit system. These credits were used by the city to argue that the SWU fee is voluntary, at least to the extent that the fee can be reduced. The Court found that the credit system does not make the fee voluntary. No amount of mitigation measures can result in credits that would eliminate or substantially reduce the fee.

I have installed a 1,500-gallon underground rainwater cistern and use the runoff from my roof for irrigation. If the cistern overflows, the water is directed into an underground drainfield of sand and perforated drain tile. For this effort, I receive a credit of $8.10 per quarter. This credit was not a factor in my decision to install this cistern and drainage system. It will be over 50 years before I recover the costs of installation. In fact, I would have received the same $8.10 per quarter credit for a much smaller (500-gallon minimum) cistern that overflows to the city storm drainage system. It is difficult to argue that such a credit system implies that the fee is voluntary or proportionate.

I am not complaining. I support Ann Arbor's use of a SWU and do not find the fees excessive.

However, a more proportionate and rational SWU fee schedule would not only be more likely to withstand legal challenges but also would better serve the city's regulatory charge of reducing and treating runoff.

Conclusion

The Platt decision generally affirms the constitutionality of stormwater utility fees, but SWUs may be successfully challenged if a court finds them not to meet the criteria of proportionality and voluntariness. Municipalities that wish to adopt their own SWU should design a program and fee schedule that is proportionate with the costs of maintaining the system relative to the stormwater management services provided to individual property owners.

Legislation has been introduced that would further legal support for SWUs. As of October 2024, this legislation is in committee. However, the proposed text may be useful in guiding the adoption of a SWU that would withstand challenges under the Headlee Amendment.

Stormwater Utility Fees can provide dependable dedicated revenue to manage stormwater infrastructure, reduce flooding, and improve the condition of natural water resources. While stormwater infrastructure may not be a high priority for many communities, the next big storm may reveal the consequences of not maintaining these systems. The adoption of a SWU should be earnestly considered by municipalities that don't yet have one and are struggling to fund public infrastructure. The recent Platt decision can provide some confidence that SWUs will hold up in court, but care must be taken to assure that SWU fees are proportional and reflect regulatory priorities.

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