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THE *DURANT* DECISION

In Brief

At the November 1978 general election, Michigan voters approved the Headlee Amendment to the State Constitution. Among other things, the amendment obligated the State to pay in future years the same proportion of costs for activities or services required of units of local government as the State paid in the year in which the amendment took effect. In 1980, a number of school districts and taxpayers filed suit (the *Durant* case) alleging that the State had violated this constitutional obligation as it related to elementary-secondary education.

On July 31, 1997, the Michigan Supreme Court held that special education programs are a State mandate and that the State had failed to fund such programs at the level required by the State Constitution. The Court also ordered the State to pay approximately $212 million in damages due to what the Court called the state's "prolonged recalcitrance" in refusing to comply with the Headlee Amendment.

The Supreme Court's decision brought to conclusion the judicial phase of *Durant*. Following the court's action, focus shifted to the executive and legislative branches to implement the Court's order. In November 1997, the elements of a financial settlement covering not only the plaintiffs, but other school districts similarly affected by the state's actions, were completed. The financial dimensions of the compensation to non-plaintiffs brought the total costs to the State to $844 million. In addition, the State approved school aid appropriations for Fiscal Years 1998 and 1999 that provided significant improvements in financial support for all districts.

Correcting the underfunding of special education programs is not the only Headlee Amendment issue which should concern the Governor and Legislature. An effort should be undertaken to identify and catalogue existing mandates imposed upon units of local government by the State, and to identify new mandates as they are adopted. In addition, the Legislature should invigorate the local government claims review board which it established in 1979. Although that board was established to evaluate mandate claims, it has met only once in 18 years. Finally, the Legislature needs to adopt amendments to its joint rules to establish a process to identify potential mandates, as required by the Headlee Amendment implementation legislation.

Background

At the November 1978 general election, Michigan voters approved a tax limitation amendment to the State Constitution. The amendment, generally referred to as the Headlee Amendment, amended Section 6 of Article 9 of the Constitution and added ten new Sections (25 through 34) to Article 9.

Section 29 of the amendment requires the State to pay in future years at least the same proportion of costs for activities or services required of units of local government as it paid in the year in which the amendment took effect. Specifically, the first two sentences of Section 29 of Article 9 provide as follows:

> The state is hereby prohibited from reducing the necessary costs of any existing activity or service required of units of Local Government by state law. A new activity or service or an increase in the level of any activity or service beyond that required by existing law shall not be required by the legislature or any state agency of units of Local Government, unless a state appropriation is made and disbursed to pay the unit of Local Government for any necessary increased costs.

The first sentence encompasses activities or services which were required of units of local government when the Headlee Amendment took effect; the second, activities or services which might be required thereafter. However, the two sentences share a common purpose: to prevent State policymakers from shifting to units of local government responsibility for services previously provided by State government.

Section 29 was thought to be necessary because a companion section of the Headlee Amendment limited State government revenues in any given year to a fixed percentage of total personal income in Michigan. Drafters of the Headlee Amendment anticipated that state policymakers might attempt to mitigate the effects of the State revenue limit by shifting to units of local government responsibility for programs previously funded by the State, in order to save the money the State would have needed to spend if it continued to provide such services. Section 29 was intended to forestall such attempts unless they were accompanied by State appropriations to fund the services transferred.

Anatomy of a Lengthy Lawsuit

In 1980, a lawsuit was filed in the Michigan Court of Appeals on behalf of seven taxpayers, including one Donald Durant, who resided in the Fitzgerald School District.[1] The essence of the lawsuit was that State officials had reduced the proportion of educational costs paid by the State to a level below that required by the Headlee Amendment. Over the next 17 years, the *Durant* case would beat a well-worn path between the Court of Appeals and the Supreme Court, culminating with a final decision by the high court on July 31, 1997.

The *Durant* case was, when filed, one of first impression, meaning that the issues involved were being raised for the first time. However, there was nothing inherently difficult about those issues, and certainly nothing to foreshadow the fact that it would take the courts nearly two decades to resolve them. What made *Durant* unique was an initial unwillingness of the Court of Appeals to hear the lawsuit and what the State Supreme Court referred to as the "prolonged recalcitrance" on the part of State officials in defending it.

An Unwilling Court of Appeals

The *Durant* case was filed in the Michigan Court of Appeals pursuant to Section 32 of Article 9 of the State Constitution. Section 32, which is a part of the Headlee Amendment, provides that "[a]ny taxpayer of the state shall have standing to bring suit in the Michigan Court of Appeals to enforce the provisions..." of the amendment.

The drafters' notes do not indicate why the authors of the Headlee Amendment chose the Court of Appeals as the forum in which taxpayers could bring original enforcement actions. As such, it cannot be determined whether the drafters anticipated the difficulty which that choice would produce.

That difficulty stemmed from the fact that the Court of Appeals is an appellate court. It was established not to handle complicated factual issues, which are often at the heart of taxpayer lawsuits, but to resolve issues of law raised on appeal from trial courts. Given the purpose which the Court of Appeals serves, the decision to assign to it responsibility to hear taxpayer lawsuits was arguably ill-advised. Nevertheless, that is the decision voters made when they adopted the Headlee Amendment and the Court of Appeals was obligated to act accordingly.

Instead, the Court of Appeals essentially refused to consider *Durant* on its merits, choosing instead on two separate occasions to dismiss the case on technical grounds. While it is true that the case raised a number of complex factual issues, the court was not without options for dealing with them. For example, both State law and court rules authorized the court to appoint factfinders when factual issues were in dispute. However, in the early stages of *Durant*, the Court of Appeals refused to consider factfinding as an option.

Finally, late in 1985, the Supreme Court ordered the Court of Appeals to appoint a factfinder, which the latter did in the spring of 1986. By this time, however, *Durant* had been underway for nearly six years. In effect, nearly a third of the time that

[1] Subsequently, two other lawsuits modeled after *Durant* also were filed in the Court of Appeals. These three cases were consolidated into a single proceeding, bringing the total number of plaintiff school districts to 84.

the case ultimately took to resolve was consumed, not by deciding the legal issues, but in forcing the Court of Appeals to accept its constitutional responsibility to hear taxpayer lawsuits.

A "Prolonged Recalcitrance"

A second factor which contributed to the length of *Durant* was what the State Supreme Court referred to as the "prolonged recalcitrance" of State officials in defending the lawsuit. When *Durant* was filed, the State had argued that the Headlee Amendment applied only to specific educational programs such as special education and not to elementary-secondary education in general as plaintiff school districts were contending.

The Court of Appeals and, subsequently, the Supreme Court agreed with the State. However, shortly after prevailing on that issue, the State reversed its position by arguing that special education *was not* subject to the Headlee Amendment after all. The state's revised position was based on the argument that special education was a federal, rather than a state, mandate.

This maneuver by the State did not escape the attention of the Supreme Court, which observed in its July 31, 1997 decision that

> the history of defendants' [the state's] conduct justifies the conclusion that the state has been derelict too long. Not only did defendants argue to this Court in 1985 that we ought to hold that Section 29 [of the Headlee Amendment] applied to specific activities like special education (in order to escape a larger burden for education as a whole) but, having received a favorable response on the larger burden, they reversed their position on special education.

Not only did the Supreme Court find the state's position on special education to be contradictory; it was also legally untenable after the Court of Appeals rejected it in 1990. Despite that ruling, however, the State stubbornly refused to abandon its position. In turn, this refusal directly contributed to extending the length of the case and to the Supreme Court's decision to order the State to pay damages. As that Court summarized the matter, "... defendants' prolonged recalcitrance in this case necessitates a substantial recovery aimed primarily at providing a remedy for the harm caused by underfunding."

The Complicated Issue of Damages

That the *Durant* plaintiffs sought monetary damages from the State was understandable. Both the State Court of Appeals and the Supreme Court had found that the State had unconstitutionally reduced its share of financing for special education programs. Given this fact, a remedy consisting only of judicial recognition that the State Constitution had been violated for 17 years running would have had been a hollow victory.

Indeed, as the Supreme Court observed, declaratory relief alone would have invited State officials to engage in future constitutional violations secure in the knowledge that no penalty would be imposed. That said, however, the issue of monetary damages was complicated by the question of against whom they should have been assessed and to whom they should have been paid.

Against Whom Should Damages Have Been Assessed?

The purpose of monetary damages is to compensate a plaintiff, on whose behalf a lawsuit is brought and successfully concluded, for the injuries suffered because of the actions of a defendant. In the case of *Durant*, the plaintiffs were 84 school districts and the named defendant was the State of Michigan.

However, the simple phrase *State of Michigan* encompasses a large number of public officials, elected and appointed, who comprise the three branches of State government. Conceptually, it might be argued that since the State Constitution was violated by State officials, those officials should have been held accountable. But the reality of the matter, given the nature of the violation in *Durant*, was that responsibility could not be lodged in any one State official, or even in a group of State officials. As the Supreme Court noted, *Durant* spanned three separate gubernatorial administrations.

In the absence of holding State officials personally liable for the *Durant* violations, awarding damages against the *State of Michigan* really meant awarding damages against the *taxpayers of Michigan*. Thus, one of the ironies of *Durant* was that a section of the Headlee Amendment intended to protect units of local government (local taxpayers collectively) was enforced in a manner that will cost State government (state taxpayers collectively) a judicially enforced $212 million plus a legislatively enacted total of $632 million.[2]

To Whom Should Damages Have Been Paid?

Another issue which the Supreme Court had to address was determining to whom damages should be paid, since it was not readily apparent which parties had actually suffered harm. For example, it might have seemed that damages were due those students who had been enrolled in special education programs which the State had failed to fund at the level required by the State Constitution. However, despite inadequate state funding, such programs were in fact provided, albeit at the expense of non-special education programs or local taxpayers who paid higher property taxes than might otherwise have been necessary.

Still, any argument that damages be paid to non-special education students or to local taxpayers had to confront the fact that neither group consists today of the same individuals as when the *Durant* litigation began. The non-special education students who were enrolled in kindergarten in plaintiff school districts in 1980 long ago graduated from high school. Similarly, many local taxpayers who had resided in those school districts might now reside elsewhere. In the end, the Supreme Court chose to award damages to the plaintiff school districts themselves, leaving it to the discretion of each school district to decide whether to distribute any relief to local taxpayers.

Unfinished Business

The Supreme Court's decision brought to conclusion what may be viewed as the judicial phase of *Durant*. However, correcting the underfunding of special education programs is not the only Headlee Amendment issue which should concern the Governor and Legislature.

The State Mandates Issue

As has been noted, the *Durant* case concerned special education and certain other specific education programs that the State requires school districts to offer. However, mandates imposed by State government upon units of local government extend far beyond special education, or school districts. As such, there are two problems which require legislative attention.

First, the number and type of existing mandates need to be identified and catalogued. In January of 1980, the Michigan Department of Management and Budget compiled such a list, but it has not been updated. Obviously, without knowing what mandates already exist, State policymakers cannot determine whether those mandates are being funded at the level required by the State Constitution. To the extent that an existing mandate is being underfunded, another *Durant* may wait in the wings.

Second, because Section 29 of the Headlee Amendment applies not just to existing mandates, but also to new ones, a system needs to be devised for identifying and cataloguing the latter. That need is pressing because in any given two-year legislative session, hundreds

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[2] The paradox of assessing damages against state taxpayers to compensate local taxpayers was the principal reason why the Supreme Court limited its award of damages to three years (State Fiscal Years 1991-92, 1992-93, and 1993-94) and refused to include additional years as the Court of Appeals had ordered. The Supreme Court observed that its aim was "to give the local taxpayers and students meaningful redress (to 'enforce' Section 29) without undermining the current security enjoyed by the state taxpayers." As to why damages were limited to the three-year period in question, the Court indicated that it began "... this period with the first year after the Court of Appeals ruled on the issue of liability in this case. Before that point, defendants had not had a ruling from the Court. We end it with the change in method of financing public education [brought about by voter approval of Proposal A in March of 1994]. After the change, local taxpayers are much more likely not to have suffered harm."

of bills are adopted into law. Each new law has at least the potential for creating new mandates.

It is noteworthy that less than a year after the Headlee Amendment was adopted, the Legislature anticipated and sought to address the difficulty of identifying new mandates. Section 7 of Public Act 101 of 1979, which implemented the amendment, requires the Legislature to "establish joint rules to provide for a method of identifying whether or not legislation proposes a state requirement as described in this act." Section 7 also requires that an estimate be made of the costs of the new mandate for the first three fiscal years that the new law is in effect. Unfortunately, to date neither house of the Legislature has established the joint rules required under Section 7 of Act 101.

The Local Government Claims Review Board

Finally, State policymakers should undertake steps to invigorate the local government claims review board. That board was established by Public Act 101 of 1979 to hear claims filed by units of local government pursuant to Section 29 of the Headlee Amendment. To conclude that the local government claims review board has been ineffective would be a gross understatement given that it has met only once in 18 years.

A functioning local government claims review board could serve a valuable purpose by resolving some claims short of litigation, and by providing the Court of Appeals with an evidentiary record in instances where litigation did ensue. The need for a review board will remain regardless of the resolution of *Durant* since there is no reason to believe that Headlee Amendment claims will not arise in the future.

Elements of The Financial Settlement

In recognition that school districts not directly plaintiffs in the *Durant* case and, therefore, not eligible to receive a portion of the payments ordered by the Supreme Court nonetheless may have had claims for comparable compensation by the State, as a matter of fairness the State sought a financial solution to the issue for both the plaintiffs and all other districts similarly situated. The following is the basic elements of the settlement.

Plaintiffs in the Durant Case

Approximately $212 million will be paid to the 84 plaintiff districts on April 15, 1998. The funds will be withdrawn from the State's rainy day fund (Budget Stabilization Fund) to finance the payments.

Non-Plaintiff Districts

Approximately 500 districts are potentially affected by a portion of the solution aimed at non-plaintiff districts. In order for a district to participate in the settlement, it must agree to waive any claim against the State. In return, payments totaling the estimated amount that it would have received had the district been a plaintiff in the suit will be made by the State.

Approximately $632 million will be paid in total if all districts agree to waive State liability. Waivers must be filed no later than March 2, 1998.

Unlike the payments to the plaintiffs, the State has placed restrictions on the use and timing of the payments to non-plaintiff districts.

- In general, districts will receive half their settlements in cash and half in support for bonded expenditures.

Cash payments will be made in ten equal annual installments beginning November 15, 1998. Funds must be used for technology, technology training, infrastructure, textbooks, instructional software, buses, security, or to retire debt. The constraints are intended to preclude a district from increasing its spending base by increasing pay rates and other ongoing operational expenditures. A public hearing is required to inform taxpayers of the disposition of the funds.

Districts may use the *bonding payments* for new bonds to acquire technology or infrastructure through the Michigan Municipal Bond Authority. Districts may also choose to retire existing debt or place payments in a sinking fund for future building projects. The bonding payments will be made over a fifteen year period beginning May 15, 1999.

- Districts with amounts totaling less than $75,000 for the entire period will receive a single payment fulfilling the settlement.

The payments in Fiscal Year 1998-99 will be funded from the State's rainy day fund. In subsequent years, the cash portion of the settlement, about $32 million each year, will be paid from the rainy day fund. The bonding payments will be made from School Aid Fund resources.

The Broader Picture

The *Durant* settlement was achieved as a part of a broader set of financial concessions and commitments agreed to by the State and representatives of the local school districts. The financial concessions by the State will generate a larger favorable financial effect on districts' budget than the direct *Durant*-related payments and the State was able, as a part of the settlement, to implement a revised payment schedule that relieves its critical cash flow problems. The principal components of the agreement are as follows:

- The State approved a two-year appropriation for school aid including additional funding for Fiscal Year 1997-98 and decreases in local district budget requirements by reducing the employers share of retirement contributions beginning in Fiscal Year 1997-98.

The additional 1997-98 funding, totaling nearly $100 million, is primarily in the areas of special education and at-risk programs.

The retirement savings are achieved by fully reflecting the very large increase in the value of the retirement fund portfolio through September 30, 1997 and by reducing the assumed rate of increase in employee salaries in the future from five to four percent per year. These savings are being passed along to the districts and will result in more than $300 million of cost reductions annually that may be redirected to other areas in local districts budgets.

The Fiscal Year 1998-99 school aid appropriations include additional funding for enrollment growth, special education cost increases, at-risk programs, and class size reduction pilot programs.

- In the current fiscal year, the State's heavily front-loaded schedule of payments to school districts will be modified.

For the last several years more than 95 percent of the annual appropriation was paid in the first nine months of the State's fiscal year while roughly 75 percent of the revenues supporting these payments were collected during the same period. The 20 percent gap between payments and receipts would build to more than $1.5 billion by the end of June, the final month in the school districts' fiscal year.

Ten payments will be made during the months of October 1997 through July 1998 and in the next fiscal year eleven equal payments will be made in the months October through August. This change will improve significantly the State's cash position from the seasonal low point in the last days of June and early July. A modified payment schedule likely would have been required in the future if the State were to deplete the rainy day fund during an economic downturn. This improvement in the State's cash flow was recently cited as a factor in the State's bond rating upgrade by Standard & Poors.

The dramatic improvement in the State's cash position resulting from the payment schedule change worsens the aggregate cash position of the school districts dollar for dollar. The result will be a combination of reduced short-term investment earnings and increased short-term borrowing with attendant borrowing costs. Generally, school districts are in a stronger cash position than the State and should be able to manage the cash flow losses without significant adverse programmatic effects, especially given the increased State resources provided through the reduced retirement contributions and other state aid increases. However, some individual districts likely will experience difficulties managing their cash requirements and will require short term borrowing to make timely payments during some parts of the year. To ease the potential problems for the districts, the State made provision for limited emergency advances of state aid to smooth the impact of the payment schedule changes on the most seriously cash-strapped districts.

The *Durant* settlement payments for the 84 *plaintiff* districts could be passed along to district taxpayers if individual district boards chose to do so. The practical problems of determining the appropriate payments to taxpayers combined with the financial pressures most local school board members perceive make this action unlikely. For *non-plaintiff* districts the Legislature either assumed that no district would choose to share the windfall with local taxpayers or that such an action would be unacceptable from a State standpoint. Consequently, repaying taxpayers was not included by the Legislature as one of the permitted uses of the payments. However, by permitting districts to use the payments to retire existing debt, the current taxpayers could benefit through reduced millage rates for debt service.

It seems likely that most and perhaps all non-plaintiff districts will agree to waivers and accept the State's settlement, since it is unclear that anything could be gained from holding out. Regardless of whether a few districts fail to agree, this peculiar chapter in the State's relationship with the public school system is at a close and the protection provided to local governmental units by the Headlee Amendment has finally proved to be effective.