



CRC MEMORANDUM



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STATEWIDE BALLOT ISSUES: PROPOSAL 2012-01 REFERENDUM ON PUBLIC ACT 4 OF 2011 THE LOCAL GOVERNMENT AND SCHOOL DISTRICT FISCAL ACCOUNTABILITY ACT

CRC's Analysis of State Ballot Issues

This paper is one in a series of papers that analyze the six questions Michigan electors will be voting on at the November 6, 2012, general election. The papers, information about webinars, links to the actual proposed amendments, and ballot language can be accessed at <http://election.crcmich.org>. The Citizens Research Council of Michigan does not endorse candidates for office or take positions on ballot issues. In analyzing these ballot issues, CRC hopes to provide more information so that voters can make better informed decisions in formulating their vote.

Public Act 4 of 2011 (PA 4) is the Local Government and School District Fiscal Accountability Act. It is the third iteration of Michigan laws that allow the state to appoint an emergency manager who has authority over the financial decisions of a financially distressed local government, and it extends the authority of the appointed emergency manager to the non-financial operations of the local government. This act allows state appointed managers to assume the responsibility of locally elected officials, and grants those appointed managers more powers than locally elected officials have. Among the expanded powers granted to emergency managers under PA 4 are the authority to reject, modify, or terminate one or more of the terms of an existing contract and, under specified conditions, to reject, modify, or terminate one or more of the terms and conditions of a collective bargaining agreement.

Article II, Section IX of the Michigan Constitution reserves to the people the right to subject a law to referendum by distributing petitions to be signed by registered voters who number not less than five percent of the amount of votes cast for all candidates for governor at the last election. The State Board of

Canvassers has ruled that sufficient signatures have been gathered and an initiated referendum petition to repeal Public Act 4 of 2011 was placed on the November 6, 2012 statewide ballot.

On August 8, when the state Board of Canvassers placed the issue repealing PA 4 of 2011 on the November 6, 2012 ballot (as it was directed to do by the Michigan Supreme Court), PA 4 was suspended, in accordance with Article II, Section 9 of Michigan's Constitution. Should a majority of electors vote "Yes" on the referendum, the law will be reinstated. Should a majority of electors vote "No," PA 4 will be repealed. Public Act 4 of 2011 can be accessed at <http://legislature.mi.gov/doc.aspx?2011-HB-4214>.

It is the operative position of the state that the preceding iteration of the law, PA 72 of 1990, was revived when PA 4 was suspended: PA 72 was repealed when PA 4 became effective, but the repeal became ineffective when PA 4 was suspended. PA 72 does not allow emergency financial managers to abrogate contracts or collective bargaining agreements, nor does it provide certain other powers contained in PA 4.



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PROPOSAL 2012-01 A REFERENDUM ON PUBLIC ACT 4 OF 2011 THE EMERGENCY MANAGER LAW

Public Act 4 of 2011 would:

Establish criteria to determine the financial condition of local government units, including school districts.

Authorize state-appointed review team to enter into a consent decree with a local government, with local government approval.

Authorize Governor to appoint an emergency manager (EM) upon confirmation of a financial emergency, and allow the EM to act in place of local government's governing body and chief administrative officer.

Require EM to develop a financial plan and issue orders to resolve the financial emergency, including modification or termination of contracts and collective bargaining agreements.

Repeal Public Act 72 of 1990.

Should this law be approved?

YES

NO

History

The forms and rights of local governments are dictated in state law and vary widely among states. Michigan, New York, Pennsylvania, and Rhode Island have been the most active in intervening in the affairs of general purpose local governments (the 1975 state takeover of New York City's finances remains the most famous example). Michigan is one of 26 states that permit their municipalities to file for bankruptcy under federal law.

The State of Michigan has adopted a number of statutes that are intended to ensure that its local units of government do not incur financial emergencies or that are designed to assist financially distressed local governments.¹ All of these statutes focus on

the local government's budget, revenues, and expenditures; none address underlying causes such as erosion of the tax base, or establish minimum required public service levels to protect residents' health and wellbeing.

PA 4 of 2011 is the latest and the most intrusive version of Michigan laws that allows state appointment of a manager who has extraordinary powers over a local unit of government that is found to have a financial emergency. The initial statute in this progression, PA 101 of 1988, was adopted in response to the court appointment of a receiver with ill defined authority to address a financial emergency in the City of Ecorse. PA 101 established a uniform statewide approach to identify and address extreme financial distress in local general purpose governments, including the appointment of emergency financial managers. The next iteration, PA 72 of 1990,

¹ Including, but not limited to, PA 2 of 1968, the Uniform Budgeting and Accounting Act; PA 243 of 1980, the Emergency Municipal Loan Act; PA 80 of 1981, the Fiscal Stabilization Act; and PA 34 of 2001, the Revised Municipal Finance Act.

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extended somewhat modified provisions of PA 101 to school districts: PA 72 applied to cities; villages; townships; counties; authorities established by law; public utilities owned by cities, villages, townships or counties; and school districts. Under PA 72, emergency financial managers were appointed in the following units of government:

City of Hamtramck (2000)
City of Highland Park (2001)
City of Flint (2002)
Inkster Public Schools (2002)
Village of Three Oaks (2008)
City of Ecorse (2009)
City of Pontiac (2009)
Detroit Public Schools (2009)
City of Benton Harbor (2010)

In recent years, Michigan local governments, including school districts, have come under increased financial pressure as a result of the national recession and the reorganization of the manufacturing, and particularly the automotive, sector. These conditions have had significant local effects: declining property values; high unemployment and wage freezes; and weak sales. This has reduced local government revenues from property taxes (the sole local tax for most general purpose governments) and municipal income taxes (22 Michigan cities impose municipal income taxes). Tax limitations in the state constitution and state statutes, in some cases in local charters, as well as political challenges, have affected local government's ability to raise tax rates or increase tax revenues. In addition, state budget challenges have resulted in decisions to reduce the amount of state shared revenues to local governments and local school districts.

At the same time that revenues declined, some local governments were faced with growing unfunded pension and other retiree costs, increased financial obligations associated with contractual collective bargaining agreements, and in some cases, increases in limited tax debt service payments. All of these pressures made expenditure reductions very difficult. Adding to local government challenges, the weak economy in some communities increased de-

mands for specific locally provided public services.

PA 72 was replaced by PA 4 in part to strengthen local officials' resolve to meet the heightened challenges imposed by the recession and slow recovery and in part to address perceived weaknesses in the statute. While the general process that was contained in the previous laws was retained, the threshold for state intervention was lowered, the authority of emergency managers was expanded to include operations, and local control was further eroded. In the extreme event under PA 4, the continued existence of the local government could be placed in jeopardy: emergency managers appointed to municipal governments may, with approval of the governor, disincorporate or dissolve the municipal government.

When PA 4 was enacted in 2011, it retained the process that was established in the earlier acts: trigger events and preliminary review; appointment of a review team authorized to negotiate a consent agreement; a limited set of possible recommendations if a consent agreement is not reached; local government right of appeal; state appointment of an emergency manager with specified powers and duties. The differences between PA 72 and PA 4 are the subject of CRC Report 368, *The Local Government and School District Fiscal Accountability Act, PA 4 of 2011*, published in April, 2011 and available at no cost on the CRC website.²

One assumption contained in PA 101, PA 72, and PA 4 is that very difficult changes may be needed to regain financial stability, and that these changes cannot or will not be made by locally elected officials absent the real threat of state takeover. Another assumption underlying all three iterations is that a demonstrated financial emergency, as defined in state law, justifies a state takeover. The great departure in PA 4 is the granting of powers to emergency managers that are significantly greater than those that may be exercised by locally elected officials and the extension of those powers into every aspect of the local government.

² See CRC Report #368, *The Local Government and School District Fiscal Accountability Act, PA 4 of 2011*, www.crcmich.org/PUBLICAT/2010s/2011/rpt368.html.

Major Components of PA 4

Consent Agreements

Under PA 4, state-appointed review teams may negotiate consent agreements with local units of government that have been found by the state Treasurer or, in the case of school districts, the state Superintendent of Public Instruction, to have a financial emergency. Locally elected officials remain in place and are responsible for implementing the consent agreement. Consent agreements may include a continuing operations plan developed by local officials or a recovery plan that supersedes the local budget and appropriations ordinance and is developed by the state financial authority. The act specifies the terms and conditions for the plans. Those agreements may include granting to a local official or governing body nearly all of the powers that would be available to an emergency manager. The only power that cannot be bestowed in a consent agreement is the power to abrogate collective bargaining agreements. However, 30 days after a consent agreement is adopted, the local government becomes exempt from the state requirement to bargain with the representatives of employees; after union contracts expire, the local government is not required to bargain and may impose employment terms. (The consent agreement reached with the City of Detroit required the imposition of employment terms after the expiration of most union contracts on June 30, 2012.) Under PA 4, the consent agreement may grant a local official or governing body the power to reject, modify, or terminate one or more terms and conditions of a contract prior to expiration of the contract (collective bargaining agreements are treated differently than contracts).

Emergency Managers

If a financial emergency exists and no acceptable consent agreement can be negotiated, or if there is a material breech of a consent agreement, the governor "shall declare the local government in receivership and shall appoint an emergency manager to act for and in the place and stead of the governing body and the office of chief administrative officer of the local government." These state-appointed emergency managers may remove essentially all author-

ity from locally elected officials. Emergency managers are empowered to, among other things, abrogate contracts; sell assets; renegotiate debt; assume control of pension funds that are not actuarially funded at 80 percent or more excluding the value of pension bonds or certificates; recommend consolidation with another local government; or with the governor's approval, disincorporate or dissolve the local government or file for bankruptcy under federal law.

An emergency manager is to "act as the sole agent of the local government in collective bargaining with employees or representatives and approve any contract or agreement. Furthermore, an emergency manager may reject, modify, or terminate one or more terms and conditions of an existing collective bargaining agreement "after meeting and conferring with the appropriate bargaining representative and, if in the emergency manager's sole discretion and judgment, a prompt and satisfactory resolution is unlikely to be obtained." Public Act 4 states that this is "a legitimate exercise of the state's sovereign powers" if four specified conditions are satisfied:

- (i) The financial emergency in the local government has created a circumstance in which it is reasonable and necessary for the state to intercede to serve a significant and legitimate public purpose.
- (ii) Any plan involving the rejection, modification, or termination of 1 or more terms and conditions of an existing collective bargaining agreement is reasonable and necessary to deal with a broad, generalized economic problem.
- (iii) Any plan involving the rejection, modification, or termination of 1 or more terms and conditions of an existing collective bargaining agreement is directly related to and designed to address the financial emergency for the benefit of the public as a whole.
- (iv) Any plan involving the rejection, modification, or termination of 1 or more terms and conditions of an existing collective bargaining agreement is temporary and does not target specific classes of employees.

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PA 4 grants these extraordinary powers as a tool to rebalance local budgets characterized by eroded revenues and costs fixed by collective bargaining agreements that are no longer affordable, or by corruption, or by irresponsible decisions. Objections to this grant of extraordinary power focus on the loss of local control, the effect on voting rights (thus far, most of the entities for which emergency managers have been appointed are predominately African-American), and interpret the extraordinary powers granted to emergency managers as a threat to democracy. Objections also focus on the threat to collective bargaining rights and to public sector unions.

The "threat to democracy" can be defined as taking control away from locally elected officials and investing that control in an unelected official who is not directly responsible to residents of the local unit. It could also be argued, however, that a threat to democracy occurs when local elected officials fail to manage at a minimally acceptable level, fail to be adequate stewards of the public trust, and fail to avoid a financial emergency. In this interpretation, democracy is protected by statewide elected officials who must step in to correct the local problem and protect the larger political entity.

Michigan citizens have provided in the state constitution for a level of home rule, subject to that constitution and state statutes. Article VII, Section 22 of the Michigan Constitution states "Under general laws the electors of each city and village shall have the power and authority to frame, adopt and amend its charter, and to amend an existing charter of the city or village heretofore granted or enacted by the legislature for the government of the city or village. Each such city or village shall have the power to adopt resolutions and ordinances relating to its municipal concerns, property and government, subject to the constitution and law. No enumeration of powers granted to cities and villages in this constitution shall limit or restrict the general grant of authority

conferred by this section." Thus, "local control" is not an absolute right, but rather is defined in, and may be changed by, state law. PA 4 and associated statutes changed the legal definition of local control in Michigan.

The collective bargaining rights of public sector employees are defined by each state for that state and its local governments. Article XI, Section 5 of the Michigan Constitution provides state police troopers and sergeants with the constitutional right to collective bargaining. These are the only public employees in Michigan with constitutionally protected collective bargaining rights. The collective bargaining rights of all other public employees in Michigan are contained in PA 336 of 1947, as amended, the Public Employment Relations Act (PERA). As noted, PA 4 empowers emergency managers to abrogate collective bargaining agreements under specified conditions. In situations where local officials have adopted a consent agreement, the local government is exempted from the PERA requirement to bargain with representatives of employees 30 days after that consent agreement is approved. At that point, collective bargaining agreements may be allowed to expire and need not be renegotiated: new employment terms including cuts in wages and changes in benefits and work rules, may be imposed. Thus, for local governments in a financial emergency, which may or may not be caused by, or exacerbated by, the refusal of unions to accept concessions that would reduce expenses, public sector union rights are seriously affected.

Proposal 2012-02, which seeks to amend the state constitution to guarantee the right to organize for the purpose of collective bargaining with public and private employers, will also appear on the November 6, 2012 ballot. Should that proposal be approved and PA 4 be reinstated, provisions in PA 4 that allow an emergency manager to abrogate collective bargaining contracts would be voided.

Effect of Suspension of PA 4

The Michigan Attorney General issued an opinion stating that PA 72 of 1990, which was repealed and replaced by PA 4, was immediately reinstated when PA 4 was suspended.

Some opponents of PA 4 contend that the repeal of PA 72 was valid regardless of whether the act that repealed it was suspended, and that suspension of PA 4 means there is no authorization for emergency managers, emergency financial managers, or consent agreements. Some opponents hope that actions taken under PA 4, such as the imposition of employment terms under the Detroit consent agreement, will be voided.

On the date the issue was placed on the ballot, emergency managers were in place in the following units of government:

Detroit Public Schools (March 2009)

City of Pontiac (March 2009)
City of Ecorse (October 2009)
City of Benton Harbor (April 2010)
City of Flint (November 2011)
School District of the City of Highland Park (January 2012)
Muskegon Heights School District (April 2012)

After PA 4 was suspended, the Local Emergency Financial Assistance Loan Board reappointed emergency financial managers under PA 72 (because the emergency manager in Flint did not qualify under PA 72, a new emergency financial manager was appointed in that city).

Also at the time PA 4 was suspended, the following units of government were operating under consent agreements:

City of River Rouge (October 2009)
City of Inkster (February 2012)
City of Detroit (April 2012)

Alternative Approaches to Local Financial Emergencies

Local governments are creatures of the state, and state governments are responsible for oversight of those local governments. If PA 4 or some variation of PA 4 were not employed by the state government to address local financial emergencies, some other approach would be required, and this would almost certainly require state enabling legislation. The following list of approaches is not exhaustive, but illustrates the options that might be employed.

One possibility is to allow another means for insolvent local governments to file for reorganization of debt and financial obligations under Chapter 9 of the federal bankruptcy code. Only 26 states allow their municipalities to file under Chapter 9, and in Michigan that can only occur if an emergency manager recommends that course of action and the state agrees. PA 4 seeks to avoid the use of municipal bankruptcy by giving emergency managers many of the powers that are available in the federal process. Filing for bankruptcy would protect the local government from lawsuits during the proceedings and could result in restructuring debt and other post employment benefits and rewriting collective bar-

gaining agreements. Effects on pension obligations are unknown, but bondholders, employees, and retirees could be negatively affected. Bankruptcy is expensive and unpredictable, and the collateral damage to other municipalities and to the state could be significant.

Under current constitutional provisions, the state cannot mandate increases in local taxes, but the state could rely on the courts to enforce contracts. Unpaid employees, retirees, vendors, or bondholders would sue the offending local government and that government could be forced by the court to impose on taxpayers judgment levies sufficient to pay the debt. In this case, taxpayers would be held directly responsible for the fiscal decisions of their elected officials.

The state might authorize a method to impose a deficit elimination levy or special assessment that would impose a tax or fee on property taxpayers to retire a local government deficit. Or the state could authorize and/or purchase unlimited tax deficit elimination bonds to be repaid by property taxpayers.

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This tactic might be effective in the case of a one-time event that caused a financial emergency, but would not be effective over the longer term in cases of chronic mismanagement or long term economic decline.

The state could establish oversight or advisory committees, as it has done under the consent agreement with Detroit, Inkster, and River Rouge, to assist local officials in making financial decisions, though without threat of a state takeover or loss of state-source revenues, such committees would have far less influence.

The state could make state-source revenues such as the economic vitality incentive program (formerly known as statutory state revenue sharing) contingent on local governments avoiding deficits. This would increase the risks associated with bad financial management and could exacerbate local fiscal problems.

The state could impose model charters on local units of government that are judged to have dysfunctional locally adopted charters that contribute to structural deficits. Imposition of a model charter by the state could remove some local barriers to increasing taxes or reducing expenditures. One definition of "local control" is the ability of local residents to write a charter within constraints set in state statute; this option would remove that local control over its foundational document if that government had a financial emergency.

The Michigan Constitution protects the accumulated pension rights of state and local government em-

ployees, but prospective benefits may be bargained. The state could limit pension funding assumptions as a means to ensure adequate funding, or it could assume management of severely underfunded pension systems, and divert state revenue sharing and other payments directly to those pension funds until a specified funding threshold was met (80 percent is one standard). The intent of this strategy would be to encourage local officials to negotiate more affordable plans, such as defined contribution or blended plans.

If it were considered to be in the state's best interest, the legislature and governor could prohibit certain expensive practices by local governments, such as providing retiree health insurance. State statutes could exclude more subjects from collective bargaining in an effort to help local officials control costs. A more extreme strategy would eliminate collective bargaining for all or most public employees (extending that to state police troopers and sergeants would require a constitutional amendment). (Proposal 2012-02 seeks to amend the state Constitution to guarantee public sector collective bargaining rights).

Cities, villages, townships, counties, and school districts are all "creatures of the state" with the rights allowed, and restrictions imposed, by the state. A more universal approach to local government financial distress would shift responsibility for functions among governmental units, and could alter the flow of funds among governmental units to create more regional (and more economical) service delivery systems with larger tax bases.

Conclusion

A number of local governments are in financial distress, and may not be able to keep promises made to retirees, employees, residents, local businesses, vendors, and bondholders. The national and global economic conditions that have caused much of this distress are not controllable by locally elected officials. Local elected officials are nonetheless respon-

sible for ensuring that that government's expenses do not exceed revenues, and the state is responsible for ensuring that local governments avoid financial collapse. On November 6, the voters will decide if PA 4 is the appropriate means by which the state meets its obligation.