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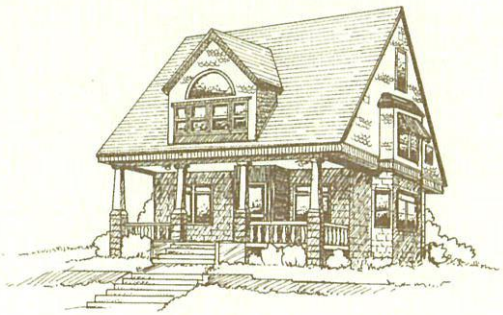

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September 6, 2023

Rob Middlemis-Brown, Supervisor
Sherman Township
8872 Second Street – Gay
Lake Linden, MI 49945

via email: shermantwpsupv@gmail.com

Dear Supervisor Middlemis-Brown:

I have examined the questions and issues surrounding Sherman Township's water and sewer system that we recently discussed by telephone. The first question relates to the terms on which Sherman Township sold the former Gay School property to the Keweenaw County Historical Society for use as a museum in or about 2008, according to the documents I was provided. Sherman Township offered two proposals. Proposal A included payment of $10,000, plus "the Township will provide sewer, water, and garbage services at no cost to the Historical Society for as long as they occupy the school." Proposal B offered to sell the School for $5,000, but required the Historical Society to pay all sewer, water and garbage charges, which totaled approximately $1,126 per year at that time. The Historical Society accepted Proposal A. It is my understanding that the Historical Society paid connection charges for water and sewer, but that Sherman Township has been providing water and sewer service without charge since then. You estimated that the Historical Society connected to the water and sewer systems in approximately 2011, so this practice has been ongoing for approximately 12 years. You inquired whether Sherman Township can lawfully provide water and sewer service to the Historical Society without charge.

Section 4.1 of Sherman Township's Water Ordinance 1-07 provides:

> The rates and charges shall be designed to provide revenues which are proportionate to the cost of providing water service to the users of the System. Such cost shall include but not be limited to the cost of construction,

> improvements, operation, maintenance, replacement, depreciation, administration and a rate of return on the System's investment. **No free water service shall be furnished to any user of the System**. The Township Board shall establish a schedule of water rates, deposits, fees, penalties and charges for services. This schedule shall be adopted by resolution and may be amended from time to time by the Township. (Emphasis added.)

Similarly, Subdivision 1101 of Sherman Township Sewer Ordinance 2-02 provides in pertinent part, "no free service will be granted." Subdivision 1102 further provides:

> The Township Board shall at least annually determine and fix by resolution, the unit costs for use of the Wastewater Disposal System Facilities on the basis of use or; flow; BLOD; SS; or any other pollutant, taking into consideration the cost of treatment of such sewage and may increase or decrease such unit cost as often and in such amounts as may reasonably be required to accomplish the purposes of this section.

The Ordinance provisions prohibiting free water or sewer service are derived directly from the Revenue Bond Act, MCL 141.101, et seq. The Revenue Bond Act authorizes a public corporation, including a township, to construct and operate sewage disposal systems and water supply systems, among numerous other public improvements. Its provisions apply regardless of whether a municipality finances the public improvements by issuing bonds. *Seltzer vs. Sterling Township,* 371 Mich 214; 123 NW2d 722 (1963). Many of the provisions within this Act were adopted to help assure that the utility system is self-sustaining from charges and revenues generated, and to assure adequate funds for payment of bond obligations. Section 118(1) of the Revenue Bond Act provides:

> Except as provided in Subsection (2**), free service shall not be furnished by a public improvement to a person, firm, or corporation, public or private, or to a public agency or instrumentality**. The reasonable cost and value of any service rendered to a public corporation, including the borrower, by a public improvement shall be charged against the public corporation and shall be paid for as the service accrues from the public corporation's current funds or from the proceeds of taxes which the public corporation, within constitutional limits, is hereby authorized and required to levy in an amount sufficient for that purpose, or both, and those charges, when so paid, shall be accounted for in the same manner as other revenues of the public improvement. MCL 141.118(1) (emphasis added).

The exception referred to in Subsection 2 of Section 18 of the Revenue Bond Act applies to hospitals and health care facilities providing care to the indigent, and has no applicability to

Sherman Township's water or sewer systems. Consequently, it is my opinion that the portion of the contract with the Keweenaw County Historical Society to provide free water and sewer service for as long as they occupy the former Gay School violated the Township's Water Ordinance, Sewer Ordinance, the Revenue Bond Act, and was therefore unlawful.

This principle was also recently discussed and reaffirmed by the Michigan Court of Appeals in *City of Highland Park vs. State Land Bank Authority,* 340 Mich App 593; 986 NW2d 638 (2022). There, the State Land Bank Authority, which is exempt from paying certain fees on properties it acquires through foreclosure for non-payment of taxes, argued that it was not required to pay storm water system charges under the City of Highland Park's applicable ordinances or the Revenue Bond Act. The Court of Appeals disagreed, citing the same section that disallows free water or sewer service.

The inquiry does not end here, however, because the Historical Society accepted the Township's offer, purchased the School for $5,000 more than it would have paid under Proposal B, made improvements to the property, and has continued to occupy the property as a museum since connecting to the water and sewer systems. In short, the Historical Society appears to have complied with all terms under the contract. It is therefore necessary to determine whether the contract remains enforceable.

Michigan law distinguishes between municipal actions that are unlawful due to defects in the manner enacted, from acts that are unlawful because they are outside the authority of the governmental body to enact. *DiPonio vs. Garden City,* 320 Mich 230; 30 NW2d 849 (1948). *Parker vs. Township of West Bloomfield,* 60 Mich App 583; 231 NW2d 424 (1975). Stated differently, if the subject matter of an act or a contract is within the scope of a municipality's authority but that authority was exercised in an irregular or deficient manner, the act or contract may be ratified and enforced. *Parker vs. Township of West Bloomfield, supra.* In contrast, if the municipal body approves action or enters a contract where it specifically lacked authority to do so, it will be considered "ultra vires," void and unenforceable. One authoritative municipal legal treatise summarizes the law on this subject:

> Contracts which a municipal corporation is not permitted legally to enter into are not subject to ratification, and a city may not be estopped to deny the invalidity of a contract that is ultra vires in the sense that it is not within the power of the municipality to make. In other words, no ratification or estoppel can make lawful a municipal contract which is beyond the scope of the corporate powers, or which is not executed in compliance with mandatory conditions prescribed in the charter or statutes, or which is contrary to a declared policy adopted to protect the public. The notice imputed to all persons dealing with a municipal corporation of the limits of its powers, is in

> some cases advanced as the reason upon which these rules are based. A member of the public who deals with the municipal corporation and profits thereby is responsible for knowing whether the person he or she is dealing with has the authority to contract away public property. Thus, persons who contract with the government do so at their peril when they fail to take notice of the agent's authority. A contract cannot be ratified if it violates an express provision of the constitution, or of the statutes, charter or other laws. … McQuillin Mun. Corp. Section 29:110(3d ed.).

In our case, granting free water and sewer service to the Historical Society violates two Township ordinances and at least one state statute. The Township Board's action surpassed the scope of its legal authority, and constituted more than just a procedural irregularity in its adoption. In my opinion, that portion of the action awarding water and sewer service free of charge is ultra vires and unenforceable. In *Village of Reed City vs. Reed City Veneer and Panel Works*, 165 Mich 599 (1911), a committee of the Village of Reed City entered a contract with Reed City Veneer and Panel Works in which the Village would expend $10,000 to purchase land and build a factory that would employ 40 workers with a total average payroll of $20,000 per year, and would donate the land and building to the private corporation at the end of five years. The factory burnt down and a dispute arose regarding entitlement to fire insurance proceeds. The court concluded that the original contract to gift public assets was invalid, and that the insurance proceeds should be paid to the Village under the facts of that case.

Similarly, in *Knights of the Iron Horse vs. City of Detroit*, 300 Mich 467; 2 NW2d 466 (1942), the plaintiff, a nonprofit organization, argued that the City of Detroit agreed that if plaintiff purchased a number of new trucks, the City would rent those trucks for 30 months at a specified rate and minimum number of hours per week. The plaintiff attempted to enforce this arrangement under various theories, including contract, "moral obligation," or estoppel. The Michigan Supreme Court concluded that such an agreement would violate the City of Detroit's charter, that the City lacked legal authority to enter into a contract on these terms, and that a contract, if made, was unenforceable, even though the plaintiff purchased the trucks in reliance on discussions with the City.

There are numerous other cases in which municipal entities have entered contracts that violated some provision of law or otherwise exceeded their scope of legal authority. The courts have generally found these contracts or agreements to be void and incapable of enforcement.

Consequently, I recommend that Sherman Township notify the Keweenaw County Historical Society that it can no longer honor the prior agreement to provide free water and sewer service. Only this portion of the agreement is directly unlawful under the Revenue

Bond Act or the Township's ordinances. Sale of the property is not affected, for example. If Proposal B was selected, this question would not have arisen. Under Proposal A, it was estimated that the combined cost of water, sewer and garbage service totaled approximately $1,126 per year. I do not have a break down for the cost of garbage service. Nonetheless, the free water and sewer service has been in place for approximately 12 years. The Historical Society paid $5,000 extra for the School property in order to receive these free services. It seems virtually certain that the Historical Society has received more than $5,000 of free water and sewer service over the intervening years. It could be argued that the $5,000 additional payment was an advance payment of future services for some period of time, reduced to an actuarial present value. Under this approach, the Historical Society would only be receiving "free" services once the prepayment of future services was used up. That date would depend not only on the value of those charges, but also on the interest rate used to calculate an estimated present value.

There may also be an argument that once the prepayment was used up, the Township may have the legal right to demand reimbursement for the difference. In no event could a claim for reimbursement recover charges incurred more than six years ago, however. This type of claim would be subject to a six-year statute of limitation.

During our discussion, you also indicated that Sherman Township is not billed for water or sewer service to its own buildings, but that it does pay rent for fire hydrants. You also indicated, however, that the water plant was constructed inside the Township Community Hall, with no lease or rent charged. Additionally, the Township provides a broad spectrum of in-kind services to support both the water and sewer systems. This includes a licensed operator and assistant, budget development, accounting, and other services. In this context, the Township has arguably not been receiving "free" water or sewer service. In fact, if an accurate accounting was kept, the Township has probably been subsidizing the water and sewer systems. Most municipalities are billed for water and sewer services at their township hall, fire department or other publicly-owned buildings. This results in funds being transferred from one township account into a different township account. Nonetheless, it helps accurately establish the revenues and expenses of each utility.

Payment for utility use with in-kind services was addressed in a fairly recent Michigan Court of Appeals case, *Youmans vs. Charter Township of Bloomfield,* 336 Mich App 161; 969 NW2d 570 (2021). That case involved a class action claiming that Bloomfield Township was receiving free services in violation of Section 18 of the Revenue Bond Act, MCL 141.118(1). The court concluded that the Township was providing extensive in-kind services valued between $700,000 and $800,000. The court held that these in-kind services satisfied the prohibition against receiving free services under the Revenue Bond Act. The court held:

> Therefore, we are not persuaded that the trial court clearly erred when it found that the Township's provision of in-kind services constituted sufficient payment for the disputed PFP services. And in light of the finding that the Township *was* paying for those PFP services, we cannot conclude that the trial court erred by failing to hold that the Township was receiving "free" PFP services in contravention of MCL 141.118(1). *Id.*, pp. 223-224; NW2d at 604. (Emphasis in original.)

It was not clear to me from our discussion whether Sherman Township is regularly adjusting its water and sewer rates to generate sufficient revenue to cover its expenses. This is not only recommended, but required under state law.

You mentioned that there have been periodic complaints from residents within the water and sewer districts regarding rates. I would need additional information in order to evaluate the validity of any such complaints. The courts have generally held, however, that it is permissible to charge a regular fee to properties that are not connected to the system. These charges are justified on the basis that these systems are available to these properties when or if they choose to connect, and that this enhances the value of the properties.

You also mentioned that additional connections to either system has been problematic and intimidating to the property owners in some instances. I would need additional information on specific issues to comment on those situations. For the most part, expansion of an existing system is permissible, and is usually beneficial to the Township. I would also probably need to review any terms and conditions of US Department of Agriculture Rural Development funding, or other documents governing Sherman Township's specific issues, however.

If this correspondence raises further questions, or if I have failed to address your inquiries, please do not hesitate to contact me.

Sincerely,

Roger W. Zappa

RWZ/nz