MICHIGAN'S NEW LOCAL GOVERNMENT AND SCHOOL DISTRICT FISCAL ACCOUNTABILITY ACT: WHAT YOU NEED TO KNOW

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Introduction

On March 16, 2011, Michigan Governor Rick Snyder signed the Local Government and School District Fiscal Accountability Act (the "**Fiscal Accountability Act**" or the "**New Act**") and certain other companion bills to provide for enhanced review, management and control of financially distressed municipalities in Michigan. The Fiscal Accountability Act replaces the Local Government Fiscal Responsibility Act of 1990, P.A. 72 of 1990 ("**Act 72**"). Hailed by some and bemoaned by others, the Fiscal Accountability Act continues many of the policies embodied by Act 72, but broadens those powers in many ways.

The reforms created by the New Act include:

- Expansion of triggers that lead to state review of local government;
- Greater flexibility for the state in conducting preliminary reviews of whether a local government is under financial stress;
- The creation of "review teams," which can enter into consent agreements with local governments to address financial stress without appointing an emergency manager;
- Extending certain powers formerly enjoyed only by emergency managers to current local government officials in certain cases (e.g., upon authorization by the state and in conjunction with a consent agreement);
- Mandatory declaration of receivership and appointment of an emergency manager if the Governor determines that a financial emergency exists; and
- Expanded powers for emergency managers, including the power to reject, modify or terminate an existing contract or a collective bargaining agreement, to disincorporate or dissolve a municipal government with the approval of the Governor or to recommend consolidation with another municipal government.

The New Act uses the term "**emergency manager**" instead of "emergency financial manager" to reflect the expanded operations and administrative powers provided to the emergency managers beyond those that were provided to emergency financial managers under Act 72. This change is, in part, a reaction to the Wayne County Circuit Court's December 2010 decision in *Adams v. Bobb*, where the Court held that emergency financial manager powers under Act 72 were limited to financial decisions and that the school board maintained its powers over academic policies of the school district. The New Act makes it clear that, upon the appointment of an emergency manager, the powers of the chief administrative officer and governing body of the local unit of government are suspended and the emergency manager has broad powers to operate and implement its restructuring plan—including, in the case of a school district to implement an academic plan.

The following is a brief review of the Fiscal Accountability Act. In this overview, as in the New Act itself, "**municipal government**" refers to "a city, a village, a township, a charter township, a county, an authority established by law, or a public utility owned by a city, village or township or county." The term "**local government**," as used in the New Act, refers to a "municipal government or school district."

Initial Stages

Although much of the media coverage of the Fiscal Accountability Act has focused on emergency managers and their powers, emergency managers are appointed only after several initial steps and layers of review. The initial steps and review allow the state and local government to work together to address early signs of financial stress before the situation becomes so severe that an emergency manager must be appointed.

Preliminary Review

Empowering the state and local governments to address early warning signs of financial stress is a primary goal of the New Act. To that end, the New Act authorizes a preliminary review of whether a financial emergency exists. This analysis is performed by the "**state financial authority**"—the State Treasurer in the case of municipal governments and the Superintendent for Public Instruction for school districts. The following early warning signs can trigger an investigation of a local government's finances by the state financial authority:

- A request by a local government's governing body or chief administrative officer;
- Requests by creditors meeting certain criteria,
- Petitions from registered electors;
- A local government's failure to meet payment obligations for pension funds;
- Nonpayment of wages;
- Bond or note payment defaults;
- A resolution by the Michigan Senate or House of Representatives;
- Breach of obligations under a local government's deficit elimination plan;
- Long term debt rating within or below the BBB category; or
- Violations of state laws governing the issuance of bonds or notes.

The New Act also confers on the State Treasurer broad authority to initiate investigations based on "other facts or circumstances that … are indicative of municipal financial distress." A state financial authority must provide written notice of a preliminary review to the local government and must complete this review within 30 days.

Review Team

If the state financial authority reaches a finding of "**probable financial stress**", the Governor appoints a "review team" that includes each of the following:

- the State Treasurer or his/her designee;
- the Director of the Department of Technology, Management, and Budget;
- a nominee of the Senate Majority Leader; and
- a nominee of the Speaker of the House of Representatives

In addition, the Governor may include individuals with "relevant professional experience" to engage in a review of municipal financial management. For school districts, this team must also include the Superintendent of Public Instruction.

The review team's primary charge is to examine the local government's finances and "[n]egotiate and sign a **consent agreement** with the chief administrative officer of the local government." Any consent agreement reached must provide for remedial measures to address the financial crisis with regular reporting to the state financial authority. A consent agreement may also include (a) a **continuing operations plan** (which includes a budget, a projected cash flow, an operating plan, an evaluation of pension and health care obligations, and a provision for quarterly reports to the state financial authority), or (b) a **recovery plan** (which includes terms similar to a continuing operations plan, and may also provide for a local auditor or inspector, and supersedes local budgets and general appropriations ordinances).

A consent agreement can become effective only by resolution of the governing body of the local government. The consent agreement may include a grant to the chief administrative officer, the chief financial officer, the governing body, or other officers of the local government by the State Treasurer of one or more of the powers prescribed for emergency managers in the New Act for such periods and upon such terms and conditions as the State Treasurer determines as necessary to achieve the goals and objectives of the consent agreement. These powers may not include the power to reject, modify or terminate the terms of an existing collective bargaining agreement. Thirty days after entering into a consent agreement, however, a local government is exempt from collective bargaining requirements under the Public Employment Relations Act, MCL 423.201, *et seq.*, unless the state treasurer concludes that this exemption should not apply.

A review team must provide a report to the Governor and state financial authority within 60 days which assesses whether certain events have occurred or are likely to occur. These indicators of financial distress include:

- Bond or note payment defaults;
- Failure to meet tax withholding or pension plan contribution requirements;
- Failure to pay wages or retiree benefits;
- Failure to follow a deficit elimination plan;
- Unsettled loans to the general fund from other government funds;
- Structural operating deficit;
- Unauthorized use of restricted revenues; and
- Other "facts and circumstances indicative of local government financial stress or financial emergency".

In addition, the report must specify the degree of the municipal government's financial distress. "Financial distress" has specific definitions under the New Act:

- Local government is in "**no financial stress or mild financial stress**" if none of the indicators of financial distress have occurred or are likely to occur in the current or next fiscal year (or are likely to "threaten the local government's capability to provide necessary governmental services essential to public health, safety, and welfare");
- A local government is in "**severe financial distress**" if (a) one or more of the indicators of financial distress have occurred or are likely to occur in the current or next fiscal year (or are likely to "threaten the local government's capability to provide necessary governmental services essential to public health, safety, and welfare") or (b) "the chief administrative officer of the local government recommends that the local government be considered in severe financial stress."
- A "**financial emergency**" exists if (a) 2 or more of the indicators of financial distress have occurred or are likely to occur in the current of next fiscal year, (b) the local government prevents the review team from completing its report; (c) the local government fails to comply with a continuing operations plan, recovery plan, or deficit elimination plan, (d) the local government breaches a consent agreement, (e) the local government is in "severe financial distress" and a consent agreement has not been adopted; or (f) the chief administrative officer and state treasurer agree that there is a financial emergency.

Assessment by the Governor and Administrative Review

Within 10 days after receiving the review team's report, the Governor must reach one of the following conclusions:

- The local government is not in severe financial distress;
- The local government is in severe financial distress but a consent agreement addressing that financial distress has been adopted;
- The local government is in a state of financial emergency and "no satisfactory plan exists to resolve the emergency"; or
- The local government has entered into a consent agreement but breached that agreement.

If the Governor determines that there is a "financial emergency," he or she must provide written notice to the governing body and chief administrative officer of the local government. The local government may then request a hearing before the state financial authority or its designee. After the hearing, the Governor—in his or her sole discretion—assesses the record and determines whether a financial emergency exists. The Governor must follow this determination with written notice to the local government that details the facts supporting the Governor's conclusions.

If two-thirds of the members of the affected local government's governing body vote in favor of an appeal, the Governor's determination may be appealed to the Ingham County Circuit Court. The court may set aside the Governor's decision only if it determines that it is either (a) not supported by competent, material and substantial evidence on the whole record, or (b) arbitrary, capricious, or an abuse of discretion.

Once a financial emergency is declared and this finding is confirmed (or not appealed within the statutory period), the Governor must declare the local government in receivership and appoints an emergency manager to act for and in place of the governing body and office of chief administrative officer of the local government.

The Emergency Manager

Much of the discussion during the drafting of the New Act centered on the proposal that an emergency manager could be a firm rather than an individual. The New Act, however, requires the emergency manager to be an individual. That individual must have at least five years of experience and demonstrable expertise in business, financial, or local or state budgetary matters. Furthermore, he or she *does not* have to be a resident of the local government over which he or she is appointed to manage.

Upon appointment, the New Act suspends the powers of the chief administrative officer and governing body of the local government and empowers the emergency manager to issue orders necessary to accomplish the purposes of the New Act. As under Act 72, the New Act enables the emergency manager to restructure the operations of the local government. The New Act, however, expands the tools available to the emergency manager and provides additional powers including:

- Modifying, rejecting, terminating or renegotiating all existing contracts of the local government, including collective bargaining agreements.
- Selling, leasing or otherwise transferring the assets, liabilities, functions and responsibilities of the local government;
- Ordering one or more millage elections for the local government;
- Recommending that a city, village or township consolidate with one or more other municipal governments;
- Disincorporating and dissolving the municipal government;
- Removing one or more of the serving trustees of the local pension board if the pension fund is not actuarially funded at a level of 80% of more;
- For a school district, developing and implementing an academic plan; and
- Recommending that the local government be authorized to file for bankruptcy under Chapter 9 of the Bankruptcy Code.

A local unit under a receivership is exempt from the collective bargaining requirements until the earlier of the end of the receivership or five years. Before the receivership can be terminated by the Governor, the emergency manager is charged with developing and implementing a two year budget for the local unit.

Conclusion

The Fiscal Accountability Act and its implications for Michigan are complex and evolving. For a full assessment of the Act's impact on your business or local unit of government, please feel free to contact one of the following attorneys on Dickinson Wright's **Local Government Fiscal Stress Team**:

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