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BILL ANALYSIS

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Senate Bill 372 (Substitute S-1 as reported)  
Sponsor: Senator Laura M. Toy  
Committee: Local, Urban and State Affairs

Date Completed: 2-7-06

### **RATIONALE**

The Detroit Water and Sewerage Department (DWSD) serves more than 4 million southeastern Michigan residents in 126 communities, pumping an average of 675 million gallons of water per day. The water system originally was constructed to serve the City of Detroit, but the city's suburbs began tying into the system following the Great Depression when they found it more economical to do so than to build their own plants. The Detroit water and sewerage systems merged in the mid-1960s, after a report from the National Sanitation Foundation recommended that Detroit become the sole provider of pollution control services for the six-county metropolitan area.

In recent years, there have been allegations that the DWSD has been mismanaged, with the *Detroit News* publishing a series of articles in 2002 that alleged, among other things, lax collection policies for delinquent accounts, questionable contracting practices, and bribery. In addition, many of the communities outside of Detroit that are served by the system believe that they are being overcharged for water and sewerage service. The communities contend that their inflated bills are funding discounted rates for Detroit customers and that one of the reasons their rates are so high is that the DWSD is mismanaging its money.

Some people believe that an authority made up of representatives of communities served by the DWSD should be appointed to provide oversight and review of the system to prevent further mismanagement.

### **CONTENT**

**The bill would create a new act to require a city that owns or operates a water or sewer system that provides service to more than 20% of the State (i.e., Detroit) to establish an authority to provide review and oversight of the system's contract process and administration, rates and rate-setting processes, budget, finance, and operations. The bill would provide for appointments to the authority by the city and each qualified county (a county with a population of 400,000 or more that is served by the system). The authority would be required to do the following:**

- Ensure that rates for water and sewer services were just and reasonable.**
- Require rate alteration notices to customers, as specified in the bill.**
- Review all contracts over \$50,000, and contract overruns that caused a contract to exceed \$50,000.**
- Establish recommended policies and procedures (including competitive bidding) for the contracting of services for the system.**
- Appoint a certified accounting firm to conduct a financial and performance audit of the transactions and accounts of the system for the preceding fiscal year.**

The bill would take effect on October 1, 2006.

### Authority Establishment; Rates

A city that owns or operates a water or sewer system would have to establish an authority to provide review and oversight of the system as provided under the bill. The review and oversight would have to include the system's contract process and administration, rates and rate-setting processes, budget, finance, and operations. ("Water or sewer system" would mean a water supply facility or sewerage services facility, or both, that provides water or sewerage service to more than 20% of the population of the State. "City" would mean a city chartered under the Home Rule City Act.)

Except as otherwise provided, the authority would have to make sure as part of its review and oversight function that the system was in compliance with the bill's rate provisions.

The rates for water and sewer service would have to be just and reasonable. Notice to customers would be required for any rate alteration and would have to be included in the bill of each affected customer of the system before the effective date of the rate alteration. The notice would have to contain at least all of the following information:

- A statement that the customer's rate could change.
- An estimate of the amount of the annual change for the typical customer that would result from the rate change.
- A statement that a customer could comment on or receive complete details of the rate alteration by calling or writing to the authority. Complete details of the rate alteration would have to be provided free of charge to the customer at the expense of the system.

A system would be allowed only one rate increase during any 12-month period.

### Authority Membership

Within 30 days after the bill's effective date, each qualified county and qualified city, or within 30 days after the date a county or city became qualified, would have to make appointments to the authority. ("Qualified city" would mean a city that owns or operates a water or sewer system. "Qualified county" would mean a county with

a population of 400,000 or more that is served by the water and sewer system (currently, Genesee, Macomb, Oakland, and Wayne Counties).)

One person would have to be appointed to represent each qualified county that did not have the qualified city located within the county. The appointment would have to be made by the county board of commissioners.

Three people would have to be appointed to represent the qualified city. The appointment would have to be made by the mayor of the city, with the advice and consent of the city's governing body.

If a qualified county had the qualified city within the county, one person who did not live or work within the qualified city would have to be appointed to represent the county. The appointment would have to be made by the majority vote of the chief elected officials of the five largest local units of government within the county.

A person appointed to the authority would serve for a term of four years. A successor to a member would have to be appointed in the same manner and would serve a term of four years. A person could be reappointed to the authority. If a vacancy occurred before the end of a four-year term, the person appointed to fill the vacancy would have to be appointed in the same manner for the balance of the four-year term. A person appointed to the authority could be replaced by the appointing entity at any time.

Individuals appointed to the authority would be public servants under Public Act 317 of 1968 (which governs public servants' contracts with public entities), and would be subject to any other applicable law with respect to conflicts of interest.

The authority would have to establish policies and procedures requiring periodic disclosure by appointees of relationships that could give rise to conflicts of interest.

### Authority Operations

A majority of the people appointed to the authority would constitute a quorum for the transaction of business. An appointee would have one vote.

The authority would have to elect a chairperson and other officers as it considered necessary. The authority would have to adopt bylaws and rules to govern its operation.

The first meeting of the authority would have to be held within 45 days after the bill's effective date, or within 45 days after the date a city became a qualified city. After its first meeting, the authority would have to meet at least quarterly and at such other times as it determined.

The authority would have to establish and maintain a website to provide to the general public the information required under the bill.

The authority would be subject to the Freedom of Information Act and the Open Meetings Act.

#### Recommended Policies & Review: Contracts

The authority would have to establish recommended policies and procedures for the contracting of services for the system. The authority would have to review all contracts approved or issued under the following provision.

The recommended policies and procedures would have to include a recommendation that a contract would not be awarded by the system for the construction, repair, remodeling, or demolition of a water or sewer facility unless the contract was let pursuant to a procedure that required competitive bidding. This provision would not apply if the authority determined that any of the following applied:

- The negotiated contract amount was less than \$50,000 over the lifetime of the contract and any contract renewals or extensions.
- The contract was for emergency repair or construction necessitated by a sudden, unforeseen occurrence or situation of a serious and urgent nature and was not for convenience or expediency. The contract could not be for a period of more than one year.
- The repair or construction was necessary to ensure safety or otherwise to protect life or property. The contract could not be for a period greater than one year.

-- Procurement by competitive bids was not practicable to meet the water and sewer system needs efficiently and effectively or another procurement method was in the public's best interests.

The authority would have to review all contracts and contract renewals, extensions, and change orders or appropriations in an amount over \$50,000. The authority also would have to review all contract overruns from the original contract amount for contracts in which the negotiated amount was less than \$50,000 over the lifetime of the contract and any contract renewals or extensions; and for contracts less than \$50,000 if the overrun caused the contract amount to exceed \$50,000.

The authority would have to recommend policies and procedures for hiring professional service contractors.

All contracts and the authority's review of the contracts would have to be posted on the authority's website.

#### Authority Budget & Audit

The chief financial officer of the water and sewer system would have to prepare and submit to the authority for review and comment a detailed operating and capital budget for each fiscal year. The required budget would have to be submitted at least 60 days before the beginning of each new fiscal year and would have to be posted on the authority's website. The authority would have to complete its review and issue its comments within 42 days from the date the budget was received.

The chief financial officer would have to notify the authority immediately if actual expenditures exceeded the budgeted amount. The chief financial officer of the system would have to provide the authority with any other financial information that the authority considered necessary to carry out its responsibilities under the bill. The information provided would have to be posted on the authority's website.

Within 30 days from the end of the water and sewer system's fiscal year, the authority would have to appoint a certified public accounting firm to conduct a financial and performance audit of the transaction and accounts of the system for the preceding

fiscal year. The completed audit reports would have to be submitted to the authority within six months from the end of the system's fiscal year and posted on the authority's website.

### Other Provisions

The authority would have to establish an ethics manual governing the conducting of system business and the conduct of employees of the system. The authority would have to establish policies that were no less stringent than those provided for public officers and employees by Public Act 196 of 1973 (which sets the standards for the conduct of public officers and employees).

An employee of the water and sewer system who became aware of or suspected that any actions by another employee or entity of the system were prohibited by any law, rule, regulation, or policy, would have to report the violation to the authority. Any person who made a report would have the same protections and rights as provided under the Whistle-Blower's Protection Act.

A challenge to the validity of any of the bill's provisions would have to be filed with and decided by the Court of Appeals pursuant to Article VI, Section 10 of the Michigan Constitution (which requires the jurisdiction of the Court of Appeals to be as provided by law).

## **BACKGROUND**

### U.S. District Court Involvement

The United State District Court for the Eastern District of Michigan has been involved in DWSD operations and rate-setting since 1977 when the United States Environmental Protection Agency sued the Detroit department and the Michigan Department of Environmental Quality for violating its discharge permit. Settlement agreements relating to rate-setting were developed in response to this and other lawsuits and have influenced the current DWSD rate methodology since 1980. Rate settlements have addressed issues such as proportionality, look-backs, cost allocations for specific projects, bad debt expense allocation, and flow measurement data.

As part of the settlement, the Court took oversight of the DWSD for an indefinite

term. The Court also created the position of special administrator, who had power over the contracting, hiring, and management of the department. The special administrator post was filled by the Detroit mayor, but the position of special administrator was discontinued in January 2006.

The Court also formed the Southeast Michigan Consortium for Water Quality in 2001. In 2003, the Court formally designated the Consortium as the entity to resolve problems in the region related to water supply and wastewater treatment. The Consortium consists of 40 city and suburban leaders and is designed to build regional consensus on efficient operation and management of the system, future improvements, policies to guide infrastructure needs, and rates needed to ensure adequate and equitable funding.

### Previous Legislation

In 2003, Governor Jennifer Granholm vetoed Senate Bill 195, which would have created a new act to establish an authority to provide review and oversight of the contract process and rates charged by Detroit's water and sewer system. The bill would have required the authority to establish policies and procedures for the review and approval of the rates and charges imposed or assessed by the water or sewer system. The authority also would have been required to establish policies and procedures for the contracting of services for the system that provided for the following:

- The authority would have the exclusive authority to review and approve all contracts and contract renewals, extensions, and charge orders or appropriations of more than \$50,000.
- The authority would review all contract overruns from the original contract amount for approved contracts of more than \$50,000 and for contracts of less than \$50,000 if the overrun caused the contract amount to exceed \$50,000.
- A contract could not be awarded by the system for the construction, repair, remodeling, or demolition of a water or sewer facility unless the contract was let pursuant to a procedure that required competitive bidding, with certain exceptions.

In her veto message, the Governor indicated that some provisions in Senate Bill 195 appeared to conflict with the Michigan Constitution. For example, she stated that the bill contravened Article VII, Section 24 by abrogating the ability of cities and villages to own and operate water supply and sewerage systems. The Governor also stated that the bill failed to solve the regional problem but instead pitted Detroit against its suburbs. Finally, the veto message pointed out that the United States District Court for the Eastern District of Michigan had issued orders giving specific direction regarding the management of the DWSD, and had formed the regional consortium. According to the veto message, problems with the system should be resolved through the court mechanism.

## **ARGUMENTS**

*(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)*

### **Supporting Argument**

During the past few years, suburban residents served by the DWSD have seen significant increases in their water and sewer bills at a time when there have been repeated allegations of financial mismanagement by the department. Additionally, it has been reported that the department has been lax in collecting on delinquent accounts (many of which are located within the City of Detroit), which has left many suburban customers believing that they are subsidizing the water service of delinquent Detroit customers. The proposed seven-member authority would help ease suburban concerns about the DWSD's misuse of funds by providing review and oversight of the system's contract process, administration, rate-setting process, and other departmental activities. The bill would require the authority to review all contracts and contract renewals, extensions, and change orders or appropriations in an amount over \$50,000. The review and oversight would alleviate concerns that suburban rate increases are funding an inefficient department that has been overpaying when awarding contracts and failing to collect money it was owed.

Additionally, the bill would require the authority to write an ethics manual governing the conduct of DWSD business

and the conduct of department employees. The ethics manual would ensure that the department was run in the best interests of the residents it served, not just the interests of those who might profit from dubious managerial decisions and unethical or illegal practices. The bill would require an employee who became aware of an activity by an employee or entity of the system that was prohibited by any law, rule, regulation, or policy to report it to the authority.

Since only about one-quarter of the people served by the DWSD actually live in Detroit, a seven-member authority that had four members from outside the city would better reflect the makeup of the Department's customer base. Currently, Genesee, Macomb, Oakland, and Wayne Counties do not play a role in the DWSD's management decisions.

**Response:** The department has an existing seven-person board that consists of four city residents and three members representing suburban wholesale customers.

### **Opposing Argument**

Detroit built and owns the DWSD. Detroit borrowed the money and took on the risk of building the system without the assistance of either the State or the surrounding communities. Wresting control of the department from the city would violate the Michigan Constitution because it would be a taking of the department through State regulation. The bill would establish an authority to provide "review and oversight" of the system, which is, effectively, control of the system. In her veto message concerning Senate Bill 195 of 2003-2004 (which would have created a similar authority to oversee the DWSD), the Governor pointed out several constitutional problems with creating an authority to oversee the DWSD. These concerns would apply to Senate Bill 372 (S-1). Among the provisions of the Michigan Constitution that would be violated by the creation of an authority, the Governor listed Article VII, Section 24 (because the bill would have abrogated the ability of cities and villages to acquire, own, and operate water supply and sewerage systems); and Article 1, Section 10 (because it would have impaired contracts and threatened the commitments of bondholders of local governments operating a water and sewerage system).

**Response:** Article VII, Section 24 of the Michigan Constitution states "...any city

or village may acquire, own or operate...public service facilities for supplying water..."; it says nothing that would impair the State's ability to establish an authority to provide review and oversight. Review and oversight do not constitute ownership.

**Opposing Argument**

By establishing an authority whose power would be divided among southeastern Michigan's largest counties, the bill would continue the region's current dissention regarding the management of the DWSD, rather than encourage cooperation. Creating an authority with a majority of members from suburban communities also would remove control of the DWSD from the city.

**Opposing Argument**

Many suburban DWSD customers are upset about the high rates they are being charged for water and sewer service, but the primary reason their rates are so high is that local municipalities add a surcharge to their customers' bills to cover the costs of running their municipal systems. The rates charged by the DWSD are consistently ranked among the lowest for the nation's largest cities. Additionally, the DWSD has made a large effort over the past few years to make its decision-making process more accessible to the public when it comes to setting rates. Currently, the department posts materials regarding the setting of water and sewer rates on its website as they become available.

If suburban communities served by the DWSD are unhappy about the rates they are being charged by the department, they are free to establish their own system or join with other communities to establish a regional system of their own.

**Opposing Argument**

Judge John Feikens, the Federal judge who has been overseeing the DWSD's operations since 1977, designated the Southeast Michigan Consortium for Water Quality as the key problem-solving entity for matters related to the region's water supply and wastewater treatment in 2003. Even with the advisory group, Judge Feikens remains the final-decision maker under any circumstance. The bill would appear to contravene the decision of the Federal judge by usurping his authority and adding an

additional layer of oversight and review to the DWSD's decision-making process.

Legislative Analyst: J.P. Finet

**FISCAL IMPACT**

The bill would have no fiscal impact on State or local revenue or expenditures. The bill would not provide for any revenue source for the authority, provide for any members of the authority to be paid, or authorize the authority to spend any money.

Fiscal Analyst: David Zin

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.