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BILL ANALYSIS

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Senate Bill 372 (Substitute S-2 as passed by the Senate)  
Sponsor: Senator Laura M. Toy  
Committee: Local, Urban and State Affairs

Date Completed: 3-15-06

### **RATIONALE**

The Detroit Water and Sewerage Department (DWSD) serves more than 4 million southeastern Michigan customers 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 a board 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 a water accountability advisory board to provide review and oversight of the system's contract process and administration, rates and rate-setting processes, budget, finance, and operations, and make recommendations regarding those activities. The bill would provide for appointments to the board by the city and each qualified county (a county with a population of 400,000 or more that is served by the system).**

**The board would be required to provide recommendations on the following:**

- The system's rates and rate-setting process.**
- The system's use of competitive bidding to award contracts.**
- All contracts, renewals, extensions, and change orders or appropriations in an amount over \$50,000 that were approved by the system.**
- The system's budget, budget administration, expenditures, finances, and other financial matters.**
- The establishment of an ethics manual governing the conducting of system business and the conduct of employees of the system.**
- Assisting the system in providing services to its customers.**

**The bill states that it would not limit or alter the powers and rights of a city to own and operate a water and sewer**

## **system under the Michigan Constitution.**

The bill would take effect on October 1, 2006.

### Board Establishment; Rate Review

A city that owns or operates a water or sewer system would have to establish a water accountability advisory board to provide review and oversight of the system and make recommendations to 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.)

The bill states that the proposed act would not limit or alter the powers and rights to own and operate a water and sewer system granted to a city under Article VII, Section 24 of the Michigan Constitution (which states, "...any city or village may acquire, own or operate...public service facilities for supplying water...[and] sewage disposal...").

The board would have to review the system's rates and rate-making process and make recommendations to the system regarding the setting of rates. As part of its review and oversight, the board would have to issue an annual report, which would have to include all of the following assessments:

- Whether the rates for water and sewer service were just and reasonable.
- Whether customers were notified of a rate alteration before the effective date of the rate alteration.
- Whether any notices regarding rate alterations contained 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 by the rate change; or a statement that a customer could comment on or receive complete details of the rate alteration by calling or writing the system.

- Whether the system provided at no cost to the customer complete details of the rate alteration.
- Whether the system had more than one rate increase during any 12-month period.

The annual report and recommendations would have to be posted on the board's website.

### Board Membership

Within 30 days after the bill's effective date or within 30 days after the date a county or city became qualified, whichever was later, each qualified county and qualified city would have to make appointments to the board. ("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 or 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. For the initial appointments to the board, if there were more than one qualified county, the county with the largest population would appoint a person to a one-year term, the next largest county in population to a two-year term, and all other counties to a four-year term.

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. For the initial appointments to the board, one person would have to be appointed to a one year term, one to a two-year term, and one to a three-year term.

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, excluding the qualified city. For the initial

appointment, the person would have to be appointed to a four-year term.

After the initial appointments, a person appointed to the board would serve 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 board. If a vacancy occurred before the end of a term, the person appointed to fill the vacancy would have to be appointed in the same manner for the balance of the term. A person appointed to the board could be replaced by the appointing entity at any time.

Individuals appointed to the board, or the executive director and any staff of the board, would be subject to the same requirement as provided under Section 2 of 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. (Subject to certain exceptions, Section 2 of Public Act 317 prohibits a public servant from 1) being a party, directly or indirectly, to any contract between himself or herself and the public entity of which he or she is an officer or employee; 2) directly or indirectly soliciting any contract between the public entity and himself or herself, any firm of which he or she is a partner, member, or employee, any private corporation in which he or she has more than a specified ownership interest, or any trust of which he or she is a beneficiary or trustee; or 3) taking part in the negotiations for such a contract or representing either party in the transaction.)

The board would have to establish policies and procedures requiring periodic disclosure by appointees, the executive director, and any staff of the board, of relationships that could give rise to conflicts of interest.

#### Board Operations; Staff Appointments

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

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

Each member of the board would have to receive a per diem, at the rate established by the qualified city for its employees, for each meeting the member attended, and would have to be reimbursed for all reasonable and necessary expenses incurred in performing the member's duties required under the bill.

The board would have to appoint an executive director and such other staff as the board considered necessary to carry out its responsibilities under the bill. The reasonable and necessary expenses of the board would have to be paid by the system. The State would have to reimburse the system through the appropriations process for any reasonable and necessary expenses of the board paid under the bill.

The first meeting of the board 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, whichever was later. After its first meeting, the board would have to meet at least quarterly and at such other times as it determined.

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

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

#### Recommended Policies & Review: Contracts

The board would have to make recommendations regarding policies and procedures for contracting by the system. The recommendations would have to include that a contract could not be awarded by the system unless the contract was issued pursuant to a procedure that required competitive bidding. The recommendations would have to provide that an exemption from competitive bidding could be allowed for any of the following:

- A negotiated contract if the amount were less than \$50,000 over the lifetime of the contract, including any renewals or extensions.
- A contract that 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 greater than one year.

- A repair or construction contract that was necessary to ensure the safety of or otherwise protect life or property. The contract could not be for a period greater than one year.
- A contract where procurement by competitive bids was not practicable to meet the water and sewer system needs efficiently and effectively or where another procurement method was in the public's best interests.

The board would have to review and make recommendations regarding all contracts and contract renewals, extensions, and change orders or appropriations in an amount over \$50,000 that were approved or issued by the system. For all contracts under \$50,000, the board would have to review and make recommendations if any renewals, extensions, or overruns caused the total contract amount to exceed \$50,000.

The board would have to review and make recommendations regarding all contracts not subject to competitive bidding that were approved or issued by the system for emergency repair or construction; repair or construction necessary to ensure the safety or otherwise protect life or property; or where procurement by competitive bids was not practicable or another method was in the public's best interests.

The board would have to recommend policies and procedures for the hiring of professional service contractors.

All contracts awarded by the system and the board's review of and recommendations concerning the contracts would have to be posted on the board's website.

#### Board Budget & Audit

The chief financial officer of the water and sewer system would have to prepare and submit to the board for review and recommendations 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 board's website. The board

would have to complete its review and issue its recommendations within 42 days from the date the budget was received.

The chief financial officer would have to notify the board immediately if actual expenditures exceeded the budgeted amount.

The board would have to review and provide oversight of the system's budget, budget administration, expenditures, finances, and other financial matters and make recommendations regarding those items. The chief financial officer of the system would have to provide the board with all budgetary and financial information that the board considered necessary to carry out its responsibilities under the bill. The board's review and recommendations and the information provided would have to be posted on the board's website.

The board would have to retain a certified public accounting firm to conduct an annual financial audit of the system and to conduct performance audits of the transactions and operations of the system. The completed audit reports would have to be submitted to the board within six months from the end of the system's fiscal year and posted on the board's website. The performance audits would have to be submitted to the board upon completion and posted on the board's website.

#### Other Provisions

The board would have to make recommendations to assist the system in providing services to its customers.

The board would have to make recommendations regarding the establishment of an ethics manual governing the conducting of system business and the conduct of employees of the system. The board would have to make recommendations regarding the establishment of 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). The board would have to review whether the system adopted the recommendations and post its recommendations and findings on the board's website.

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 board and the system. 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 States 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 the Clean Water Act. In 1977, the parties entered into a Consent Judgment, which has been subject to subsequent amendments. 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 Consent Judgment, Judge John Feikens took oversight of the DWSD for an indefinite term. In 1979, the judge created the position of special administrator, who has had power over the contracting, hiring, and management of the department. The special administrator post, which has been filled by the Detroit mayor, has been suspended and reinstated over the years, as the judge considered necessary to ensure the DWSD's compliance with the law. In January 2006, Judge Feikens issued an opinion and order denying a motion to replace the special administrator, and discontinuing the position for the present time. Also, in 2001, Judge Feikens invited civic and governmental leaders in

southeastern Michigan to form a consortium to address water quality problems.

In 2003, the judge formally designated the Southeast Michigan Consortium for Water Quality 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. Participation in the consortium is voluntary.

### Previous Legislation

In 2003, Governor Jennifer Granholm vetoed Senate Bill 195, which would have created a new act to establish a board 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 board 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 board also would have been required to establish policies and procedures for the contracting of services for the system that provided for the following:

- The board would have the exclusive board to review and approve all contracts and contract renewals, extensions, and charge orders or appropriations of more than \$50,000.
- The board 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 board 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 board to review and make recommendations regarding all contracts and contract renewals, extensions, and change orders or appropriations in an amount over \$50,000. The review should 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 board to make recommendations regarding the establishment of an ethics manual governing the conduct of DWSD business and the conduct of department employees. An ethics manual would help 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 also 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 board.

Since only about one-quarter of the people served by the DWSD actually live in Detroit, a seven-member board 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 a board 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 a board to oversee the DWSD. These concerns would apply to Senate Bill 372 (S-2).

Additionally, on January 5, 2006, Judge Feikens issued an order and opinion denying a motion by Oakland County to replace the DWSD's court-appointed administrator. In his opinion, Judge Feikens stated, "The plain language of the Michigan Constitution vests the power to operate the Detroit Water and Sewerage Department, both within and outside the City limits, with the City of Detroit. Even if there were any doubt about how to interpret Article 7, § 24, the Michigan Constitution instructs courts to construe that provision liberally in favor of the City of Detroit".

**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 a board to provide review and oversight. Review and oversight do not constitute ownership. The bill is different from the bill vetoed by the Governor in that it would provide for the establishment of an advisory board to provide review and oversight of the system and make recommendations as to how rates should be set and contracts let, while the vetoed bill would have created an authority to establish policies and procedures to be used in contracting for services and for the review and approval of rates and charges imposed or assessed by the system. The body proposed by this bill could only make recommendations about how the DWSD should be run, not take control of the system.

Neither the Federal Court nor the Michigan Supreme Court has ruled on the issue of whether Article VII, Section 24 allows the State to create a body to provide oversight of the system and make recommendations as to how it should be run.

#### **Opposing Argument**

By establishing a board whose power would be divided among southeastern Michigan's largest counties, the bill would continue the region's current dissension regarding the management of the DWSD, rather than encourage cooperation. Creating a board 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 board 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 increase State expenditures by an unknown amount and have no effect on State revenue. The bill would have an unknown impact on local revenue and expenditures. The increase in State spending would depend upon the per diem amount set by the qualified city and the necessary and reasonable costs reimbursed under the bill, assuming that the State did appropriate the necessary funds. The impact on local units would depend on the extent to which the bill affected the operational costs of the water or sewer system and/or the rates charged for services.

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.