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MUNICIPAL LAW News

Foster Swift Administrative & Municipal Group

What's Inside:

Beware of Bankruptcy Filings: Tips to Help Protect A Municipality's Interests in a Bankruptcy Case

by Ronald D. Richards Jr. & Patricia Scott

Bankruptcies involving individuals and companies are up in 2010. Though some economic indicators show improvement, data suggests more private bankruptcy filings will occur in 2010 than in 2009. Chances are good, then, that a Municipality may receive some notice of a bankruptcy. Ignore that mail at your own peril. Pay very, very close attention to any mail involving a bankruptcy case – because every bankruptcy case in which the Debtor owes the Municipality has the potential to affect a Municipality's interests. Consider the following hypotheticals:

> *Imagine that a resident of your Municipality files bankruptcy. In that bankruptcy, the Debtor proposes to pay none of the outstanding property taxes owed to the Municipality. How can the Municipality protect its right to receive full payment for the outstanding taxes?*
>
> *Imagine that your Municipality bought a truck chassis, and hired Buffalo Company to convert that chassis into a Police Truck. After the Municipality paid Buffalo Company $100,000 for the work but before the work was done, Buffalo Company files bankruptcy because it owes a third party millions of dollars due to a court judgment. The third party wants to seize the chassis and sell it to recoup some of the money Buffalo Company owes it. How can the Municipality protect its interest in the truck chassis?*

Below is a short, basic primer on bankruptcies – including reasons to give special care to any correspondence a Municipality receives about a bankruptcy case and how a Municipality can protect it interests that otherwise might be harmed during a bankruptcy.

What is voluntary bankruptcy? Bankruptcy is filed by an individual or company to obtain financial relief. The person or company filing bankruptcy is referred to as a "Debtor."

Are there different types of bankruptcies? Yes. There are basically two types of bankruptcy cases. The first type, a Chapter 7 case, totally eliminates the Debtor's debt. The second type, a Chapter 13 for individuals and Chapter 11 for companies, reorganizes the Debtor's debt and provides for partial debt relief.

How could a bankruptcy case eliminate a debt owed to a Municipality? Any debt that the Debtor owes to the Municipality can be potentially affected in a bankruptcy case. This could include, for example, water bills, sewer bills, or certain personal or real property taxes.

Can a bankruptcy case impact a Municipality's ownership or interest in anything else besides a debt? Yes. A bankruptcy case could also put at risk a Municipality's interest in bigger ticket items – such as noted in one of the hypotheticals above: a vehicle that the Municipality owns but which is in the possession of the Debtor. In short, every interest – financial or tangible – that the Municipality has and which is somehow related to the Debtor is potentially at risk in a bankruptcy.

How would a Municipality find out that there is a bankruptcy that potentially affects its interests? The simplest answer is by either mail or word-of-mouth. As to mail, a Municipality could receive documents from the bankruptcy court identifying the bankruptcy and noting how the Debtor seeks to dispose of a debt owed to the Municipality or an item in which the Municipality claims an interest. Bankruptcy courts issue various types of documents, but the most common

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documents that a Municipality might receive of a Debtor's bankruptcy filing are the following:

- Notice of Bankruptcy Filing. If the Debtor lists the Municipality as a creditor that the Debtor owes money, the Court will send a notice of bankruptcy to the Municipality;
- Notices of Dividends, Motions for Relief From Stay, Debtor's Plan. After the notice of bankruptcy, depending on the chapter, the Municipality could receive a notice of dividends, motions for relief from stay, or the Debtor's plan. The Debtor's plan proposes how the Debtor's debt will be handled amongst all creditors – i.e., how the payments will take place, at what interest rate, and over what period of time;

Each bankruptcy mailing should be given careful attention and likely forwarded to a bankruptcy attorney to evaluate.

What if the Debtor does not list the Municipality as a creditor? How does the Municipality get notice then? If the Debtor does not list the Municipality as a creditor, the Municipality will not receive notice – even if it is owed money. For that reason, a Municipality really must stay aware of persons or companies with whom it is doing business. If it hears news of that person or company perhaps filing bankruptcy, the Municipality can either investigate further on its own, or ask an attorney to investigate the bankruptcy court dockets.

What should a Municipality do if it receives notice of a private bankruptcy? If a Municipality receives notice of a bankruptcy, the first thing it should do is consider contacting an attorney. This is because bankruptcy cases have many deadlines and are extremely time-sensitive. Although each bankruptcy case is different, sometimes there is little attorney time needed to protect the Municipality's interests. For example, if the debtor lists the Municipality in the plan and the payment terms are acceptable, then little attorney time would be needed.

The second thing the Municipality must do is stop collections efforts against the Debtor. From the moment a bankruptcy case is filed, bankruptcy laws require that all who the Debtor owes money to stop collection efforts on the debt owed before the date of filing bankruptcy. The Municipality should contact an attorney to determine how to proceed in the bankruptcy case to collect the debt owed.

What could happen if a Municipality receives notice of a bankruptcy but does nothing about it? Many potential detrimental things can happen if a Municipality does not take quick actions in a bankruptcy case. If the Municipality is owed money and the Debtor proposes to pay less than what the Debtor owes, then the Municipality could lose its right to object if the Municipality does not respond, or waits too long to respond to a bankruptcy notice. Likewise, failure to timely respond could lead to the Municipality losing any interest it may have in property (e.g., vehicle or property) it owns but which the Debtor has possession.

Foster, Swift's Municipal and Bankruptcy teams have years and years of experience handling Municipality-related bankruptcies. Please let us know if you would like Foster, Swift, Collins & Smith, P.C. help with any bankruptcy related questions.

Supreme Court Holds that Affirmative Defense in MCL 691.1402a(2) Only Applies to Sidewalks Adjacent to County Highways

by Steven H. Lasher

In *Robinson v City of Lansing*, __ NW2d __ (2010), the Michigan Supreme Court examined the issue of whether MCL 691.1402a(2), which provides that a discontinuity defect of less than two inches in a sidewalk creates a rebuttable inference that the municipality maintained the sidewalk in reasonable repair, applies to sidewalks adjacent to state highways or only to sidewalks adjacent to county highways. The Supreme Court reversed the holding of the Court of Appeals and held that the rule only applies to sidewalks that are adjacent to county highways.

This case arose when the plaintiff injured herself as a result of tripping on a raised and uneven area of a brick sidewalk adjacent to Michigan Avenue, a state highway in Lansing. Throughout the course of the proceedings, neither party disputed that the raised portion of the sidewalk was less than two inches and that the defendant, the city of Lansing, maintained the sidewalk. Plaintiff argued that the City breached its duty under MCL 691.1402(1) to maintain the sidewalk in reasonable repair. The City raised MCL 691.1402a(2) as an affirmative defense and moved for summary disposition, arguing that the plaintiff failed to rebut the inference that the City maintained the sidewalk in reasonable repair. Plaintiff argued that the affirmative defense only applied to sidewalks adjacent to county highways and, as a result, was inapplicable. The trial court adopted the plaintiff's interpretation. The Court of Appeals reversed, holding that the statute at issue contained no language limiting its application to county highways.

The Michigan Supreme Court explained that MCL 691.1402a(1) states that a municipality "is not liable for injuries arising from, a portion of a county highway . . . including a sidewalk," unless the conditions set forth in MCL 691.1402a(1)(a) and (b) are satisfied. The Court pointed out that nothing in MCL 691.1402a(2), which immediately follows MCL 691.1402a(1), suggests that subsection (1) only applies to county highways but section (2) should be construed to apply to county, city, and

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state highways. According to the Court, subsection (2)'s use of "*the* highway" means that the subsection is referring to the same highway referred to in subsection (1)--the *county* highway.

The Court also pointed out that it is the Legislature's intent that statutory provisions are not to be read in isolation but rather as a whole. According to the Court, when MCL 691.1402a is read as a whole, it is "clear" that subsections (1) and (2) only apply to county highways. Further, the Court believed that instead of choosing to repeat "county" throughout the entire statutory provision, the Legislature only mentioned "county" in the first subsection but intended for the word to apply throughout the statutory provisions. The Court explained that if the Legislature intended subsections (2) and (3) to apply to highways other than county highways, the Legislature would have drafted the subsections accordingly.

Next, the Court stated that since the first three references of "highway" in MCL 691.1402a "indisputably" referred to county highways, the fourth reference to "highway" should not be construed differently. Finally, the Court emphasized that MCL 691.1402a(1) would be mere surplusage unless "county highway" in that subsection was construed to limit the application of the two-inch rule in MCL 691.1402a(2).

In sum, the Court held that MCL 691.1402a(1) limits a municipality's liability as to county highways, while MCL 691.1402a(2) codifies the two-inch rule as to county highways. MCL 691.1402a(2) only applies to sidewalks adjacent to county highways.

If you have any questions, please contact **Steven Lasher** at **517.371.8118** or **slasher@fosterswift.com.**

Clerical Error and Mutual Mistake of Fact

by Steven H. Lasher

In *Briggs Tax Serv, LLC v Detroit Public Sch*, __ NW2d __; __ Mich __ (2010), the Michigan Supreme Court examined the meaning of MCL 211.53a. Pursuant to this statute:

> Any taxpayer who is assessed and pays taxes in excess of the correct and lawful amount due because of a clerical error or mutual mistake of fact made by the assessing officer and the taxpayer may recover the excess so paid, without interest, if suit is commenced within 3 years from the date of payment, notwithstanding that the payment was not made under protest.

Seven years prior to *Briggs*, voters in the Detroit Public School (DPS) district approved a 32.25-mill school operating property tax. This millage was to expire on June 30, 2002. In March of 1994, voters approved Proposal A which precluded local school districts from levying more than 18 mills in property taxes. According to Proposal A, all unexpired millages authorized before January 1, 1994, were valid. Therefore, the 32.25-mill school operating property tax remained valid.

Although voter approval for the DPS operating millage expired on June 30, 2002, DPS levied an unauthorized 18-mill tax for tax years 2002-2004 without voter approval. DPS believed that pursuant to Proposal A, local school district electors no longer needed to approve a tax rate of 18 mills. In August 2005, DPS acknowledged that the taxes levied for 2002-2004 were levied without authorization and that revenue from those taxes might have to be refunded. Briggs sued DPS seeking a refund of the unauthorized taxes. The Tax Tribunal dismissed the claim because Briggs failed to file the suit within 30 days of the issuance of the applicable tax bills. In an amended petition, Briggs alleged that a mutual mistake of fact under MCL 211.53a occurred and, therefore, it had three years to file a suit to recover the unauthorized taxes. The Tax Tribunal held that MCL 211.53a did not apply and again dismissed the claim.

The Court of Appeals reversed, holding that Briggs could rightfully pursue a refund claim under MCL 211.53a. According to the Court of Appeals, the mistake regarding the validity of imposing the tax was a mutual mistake of fact between the taxpayer and the assessor. The Michigan Supreme Court granted respondents' applications for leave to appeal. The issue before the Supreme Court was whether a mutual mistake of fact occurred such that the three-year limitations period of MCL 211.53a applied.

The Michigan Supreme Court explained that generally a petitioner needs to file a petition with the Tax Tribunal within 30 days of the issuance of the applicable tax bills. The Supreme Court pointed out that if another statute provides a different limitations period for filing a petition with the Tax Tribunal, that statute trumps the general rule. To determine whether MCL 211.53a applied to Petitioner's claim, the Court focused its analysis on the meaning of the phrase "mutual mistake of fact made by the assessing office and the taxpayer." The Court emphasized that the phrase acquired a particular meaning under *Ford Motor Co v City of Woodhaven*, where the court found that a mutual mistake of fact existed. In that case, the Court held that a "mutual mistake of fact" is "an erroneous belief, which is shared and relied on by both parties, about a material fact that affects the substance of the transaction." In its analysis, the Court first focused on the mutuality requirement. Since the mistake at issue could be attributed to DPS alone, the court found that no such mutuality existed. Specifically, while a mistake occurred, the mistake was not made by the assessor. The assessor performed his or her statutory duties (duties which include the creation of the annual tax assessment roll, determination of property values for tax assessment purposes, and the determination of taxable values. The Supreme Court continued by acknowledging that assessors are required to spread the taxes on the tax roll, but that assessors can not review or alter certified tax rates. As a result, there could be no mutual mistake of fact.

Second, the Court explained that the collection of an unauthorized tax constitutes a mistake of law rather than a mistake of fact. The Court distinguished *Briggs* from *Ford* explaining that in *Ford*, the assessor and petitioner shared

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a mistaken belief as to the amount of Ford's property subject to tax. In contrast, the mistake in *Briggs* simply consisted of the imposition of a tax not supported by law.

For all of the foregoing reasons, the Michigan Supreme Court determined that the DPS District's mistake in levying an unauthorized mill tax for three tax years was not a mutual mistake of fact and, therefore, MCL 211.53a did not apply to Petitioner's claim. Accordingly, Briggs was not entitled to a refund, since it did not file its petition within 30 days of the issuance of the applicable tax bills, the general limitations period.

If you have any questions, please contact **Steven Lasher** at **517.371.8118** or **slasher@fosterswift.com.**

BOND COUNSEL CORNER

Need Funding? Still Time to Consider Build America Bonds

by Janene McIntyre

Build America Bonds (BABs) are taxable municipal bonds, authorized under the American Recovery and Reinvestment Act (ARRA) on February 17, 2009. ARRA provides two ways for BABs issuers to lower their net interest costs: Direct Payment BABs and Tax Credit BABs.

A municipal issuer of Direct Payment BABs receives a subsidy from the federal government equal to 35% of the interest paid to bondholders. This permits an issuer to issue municipal bonds that pay interest rates competitive with rates paid by corporations, but at a lower effective interest cost. Direct Payment BABs may finance capital projects, such as public buildings, roads, transportation infrastructure, and water and sewer projects. Direct Payment BABs may not be used for refundings, working capital or private activities.

Tax Credit BABs, used far less to date than the Direct Payment BABs, give the bond investor a federal tax credit equal to 35% of the interest paid to the bondholder each year. Tax Credit BABs can be used for capital projects, refundings, and working capital.

Currently, BABs cannot be issued after a December 31, 2010 sunset date. It is not predictable whether the BABs sunset will be extended or, if so, how they will be structured. President Obama's fiscal 2011 budget proposed permanently extending the BABs program at a reduced subsidy of 28% and expanding the uses of Direct Payment BABs to include refundings and working capital. The Small Business and Infrastructure Jobs Act of 2010 (H.R. 4849), passed by the House of Representatives on March 24, 2010, would (if passed by the Senate and enacted into law) extend the BABs program until April 1, 2013, but would reduce the subsidy to 33% in 2011, 31% in 2012 and 30% in the first three months of 2013.

If you are interested in learning how your governmental unit might benefit from issuing BABs before the sunset, please contact a member of Foster Swift's Municipal Team, including Janene McIntyre at 517.371.8123 or jmcintyre@fosterswift.com.