



## Michigan Supreme Court Rules that Building Inspection Fees Must Reasonably Relate to the Costs of Services Provided by a Municipality's Building Department

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The Michigan Supreme Court recently ruled that the building inspection fees assessed by the city of Troy, Michigan, violate Michigan's Construction Code Act (CCA). The decision, stemming from a lawsuit filed by Michigan Association of Home Builders, Associated Builders and Contractors of Michigan, and Michigan Plumbing and Mechanical Contractor Association (the "Plaintiffs"), overturned a ruling by the Michigan Court of Appeals.

### Background

In 2003, Troy's Building Department began operating with a yearly deficit that grew to an aggregate amount of \$6.7 million in 2011. In 2010, Troy privatized the Building Department and contracted with a company called SAFEbuilt.

Pursuant to the parties' contract, SAFEbuilt received 80% of all building inspection fees and Troy received the remaining 20%. If fee revenue totaled \$1 million or more, revenue sharing would adjust to 75% for SAFEbuilt and 25% for Troy. Starting in 2012, fee revenue exceeded \$1 million every year, and by 2016, Troy had collected more than \$2.3 million in fees under the contract.

The Plaintiffs brought a lawsuit in 2010 in which they alleged violations of the CCA and Michigan's Headlee Amendment (which, among other things, requires voter approval for any local tax increases or new taxes).

The Plaintiffs' primary argument was that Troy's practice of collecting "significant monthly surpluses" of building inspection fees, which were used to augment its general fund, violated MCL 125.1522(1) of the CCA.

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As the Supreme Court explained, MCL 125.1522(1) requires that fees: "(1) be reasonable, (2) 'be intended to bear a reasonable relation to the cost' of Building Department services, and (3) be used only for operation of the Building Department."

The trial court ruled in Troy's favor on the basis that the money it collected repaid loans from the general fund that had been used to operate Troy's Building Department when it ran deficits. Plaintiffs appealed the decision to the Court of Appeals which affirmed the lower court decision. The case then went to the Supreme Court.

### **The Supreme Court Decision**

The Supreme Court began by defining the three restrictions that MCL 125.1522(1) places on a municipality's authority to establish fees under the CCA.

- First, "the amount of the fee 'shall' be reasonable."
- Second, "the amount of the fee 'shall' be reasonably related to the cost of providing the service."
- Third, "the fees collected shall only be used for the operation of the enforcing agency or the construction board of appeals, or both, and 'shall' not be used for any other purpose."

The Supreme Court found that Troy's use of fees to satisfy a historical budget deficit violated the second restriction. It concluded that such use of the fee surpluses did not reasonably relate to the cost of providing the service. In support of its argument, the Supreme Court noted differences between MCL 125.1522(1) and MCL 125.1522(2) (which concerns the creation of a state construction code fund).

It explained that MCL 125.1522(2) specifically acknowledges the possibility of a surplus of fees collected by the state, and empowers the state treasurer to invest the surplus as appropriate. MCL 125.1522(1), on the other hand, makes no mention of "surplus," which the Supreme Court concluded means that the legislature did not envision a surplus "baked consistently into the fees."

In addition, the Supreme Court explained that there was evidence to suggest that Troy did not intend for its fees to reasonably relate to the cost of the services performed. While Troy collects at least 20% of the fees, it estimated that it only retained 8% of that amount to cover its Building Department's indirect costs. The Supreme Court acknowledged that Troy was entitled to apply fees that it collected to cover direct and indirect (e.g., overhead) costs.

Accordingly, the Supreme Court ruled that while Troy cannot continue to collect fees that result in surpluses to pay historical deficits of the Building Department, the case should be remanded to the trial court to determine the amount of direct and indirect costs incurred by the Building Department for the performance of services.

The Supreme Court went on to consider a few other issues related to the Plaintiffs' claims:

- Private Cause of Action: The Supreme Court explained that the CCA does not explicitly provide for a private cause of action that would allow the Plaintiffs to seek monetary damages. However, while a private cause of action for monetary damages does not exist, the Plaintiffs are allowed to pursue a cause of action for declaratory and equitable relief, such as seeking an injunction against Troy.



- **Headlee Amendment:** In general, a private citizen has no standing to challenge the actions of a public entity unless he or she has been harmed in a manner distinct from the public at large. The Headlee Amendment, however, grants taxpayers standing to pursue violations of the Headlee Amendment. The Supreme Court noted that the Plaintiffs failed to present any evidence that they (or their members) were taxpayers in Troy, and therefore did not find that the Plaintiffs had standing to pursue a claim under the Headlee Amendment.

This case is a call to action for municipalities across Michigan to examine their practices and procedures related to collecting and expending fees under the CCA. The Supreme Court explained that when it comes to setting fees to cover expenditures, “[e]xactitude is not required.” Rather, there must be a reasonable relation between fees and costs.

If you have any questions about the CCA or other issues addressed in the Supreme Court’s opinion, please contact Tom Meagher at 517.371.8161 or at [tmeagher@fosterswift.com](mailto:tmeagher@fosterswift.com). Tom concentrates his practice on the defense of employment lawsuits and commercial litigation and includes the defense of cases involving constitutional law, civil rights and discrimination, whistleblower, disability and licensing claims on behalf of private and municipal clients.