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A Municipal Law Update

Bodman PLC **February 4, 2025**

Michigan Supreme Court Holds that a Tax Cannot be Disguised as a Franchise Fee in Violation of Headlee

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The Michigan Supreme Court released an opinion yesterday holding that a municipality may not disguise a tax by imposing a utilities franchise fee upon consumers through a utilities franchise agreement when that agreement causes the utility to simply act as a collection agent of the municipality. In *Heos v City of East Lansing*, 513 Mich ___; 4 NW3d 744 (2024), the court ruled that such an arrangement violates Article 9, § 31 of Michigan's 1963 Constitution, known as the "Headlee Amendment."

In this case, the City of East Lansing and the Lansing Board of Water and Light (LBWL) entered into a renewal of a franchise agreement that required the LBWL to charge a franchise fee to consumers. The agreement required LBWL to "collect and remit to the City" the franchise fees collected under the agreement in exchange for a 0.5% administrative fee. The plaintiff, on behalf of a class, brought a six-count complaint against the city alleging, among other things, that the franchise fee was a new local tax that violates the Headlee Amendment because it was not approved by voters.

Two issues were addressed by the court: first, whether the franchise fee was a tax, and second, whether the plaintiff was a taxpayer who had timely filed a claim. Relying on the factors set forth under *Bolt v Lansing*, 459 Mich 152, 161-167; 587 NW2d 264 (1998), the court held that the franchise fee "functions as a tax because the fee was imposed for a general revenue-raising purpose, the fee was not proportionate to any costs the City incurred in LBWL providing electrical services, and the fee was not voluntary."

Distinguishing the instant facts from those in *Morgan v Grand Rapids*, 267 Mich App 513; 705 NW2d 387 (2005), the court held a significant consideration to be that, unlike the *Morgan* case where the utility was legally responsible for the franchise fee regardless of whether the customers ultimately paid that fee, the LBWL had no such legal responsibility for the franchise fees under the franchise agreement with the city. Rather, the franchise agreement provided that LBWL shall "collect and remit" the franchise fee to the city, demonstrating that LBWL "was serving only as a conduit in the City's taxation of East

Lansing LBWL consumers." The court stated that "[t]o condone a structure whereby a city can outsource taxing power to a third-party contractor as a nongovernmental fee would create a massive loophole in the Headlee Amendment and its constitutional protections."

The court's ruling represents a significant clarification for municipalities who may have included an element related to the imposition of franchise fees upon a consumer and the factors that should be considered to determine the lawfulness of such a pass-through structure.

Please contact the author, Sarah J. Gabis (734-930-2491 / sgabis@bodmanlaw.com) or any member of Bodman's Municipal Law and Government Relations Practice Group if you have questions regarding any of the information above. Bodman cannot respond to your questions or receive information from you without establishing an attorney-client relationship and clearing potential conflicts with other clients. Thank you for your patience and understanding.