

# Frequently Asked Questions About the New Michigan Local Financial Emergency Law

*(Public Act 436 of 2012)*



*Author:*

*Eric Scorsone, Ph.D., Extension Specialist  
Department of Agricultural, Food  
and Resource Economics, and MSU  
Extension, Michigan State University*

**January 2013**

**This fact sheet, in question-and-answer format, discusses the Michigan emergency manager law, known as the Local Financial Stability and Choice Act (Public Act 436 of 2012). The bill was signed into law in December 2012 and takes effect on March 28, 2013.**

# Frequently Asked Questions About the New Michigan Local Financial Emergency Law *(Public Act 436 of 2012)*

**Q. What is the new emergency manager law?**

**A.** The new law is known as Public Act 436 of 2012 (the Local Financial Stability and Choice Act). It was passed in December 2012 to replace Public Act 4 of 2011.

**Q. Why was a new law necessary?**

**A.** The law was passed because the Michigan Legislature and Gov. Rick Snyder felt that a replacement was needed for the now-defunct 2011 Emergency Manager Law (Public Act 4 of 2011). (PA 4 had been rejected by voters in a November 2012 statewide referendum.) This was deemed critical because of the fiscal crises being experienced in cities such as Detroit and Flint, and school districts such as Highland Park and Muskegon Heights.

**Q. What is the difference between the Local Financial Stability and Choice Act and the law that was rejected by voters?**

**A.** One key difference is that PA 436 gives local governments and school boards four options for addressing a fiscal emergency: a consent agreement, bankruptcy, mediation, and the appointment of an emergency manager (EM). The governor still has the power to order a financial review and declare on the basis of the findings from the review process whether a financial emergency exists. If a fiscal emergency is declared, the local government or school system must decide among the four options; doing nothing is not a choice.

**Q. When will the law be applied to a local unit of government or school district?**

**A.** The law will be applied to a community or school district if its financial situation meets certain criteria

spelled out in the law. At that point the governor – or the community or school district itself – starts the legal process by requesting a financial review. The review is designed to determine whether an official financial emergency exists, and if one does, the degree and scope of that emergency. After the financial review, if a financial emergency is declared, the local board decides which of the four methods outlined in the law they will use to address the crisis.

**Q. What conditions will trigger a financial review?**

**A.** A number of factors may trigger a state financial review of a local government or school district. These factors include:

- ▶ Missed payroll or bond payments
- ▶ Failure to comply with a state-ordered deficit elimination plan
- ▶ Violation of local government debt or budgeting rules
- ▶ Imposition of a court-ordered tax levy
- ▶ A very low credit rating
- ▶ Any other facts that, in the state treasurer’s estimation, may threaten the fiscal stability of the local government

**Q. What is involved in a financial review?**

**A.** A preliminary review is conducted by auditors from the Michigan Department of Treasury. If the auditors find evidence that a financial emergency may exist, the governor then appoints a financial review team. The team then conducts a thorough investigation to determine if, in fact, a financial emergency exists.

**Q. Who is involved in a financial review?**

**A.** A number of individual or their designees play a role in the review process, including:

- ▶ The state treasurer or designee
- ▶ The director of the Michigan Department of Technology, Management and Budget or designee
- ▶ Three representatives nominated (one each) by the governor, the speaker of the House and the Senate majority leader.

**Q. What does a financial review team do?**

**A.** A financial review team uses a fact-finding process to identify conditions that may result in the declaration of a local financial emergency, including:

- ▶ Potential for missed bond payments or missed payrolls
- ▶ Excessive amounts of money owed to vendors
- ▶ Large general fund deficits
- ▶ Loans between government funds
- ▶ Existence of a structural operating deficit
- ▶ Inappropriate use of government funds
- ▶ Missed pension contributions

If a financial review team finds that one or more of these factors exists or likely will exist in the future, the team must report that a financial emergency exists.

**Q. Can other factors lead to the declaration of a financial emergency?**

**A.** Yes, several other factors can lead to the declaration of a financial emergency, such as that:

- ▶ A local government or school district fails to comply with a deficit elimination plan.
- ▶ A local government or school district fails to cooperate with a financial review team.
- ▶ The chief administrative officer of the community or school district concludes that one or more of these conditions may or is likely to exist soon.

**Q. What happens after the financial review is finished?**

**A.** The financial review team forwards its findings to the governor. The governor then must decide within 10 days whether to declare a local financial emergency. If the governor declares a local financial emergency, then the elected board of the unit of government or school district under investigation must choose one of four options for addressing the emergency.

**Q. So, what are the four choices an elected board has?**

**A.** The four choices an elected board has under this act are:

- ▶ Entering into a consent agreement
- ▶ Filing for bankruptcy
- ▶ Accepting the appointment of an emergency manager
- ▶ Agreeing to mediation

**Q. What is a consent agreement?**

**A.** A consent agreement is a legal contract between local and state officials describing actions that must be taken to ensure that a financial emergency is rectified. Certain powers may be given to a local elected or appointed official in order to carry out a consent agreement. If a consent agreement cannot be ratified within 30 days or is not agreed to by either party, the local government or school district must proceed under another option.

**Q. What happens if a local government fails to comply with the terms of a consent agreement?**

**A.** If a material breach of the agreement occurs, the governor has the power to place the local government into receivership or into the mediation process.

**Q. What does it mean for a municipality to file for bankruptcy?**

**A.** Under federal law, municipalities in the United States may file for bankruptcy. A municipal bankruptcy filing is more like an individual filing for bankruptcy than a corporation doing so. The process is designed to help a municipality relieve itself of certain financial obligations so it can continue to function and provide critical public services. There are consequences to filing for bankruptcy including, for example, a possible credit rating downgrade and limited access to borrowing for a period of time.

**Q. What would be the circumstances in which a local unit of government would file an immediate bankruptcy?**

**A.** A local government might file for bankruptcy if it were facing an immediate cash crisis, such as knowing that it was likely to run out of cash with which to pay its bills (including for material purchases or an employee payroll), within 30 to 60 days.

**Q. Does the governor have a say in whether a local government may file for bankruptcy?**

**A.** Yes, the governor has the right to approve or disprove the bankruptcy filing and may place conditions on it. If the governor refuses to approve the bankruptcy filing request, the local government must proceed under one of the three other options specified in the law. The governor may appoint a receiver to act on behalf of the local government during a municipal bankruptcy proceeding. If the governor does not appoint a receiver, the local government chief administrative officer will act to guide the jurisdiction through the bankruptcy proceedings.

**Q. How would a bankruptcy filing help resolve a financial crisis?**

**A.** The idea is that bankruptcy will relieve the municipality of certain financial obligations so that the government can continue to provide public services. Certain creditors (such as employee groups, bondholders and vendors) may not be paid or may receive only a portion of what they are owed.

**Q. What happens if the elected officials choose to ask for the appointment of an EM?**

**A.** The powers and responsibilities of an EM under PA 346 of 2012 are very similar to those of one under the now-defunct Public Act 4 of 2011.

**Q. Can an elected board remove an EM?**

**A.** PA 436 does allow an elected board to remove an EM after he or she has served in the position for 18 months. Such an action requires a supermajority (two-thirds) vote of the elected board and the signature of the chief administrative officer (such as the county executive, mayor or school superintendent).

**Q. Can an EM raise taxes?**

**A.** No, an EM can propose to raise taxes and take it to a vote of the people, but he or she cannot unilaterally raise taxes.

**Q. What are the qualifications to be an emergency manager?**

**A.** The qualifications are that the individual must have a minimum 5 years of experience in business or

government. He or she does not have to be a resident of the local government or school jurisdiction.

**Q. What are the powers of an EM?**

- A.** The powers of an EM include to:
- ▶ Request and review all records of the local government.
  - ▶ Request, modify and terminate existing contracts under certain conditions.
  - ▶ Approve and disapprove appropriations, payments and budgets.
  - ▶ Require special financial reporting.
  - ▶ Fill vacant positions.
  - ▶ Consolidate or eliminate departments.
  - ▶ Engage in intergovernmental contracting.
  - ▶ Retain consultants.
  - ▶ Initiate court proceedings to enforce orders.
  - ▶ Sell debt.
  - ▶ Sell or transfer assets (with written approval of the state).

**Q. What type of reporting is an EM required to do?**

**A.** An EM must report to the state on a quarterly basis about financial changes, staffing changes and contract changes. This financial and operating report must explain how deficits are going to be reduced and critical public services maintained.

**Q. Can an EM's actions be challenged?**

**A.** Yes, certain actions by an EM can be challenged by the local elected board. Decisions about asset sales, changes to or termination of union contracts, and borrowing can be challenged by the local elected board within 10 days. The local elected board then has 7 days to provide an alternative with “substantially the same financial result” to the local emergency financial assistance loan board (LEFALB). The LEFALB will then have the final say over which proposal moves forward in the best interests of the public.

**Q. When does an EM's term end?**

**A.** An EM's term ends when one of two conditions is met: The financial emergency is solved or after 18 months in office, the local government board may vote to remove the EM. The removal process requires a two-thirds majority vote of the elected board and the concurrence of the chief administrative officer (such as a mayor, county executive or school superintendent).

If an EM is removed, the local government must negotiate a consent agreement with the state or begin the mediation process.

**Q. Can an EM unilaterally file for bankruptcy for the unit of government or school district over which he or she is presiding?**

**A.** If, after 6 months, the EM determines that there is no feasible plan to sustainably fix the finances of the municipality or school district, a bankruptcy filing may proceed. This filing is subject to the governor’s approval.

**Q. What is the mediation process?**

**A.** This is a process in which a local government meets with its creditors (such as employee groups, bond holders and vendors) to negotiate a settlement about who can be paid and how much. It is designed to try to avoid a bankruptcy filing or minimize the negative impact and cost of a bankruptcy by getting agreement and some consent to reductions. The parties meet with a neutral mediator who facilitates the process.

**Q. Who can be a mediator in the mediation process?**

**A.** Under the law, the mediator must be a person with ten years of experience in high level business and government and expertise in municipal organization, public finance and labor law.

**Q. Who selects the mediator?**

**A.** The chief administrative office of the local government or school district (such as the mayor, city manager or school superintendent) and the interested parties must mutually agree to a mediator. The first step is for the local government or school district to contact the interested parties. After 7 days from the first contact, the local government or school district must provide the names of five potential mediators. The interested parties may then veto up to four names. If only one candidate remains, that person becomes the mediator. If more than one candidate remains, the local government chooses a mediator from them. If the interested parties still object to the designated mediator, the state treasurer has the authority to determine whether the mediator is acceptable and meets the

legal requirements to serve in the position. If the parties fail to agree to a mediator within 7 days, the state treasurer may determine that a mediator candidate is appropriate and will be used.

**Q. What does the mediator do?**

**A.** The mediator must have no connection to any of the parties involved and must act in a fair and unbiased manner. The mediator has no power to enforce any actions or decisions. The person’s job is to create the environment and conditions through which the parties could potentially reach a settlement.

**Q. Who pays for the mediator?**

**A.** Unless otherwise agreed to by the parties involved in the negotiation, the local government pays 50 percent and the other parties combined pay 50 percent of the cost.

**Q. How long can the mediation process last?**

**A.** Generally, the mediation process lasts 60 days, with a 30-day extension possible if all parties agree. If a settlement is reached, the process is ended. However, the state treasurer may reject a settlement agreement and force the local government or school district back to one of the other three options (consent agreement, bankruptcy or appointment of an EM). If the creditors do not respond to the request for mediation within 60 days, or if the process does not resolve all outstanding disputes, the local government or school district files for municipal bankruptcy.

**Q. What happens if the local government or school district fails to begin the mediation process?**

**A.** If within 7 days the local government or school district fails to notify the interested parties of its interest in mediated talks, the state treasurer may require the local government to accept an emergency manager.

**Q. What happens if a city council or other elected board fails to make any choice?**

**A.** If an elected board fails to act on any of the four choices, they are immediately sent into the mediation process. The board will then be required to act through this process to try and address the financial emergency.

**Q. How does a financial emergency end?**

**A.** It depends on which of the four courses of action described in the law that an elected board has chosen. If a consent agreement is chosen, the state treasurer rules on whether the consent agreement has worked and the financial situation has been rectified. If the mediation process is chosen, the process ends when the parties come to a settlement agreement, which may include a prepackaged bankruptcy filing. If the immediate bankruptcy filing is selected, the process ends when the court proceedings end. Finally, if the emergency manager option is selected, the emergency ends when the EM certifies to the governor that it is resolved and the governor agrees.

**Q. Can the governor place restrictions on a local government at the end of the financial emergency?**

**A.** Yes, the governor can place several restrictions on a local government if the emergency manager option is selected, including:

- ▶ The appointment of a receivership transition advisory board
- ▶ Requiring financial training (probably for elected officials such as the city council or school board)
- ▶ The adoption of a model charter
- ▶ The use of financial best practices

**Q. What is a receivership transition advisory board?**

**A.** Such a board is established by the governor at the successful conclusion of a financial emergency. It is designed to ensure that financial problems do not reoccur. The board has the ability to:

- ▶ Convene a revenue forecasting conference
- ▶ Require cash flow and budgeting reporting
- ▶ Review and approve proposed budgets
- ▶ Review and approve debt issuance
- ▶ Review and approve collective bargaining agreements
- ▶ Perform other duties.

If problems emerge during the transition period, the board can recommend to the governor the reappointment of the previous EM or the appointment of a new one.

**Q. What will happen to the emergency managers who were appointed and the consent agreements that were entered into under the terms of PA 4 of 2011 and PA 72 of 1990?**

**A.** These agreements and emergency managers are retained as provided for under those old laws and will continue to operate as provided for under the new law, PA 436 of 2012. This would include the emergency managers in the cities of Benton Harbor, Detroit, Flint, Highland Park, Inkster, Pontiac, and River Rouge, and Highland Park Schools and Muskegon Heights Schools.