

# State Notes

## TOPICS OF LEGISLATIVE INTEREST

### January/February 2003



#### Challenging Executive Order 2001-9 *County Road Association of Michigan et al v John M. Engler et al* By Craig Thiel, Fiscal Analyst

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Executive Order (EO) 2001-9 was approved by the Legislature in November 2001 to adjust State appropriations downward in order to meet expected revenues for fiscal year (FY) 2001-02. Part of the EO affected various transportation-related funds to reduce appropriations in the Michigan Department of Transportation (MDOT) budget by \$63 million. These reductions resulted in savings to the General Fund of \$63 million. Subsequent to approval of the EO, the [County Road Association of Michigan](#) and the Chippewa County Road Commission challenged the various transportation pieces of the EO. Recently, the Ingham County Circuit Court ruled in favor of the County Road Association of Michigan and the other plaintiffs, enjoining the State from transferring to the General Fund \$32.75 million of the \$63 million in transportation-related funding. The Court's decision has a direct impact on the State's General Fund budget for FY 2001-02 in the same amount. Also, depending on the timing and final decisions of the Court regarding the lawsuit, *County Road Association of Michigan et al v John M. Engler et al*, the State's FY 2002-03 and FY 2003-04 General Fund budgets may be affected.

#### Executive Order 2001-9

Executive Order 2001-9 was issued by the Governor and approved by the Legislature in November 2001 pursuant to Article V, Section 20 of the Michigan Constitution.<sup>1</sup> The EO reduced various FY 2001-02 General Fund/General Purpose (GF/GP) appropriations to eliminate a State budget deficit caused by a shortfall in revenues. The EO reduced appropriations in the MDOT budget by \$63 million through a combination of funding shifts. These reductions resulted in savings to the General Fund of \$48 million, realized in the Michigan Department of State and Michigan Department of Treasury budgets for FY 2001-02. Also, a total of \$15 million in revenue dedicated to the Comprehensive Transportation Fund and the Transportation Economic Development Fund was redirected to the General Fund under the EO.

Executive Order 2001-9 authorized an increase in the Michigan Transportation Fund (MTF) grant to the Michigan Department of State from \$55,814,100 to \$95,814,100 for FY 2001-02. The Department of State receives an annual MTF grant to cover the costs associated with the collection of vehicle registration and titling fees. These administrative costs are allowable pursuant to Article IX, Section 9 of the Michigan Constitution.<sup>2</sup> The increase in the MTF grant was offset by an equal reduction in the level of GF/GP appropriations in the Department of State budget.

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<sup>1</sup> Article V, Section 20 states, "The governor, with the approval of the appropriating committees of the house and senate, shall reduce expenditures authorized by appropriations whenever it appears that actual revenues for a fiscal period will fall below the revenue estimates on which appropriations for that period were based. Reductions in expenditures shall be made in accordance with procedures prescribed by law. The governor may not reduce expenditures . . . from funds constitutionally dedicated for specific purposes."

<sup>2</sup> The first paragraph of Article IX, Section 9 states, "All specific taxes, except general sales and use taxes and regulatory fees, imposed directly or indirectly on fuels sold or used to propel motor vehicles upon highways and to propel aircraft and on registered motor vehicles and aircraft shall, after the payment of necessary collection expenses, be used exclusively for transportation purposes as set forth in this section."

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Under EO 2001-9, the Department of Treasury was authorized to receive a grant from the MTF in the amount of \$8 million to cover the costs of fuel tax collection. These administrative costs are allowable pursuant to Article IX, Section 9 of the Michigan Constitution. The MTF grant was offset by an equal reduction in the level of GF/GP appropriations to Treasury for FY 2001-02. Before the EO was approved, the Department did not have an appropriation from the MTF for FY 2001-02.

Combined, the funding shifts in the budgets for the Departments of State and Treasury totaled \$48 million. This had an impact on the amount of MTF funding that was made available to the Comprehensive Transportation Fund (CTF) and State and local road agencies pursuant to the formulae contained in Public Act (PA) 51 of 1951. Specifically, the statutory MTF allocations were reduced as follows: CTF by \$4.8 million, State Trunkline Fund by \$16.9 million, county road commissions by \$16.9 million, and cities and villages by \$9.4 million.

Although the Michigan Department of Transportation does not receive any direct GF/GP appropriations, both the Comprehensive Transportation Fund and the Transportation Economic Development Fund (TEDF) receive revenue that otherwise would be deposited in the General Fund. Article IX, Section 9 of the Michigan Constitution provides that not more than 25% of the general sales tax imposed at the rate of 4% on specific motor vehicle-related sales is to be used exclusively for comprehensive transportation purposes. This constitutional provision is implemented in the General Sales Tax Act.

Section 25 of the General Sales Tax Act provides that 27.9% of 25% of the general sales tax imposed at the rate of 4% on motor vehicle-related sales must be deposited in the CTF. (The remainder of the sales tax from motor vehicle-related sales is deposited in the General Fund and School Aid Fund.) This deposit to the CTF in FY 2001-02 was \$78.8 million. The total CTF revenue for the year, including the statutory allocation from the Michigan Transportation Fund, was \$242.9 million. Executive Order 2001-9 amended Section 25 of the General Sales Tax Act to reduce the amount of the FY 2001-02 sales tax revenue deposit in the CTF by \$12.75 million, and diverted this revenue to the unappropriated balance of the General Fund. At the same time, EO 2001-9 reduced various CTF-funded line items in the FY 2001-02 MDOT budget by \$9.55 million.

Section 819 of the Michigan Vehicle Code requires that a portion of the revenue from driver license fees be deposited in the TEDF. In FY 2001-02, this deposit was estimated at \$13 million. The total funding for the TEDF in FY 2001-02 was \$57.28 million. For FY 2001-02 only, EO 2001-9 amended Section 819 to reduce the amount of the deposit to the TEDF by \$2.25 million, and diverted this revenue to the unappropriated balance of the General Fund. Simultaneously, EO 2001-9 reduced three TEDF-funded programs in the MDOT budget by \$2.25 million.

In total, EO 2001-9 resulted in savings to the General Fund of \$63 million from transportation-related revenues. The \$48 million in MTF funding shifts in the budgets for the Departments of State and Treasury were continued in the enacted FY 2002-03 budget. All of the CTF program line item reductions contained in the EO (totaling \$9.55 million) were restored in the FY 2002-03 budget. The TEDF appropriation reductions also were restored in the FY 2002-03 budget.

### **County Road Association of Michigan Lawsuit**

On March 6, 2002, the County Road Association of Michigan (CRAM) and the Chippewa County Road Commission filed a complaint in Ingham County Circuit Court challenging various provisions of EO 2001-9 and requesting injunctive relief from these provisions. Specifically, the complaint consists of five counts.

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First, the plaintiffs allege that the transfer of \$40 million from the MTF to the Department of State violated Article IX, Section 9 of the Michigan Constitution, for the reason that the transfer was in excess of the expenses necessary for the collection of motor vehicle registration taxes and fees incurred by the Department. The plaintiffs also allege that the transfer of constitutionally dedicated transportation revenue by executive order violated Article V, Section 20 of the Michigan Constitution. (Implicit in the plaintiffs' arguments under this count is the question of whether constitutionally-dedicated funds can be transferred between State departments by executive order.)

Second, the complaint alleges that the defendant violated Article IX, Section 9 of the Michigan Constitution by using, for nontransportation purposes, revenues from the sale of information or products, the creation of which was funded by constitutionally dedicated funds. The plaintiffs argue that the portion of the commercial look-up fees and other revenue earned by the Department of State and other State agencies from the sale of vehicle-related information is restricted to transportation purposes pursuant to Section 9. A portion of the Department of State's commercial look-up operations is funded by MTF appropriations.

Third, the plaintiffs allege that the transfer of \$8 million from the MTF to the Department of Treasury violated Article V, Section 20 and Article IX, Section 17 of the Michigan Constitution<sup>3</sup>, and Section 10 of PA 51 of 1951 (MCL 247.661) by allowing the Department of Treasury to bill MDOT for expenses in excess of those necessary to collect motor vehicle taxes and fees. (Section 10 of PA 51 of 1951 limits the State departments that are eligible to receive appropriations from the MTF to cover their transportation-related administrative expenses. The Department of Treasury is not listed in Section 10 as one of the eligible departments. This section appears to conflict with Article IX, Section 9 of the Michigan Constitution, which does not list specific departments eligible to receive appropriations from the MTF for transportation-related collection expenses.)

Fourth, the plaintiffs allege that the transfer of \$12.75 million from the CTF to the General Fund violated Article IX, Section 17 of the Michigan Constitution for the reason that the transfer was done without an appropriation by the Legislature and represents unauthorized payment from the State Treasury. The Michigan Public Transit Association, Ann Arbor Transportation Authority, and Capital Area Transportation Authority joined CRAM in the lawsuit as intervening plaintiffs with respect to this count only.

Finally, the complaint alleges that the transfer of \$2.25 million from the TEDF to the General Fund violated Article IX, Section 17 of the Michigan Constitution for the reason that the transfer was done without an appropriation by the Legislature and represents unauthorized payment from the State Treasury.

In their complaint, the plaintiffs requested the Court to enjoin the State from implementing the sections of EO 2001-9 dealing with transfers of MTF, CTF, and TEDF funds to the Department of State, the Department of Treasury, and the General Fund. In total, the plaintiffs requested \$63 million in relief from the provisions of the EO.

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<sup>3</sup> Article IX, Section 17 states, "No money shall be paid out of the state treasury except in pursuance of appropriations made by law."



### **Court Action To Date**

On October 30, 2002, the Honorable William Collette, Ingham County Circuit Court, ruled from the bench in favor of CRAM and the intervening plaintiffs and ordered a preliminary injunction with respect to the CTF portion of EO 2001-9. An Order Issuing Preliminary Injunction was entered with the Court on December 11, 2002. The Court ordered that the State is enjoined from transferring the CTF funds to the General Fund pursuant to EO 2001-9 until further notice. The Court reasoned that the CTF funding included in EO 2001-9 is constitutionally dedicated, and therefore, it may not be transferred via executive order to the General Fund under the powers granted the Governor in Article V, Section 20 of the Michigan Constitution.

To comply with the Court order, MDOT did not transfer to the General Fund the portion of the sales tax revenue dedicated to the CTF. For the purposes of year-end book-closing, MDOT established an account payable to the General Fund from the CTF until the lawsuit has been resolved. To date, the FY 2001-02 CTF appropriation line item reductions contained in the EO have not been restored; however, these reductions were restored in the enacted FY 2002-03 budget. It is MDOT's position that the FY 2001-02 appropriations will be restored only after final resolution of the lawsuit and only if the State loses. In that event, an appropriation will be needed to address the FY 2001-02 restorations.

On November 12, 2002, Judge Collette again ruled from the bench in favor of CRAM and ordered a preliminary injunction with respect to the MTF portion of EO 2001-9. An Order Issuing Preliminary Injunction was entered with the Court on December 23, 2002. The Court ordered that the State is enjoined from transferring \$20 million in MTF funds to the Department of State or the General Fund pursuant to EO 2001-9 until further notice. The Court did not address the \$8 million MTF transfer to Treasury in its ruling.

The \$20 million represented the costs associated with funding a portion of the Driver's License Appeal Division, Driver Improvement Program, and the entire Automotive Dealer Licensing Program within the Department of State according to the most recent cost-allocation study commissioned by the Department. In its reasoning, the Court found that the MTF funds in question were constitutionally dedicated and the use of the funds for these purposes fell outside of Article IX, Section 9 of the Michigan Constitution.

The Michigan Department of Transportation reduced the FY 2001-02 MTF grant to the Department of State by \$20 million in order to comply with the Court's ruling and created an account payable for this amount to the General Fund until the lawsuit has been resolved. To account for the reduction in funding in its budget, the Department of State created an account receivable from the MTF. The \$20 million in MTF funding in question was not distributed to the CTF and State/local road agencies pursuant to PA 51 of 1951. It is MDOT's position that this funding will be distributed only upon final resolution of the lawsuit and only if the State loses.

It is worth noting that Section 502 of PA 746 of 2002, which makes supplemental appropriations for FY 2002-03 and was enacted after the Legislature approved EO 2001-9, appropriates from the MTF an additional \$40 million and \$8 million to the Departments of State and Treasury above the originally enacted amounts of \$55,814,100 and \$0, respectively. This section effectively provides the same level of MTF appropriations to the Departments of State and Treasury as EO 2001-9 provided; however, this is accomplished through legislation as opposed to executive order. It appears that this language was added to address the court challenge surrounding the MTF transfers contained in EO 2001-9.

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On January 2 and January 13, 2003, the State filed applications for leave to appeal the Circuit Court's decisions regarding the CTF portion and the MTF portion of the EO. On February 19, the Michigan Court of Appeals granted the applications for leave and stayed the preliminary injunctions issued by the lower court. It is unknown, at this time, when the Michigan Court of Appeals will review the lower court's decisions. Also, two other parties, the [Michigan Road Builders Association](#) and the [Association of Underground Contractors](#), have joined the litigation as interveners.

**Fiscal Impact**

Combined, the Ingham County Circuit Court's decisions regarding EO 2001-9 effectively reduce the State's FY 2001-02 General Fund budget by \$32.75 million. For the purposes of FY 2001-02 book-closing, this is presented as an "amount due from other funds" on the General Fund balance sheet of the State of Michigan's Comprehensive Annual Financial Report. Of this total, \$20 million is attributable to the MTF transfer to the Department of State that the Court enjoined. The remaining \$12.75 million represents the sales tax revenue transfer from the CTF. Should the State ultimately lose the lawsuit, it is likely that the General Fund will be required to reimburse the MTF and CTF for these amounts; however, other options for addressing this budgetary shortfall could be identified.

To the extent that the \$40 million MTF transfer to the Department of State was continued in FY 2002-03, that year's budget also could be affected by the Court's finding in this lawsuit. If upheld, the Court's decision to enjoin the transfer of \$20 million from the MTF to the Department of State will require the Department to absorb a cut to its budget in this amount or require additional General Fund resources in FY 2002-03. It is unlikely that a cut of this magnitude could be absorbed without a significant impact on the services provided by the Department. Similarly, if this funding mechanism is used to develop the FY 2003-04 State budget, which appears likely, that year's budget also will be affected.