

STATE OF MICHIGAN
BRANCH COUNTY CIRCUIT COURT

JASON MATE, individually and as
representative of a class of
similarly-situated persons and entities,

Plaintiff,

Case No. 2025-120507-CZ

Hon. Kirk A. Kashian
Acting Circuit Court Judge

v.

CITY OF COLDWATER, MICHIGAN
a municipal corporation, by and through THE
COLDWATER BOARD OF PUBLIC UTILITIES

Defendant.

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**PLAINTIFF'S MOTION FOR SUMMARY DISPOSITION AS TO HIS CHARTER
VIOLATION CLAIM IN COUNT I OF THE CLASS ACTION COMPLAINT**

Plaintiff Jason Mate (hereinafter, "Plaintiff"), by his attorneys, individually and on behalf of a class of similarly situated class members, moves the Court, pursuant to MCR 2.116(C)(10), for summary disposition as to the liability of the City of Coldwater, Michigan (the "City") under Count I of the Complaint (Violation of City's Charter). In support of the Motion, Plaintiff relies upon the following Brief in Support:

BRIEF IN SUPPORT

I. INTRODUCTION

This case primarily requires the Court to determine the meaning of the term “gross income” as used in a provision of the City Charter. The City claims that “gross income” is the same as “revenues.” Plaintiff claims that “gross income” is total revenues minus “costs of goods sold.” As will be seen below, the resolution of this issue will have profound financial implications for the City and thousands of citizens who receive electric service from the City.

This action challenges the retail electric rates and charges (the “Electric Rates” and “Electric Charges”) imposed by the City’s municipally-owned electric utility (the “Electric Utility or the “Electric Fund”) on citizens and entities who/which receive electricity from the City’s Electric Utility (the “Electric Customers”). The City has grossly overcharged its Electric Customers by including in its Rates a so-called “payment in lieu of taxes” charge (the “PILOT Transfer Charge”) that is designed to raise millions of dollars of revenues that the Electric Utility then transfers to the City’s General Fund “for the use and benefit of the city,” allegedly in “recognition of and in compensation for all benefits received from the City in the use of city streets, services, and facilities...” City Charter, Sec. 15.9(a) (Exhibit 1 hereto).

The City has made no attempt to justify the PILOT Transfer Charge as reflecting the reimbursement of actual costs the City allegedly incurs to support or provide these benefits to the Electric Utility, nor does the City’s PILOT Transfer Charge reflect the reasonable amount of a true “payment in lieu of taxes” charge.

The City annually allocates 6.5% of its gross electrical revenues to the PILOT Transfer Charge. However, instead of being authorized by its Charter, the City’s PILOT Transfer Charge actually violates the Charter because the City’s Charter expressly allows the City to transfer **only** 6.5% of the Electric Utility’s “gross income”—**not** “gross revenues” as is the City’s current practice,

which results in the City's electrical customers being overcharged by millions of dollars per year.

As will be demonstrated in detail below, there is a material financial difference between the 6.5% "gross income" transfer amount that is permitted by the City's Charter and the 6.5% of the "gross revenues" of the Electric Utility that the City actually has been transferring to the General Fund. Specifically, under prevailing accounting and tax principles, "gross income" of a business or enterprise is measured by the revenue made in sales **less** the direct costs involved in producing the product being sold, *i.e.* the direct costs of providing electric service. Indeed, as one tribunal recognized nearly 100 years ago, "[t]his is a simple and elementary principle of accounting, which is generally understood, and needs no elucidation on the part of this Board." *W.S. Buck Mercantile Co. v. Commissioner*, 6 B.T.A. 285, 290 (U.S. Bd. of Tax App. 1927) (emphasis added) (Exhibit 2 hereto).

The City incurs tens of millions of dollars of direct costs involved in providing electric service, such as power supply costs and distribution costs, which must be deducted to determine the "gross income" of the Electric Utility. However, prior to calculating the PILOT Transfer Charge, the City fails to deduct these significant direct costs from its gross revenues (*i.e.* the total amount of money received through the Electric Fund's sales). Accordingly, the City's calculation of the PILOT Transfer Charge violates its own Charter which requires a calculation to be made upon the "gross income" and **not** the "gross revenues" of the Electric Fund.¹

II. THE UNDISPUTED FACTS CONCERNING THE CHARTER VIOLATION CLAIM.

A. GENERAL BACKGROUND CONCERNING THE CITY'S ELECTRIC UTILITY.

The Coldwater Board of Public Utilities ("CBPU") is a department of the City established to

¹ Count II of the Complaint alleges that, in addition to violating the City's Charter, because the City's Electric Rates historically have included the PILOT Transfer Charge, those overall Rates have been unreasonable in violation of common-law ratemaking principles. Count II is not subject to this Motion.

“conduct the affairs of the city’s systems for the construction, generation, maintenance, purchase, extension, and distribution of electric light and power.” *See* Exhibit 1, City Charter §15.1 and §15.3. The CBPU currently supplies electricity to over 7,000 residential, commercial, industrial and street lighting customers. The service area of the Electric Utility has an estimated population of 18,000 people and includes the City and parts of the Townships of Coldwater, Batavia and Girard, all located in Branch County. *See e.g.* Exhibit 3 hereto, Bond Official statement at p. 21.

The City, through the CBPU, establishes its Electrical Rates from time to time through its Charter and enacted ordinances. *See* Exhibit 1, City Charter § 15.6 and *see* City Ordinances § 1044.04.

B. THE NATURE OF AND BASIS FOR THE PILOT TRANSFER CHARGE.

The City’s General Fund receives the majority of its financing from four primary sources: (a) property taxes; (b) state shared revenues; (c) fees & charges for services; and (d) an annual transfer from the City’s Electric Utility Fund (the PILOT Transfer Charge). *See* Exhibit 4, General Fund Narrative statement from the City’s Budget for FY 2026.

The City does not tout the PILOT Transfer Charges as providing reimbursement for the expenses the City purportedly incurs relating to the Electric Utility but rather uses those Transfer Charge revenues to supplement general revenues due to losses of state revenues. For example, in its FY 2026 Annual Budget, the City stated:

Being a public power community continues to be a factor in our ability to respond to changes in State related revenues. **PILOT from our utility operations continues to provide a stable revenue stream.** [*See* Exhibit 4 hereto, p. 6 (emphasis added).]

The Charter provision that authorizes the City’s PILOT Transfer Charge, § 15.9(a), “Payments to the City,” provides:

(a) The Board of Public Utilities shall, annually, pay to the Treasurer for the use and benefit of the city, **6 1/2% of the gross income** of the department, which payment shall be in recognition of and compensation for all benefits received from the city in the use of city streets, services, and facilities and shall constitute a part of the expenses of the administration and operation of the utilities of the city required to be paid under the first priority of Section 15.12 (a). [Exhibit 1, § 15.9(a) (Emphasis added).]

Thus, pursuant to the City's Charter, the Electric Utility is permitted to transfer 6 1/2% of its gross income for the "use and benefit of the city" in "recognition of and compensation for all benefits received from the city in the use of city streets, services, and facilities." *Id.*

As we will demonstrate below, "gross income" must be measured by the total Electric sales revenue **less** the direct costs involved in producing the product being sold, *i.e.* direct costs associated with supplying the electricity. In its financial statements, the City has identified certain direct costs involved in producing electric service that include: (a) Purchase Power; (b) Power Plant; (c) Natural Gas Plant; (d) Distribution; (e) Substation; and (f) Metering and Lighting. *See* Exhibit 5, Excerpts from the City's Financial Statements for the fiscal year ending June 30, 2025. Of these direct costs, the power supply costs ("Purchase Power") is the most significant. Indeed, during FY 2025, the power supply costs alone exceeded \$34 million. *See* Exhibit 5.

The City's PILOT Transfer Charges are not based upon "gross income" as required by the City's Charter but instead are based upon the Electric Fund's "gross revenues" (with some limited revenues deducted). Put another way, prior to calculating the PILOT Transfer Charge, the City fails to deduct the foregoing significant direct costs from its gross revenues (*i.e.* the total amount of money received through the Electric Fund's sales).

The City determines the amount of the PILOT Transfer Charge for each fiscal year by using the actual Electric Utility revenues from the fiscal year that is two years prior to the current year. *See* Exhibit 6 hereto. Therefore, to establish the amount of the PILOT Transfer Charge for the fiscal year 2022 beginning July 1, 2021, the City used the actual Electric Fund revenues from the fiscal year ending June 30, 2020. *Id.* For the fiscal year ending June 30, 2022, the City budgeted the "PILOT Basis" as \$37,585,293, multiplied by .065, resulting in a PILOT Transfer Charge in the amount of

\$2,443,044. *Id.*²

The City's financial statements show that since at least July 1, 2019, the City has systematically transferred, on an annual basis, at least \$2.4 million per year from the Electric Utility Fund to the City's General Fund. According to the City's Annual Certified Financial Reports ("ACFRs"), the City's General Fund received the following transfers from the Electric Utility Fund in the fiscal years referenced:

- FY 2020 – \$2,544,036. *See* Exhibit 7.
- FY 2021 – \$2,692,404. *See* Exhibit 8.
- FY 2022 – \$2,443,044. *See* Exhibit 9.
- FY 2023 – \$2,574,180. *See* Exhibit 10.
- FY 2024 – \$2,712,120. *See* Exhibit 11.
- FY 2025 – \$3,035,268. *See* Exhibit 5.

The City continued to impose the PILOT Transfer Charge in excess of \$3 million per year in the fiscal year beginning on July 1, 2025 and continues to impose the PILOT Transfer Charge as of the filing of the Complaint. *See* Exhibit 12 (City's FY 2026 Budget) at p. 68.

Under the City's Charter, the amounts used to support the PILOT Transfer Charge are expressly incorporated into the City's Electrical Rates. *See* Exhibit 1, Charter § 15.9(a), which provides that the PILOT Transfer Charge "shall constitute a part of the expenses of the administration and operation of the utilities of the city required to be paid under the first priority of section 15.12(a)." Charter, § 15.12 further provides in part that "[T]he **revenues** of each utility of the City shall be devoted to the following purposes in the order listed: First, **to the expense of administration and operation of each utility**, and the maintenance thereof as may be necessary to

² The budgeted gross revenues of the City's Electric Fund for FY 2022 were \$38,746,142. *See* Exhibit 6 hereto. At least as of FY 2022, the City apparently deducted certain non-material revenues before determining the PILOT Transfer Charges. In FY 2022, these other revenues were approximately \$1,000,000 out of total budgeted revenues of \$38,746,142.

preserve it and its facilities in good repair and working order; ...” [emphasis added]. Finally, § 14.3(b) of the Charter provides that the “**rates and charges** for any municipal utility **shall be fixed on a basis at least adequate to compensate the city for the cost of such service** and to make reasonable provision for the extension thereof according to the needs of the city.” [Emphasis added]

The foregoing Charter provisions make clear that the City’s electric customers were assessed the PILOT Transfer Charge in each and every electric bill they received. Moreover, as electric customers of the City, Plaintiff and each member of the class paid the PILOT Transfer Charge when they paid their electric bill. Due to the PILOT Transfer Charge, the City has overcharged its customers by millions of dollars.

III. PLAINTIFF IS ENTITLED TO SUMMARY DISPOSITION AS TO THE CITY’S LIABILITY FOR VIOLATING THE CHARTER, AS ALLEGED IN COUNT I OF THE COMPLAINT.

A. THE LEGAL IMPLICATIONS OF THE CITY CHARTER PROVISION

Pursuant to Article 7, § 22 of the Michigan Constitution, “[u]nder general laws the *electors* of each city and village shall have the power and authority to frame, adopt and amend its charter...” (Emphasis added.) Under Article 7, §. 22, “the electors of cities are vested with control over their cities’ charters...” and “the electorate of a city is entitled to the final word as to whether a revised charter is to be adopted.” *Sheffield v. Detroit City Clerk*, 508 Mich. 851, 853, 962 N.W.2d 157 (2021).

A city may not take any action “that contradicts limitations expressly provided in the city’s charter. The charter of a city stands as its ‘constitution’; it is the definition of a city’s rights and obligations as a municipal entity, so far as they are not otherwise legally granted or imposed.” *Bivens v. City of Grand Rapids*, 443 Mich. 391, 399, 505 N.W.2d 239 (1994).

The dispositive legal issue presented by this Motion is this: **Is “gross income” as used in Section 15.9(a) of the Charter the same as “revenues”?** For the reasons discussed below, the clear and unambiguous provisions of § 15.9(a) of the City’s Charter confirm that “gross income”

necessarily means revenues minus the cost of goods sold, and foreclose the City's interpretation that "gross income" is synonymous with gross "revenues." Because the City's PILOT Transfer Charges are based on 6 ½ percent of Electric Utility revenues and not the "gross income" of the Electric Utility, the PILOT Transfer Charges violate the City's Charter.

B. THE RULES OF INTERPRETATION APPLICABLE TO THE CITY'S CHARTER.

1. Municipal Charters Are Subject To The Same Principles Of Interpretation As State Statutes.

As an initial matter, as the City itself argues, municipal charter provisions are subject to the same rules of interpretation as statutes. *See* City's MSD Br. filed 2/18/2026 at pp. 8-9.

The primary goal of judicial interpretation of statutes is to give effect to the intent of the Legislature. *Farrington v Total Petroleum, Inc*, 442 Mich 201, 212; 501 NW2d 76 (1993). The first criterion in determining intent is the specific language of the statute. *Indenbaum v Michigan Bd of Medicine (After Remand)*, 213 Mich App 263, 270; 539 NW2d 574 (1995). The Legislature is presumed to have intended the meaning it plainly expressed. *Id.* In determining legislative intent, we look first at the words of the statute. *Id.* The words of the statute must be given their ordinary and plain meaning; only if the language is ambiguous may the courts look beyond the statute to determine the intent of the Legislature. *DiBenedetto v West Shore Hosp*, 461 Mich 394, 402; 605 NW2d 300 (2000).

When statutory language is clear and unambiguous, this Court must honor the legislative intent as clearly indicated in that language. *Western Michigan Univ Bd of Control v Michigan*, 455 Mich 531, 538; 565 NW2d 828 (1997). No further construction is required or permitted. *Id.* Indeed, "ambiguity is a finding of last resort" and it should "be reached only after all other conventional means of interpretation have been applied and found wanting." *Kendzierski v Macomb Cty.*, 503 Mich 296, 311; 931 NW2d 604 (2019), quoting *Mayor of the City of Lansing v Mich. PSC*, 470 Mich 154, 165 & n 6; 680 N.W.2d 840 (2004) (quotation marks omitted).

2. Because The Charter Provision Is Clear And Unambiguous, The Court May Not “Liberally Construe” The Charter Provision In Favor Of The City.

The City contends that its interpretation of the Charter should prevail because, under Const. 1963, art 7, § 34, “the provisions of this constitution and law concerning counties, townships, cities and villages shall be liberally construed in their favor.” City’s MSD Brief at pp. 6-8. But Michigan courts have repeatedly held that art. 7, § 34 has no application to a statute or charter that is clear and unambiguous. *See, e.g., AFP Specialties, Inc v Vereyken*, 303 Mich App 497, 505; 844 NW2d 470 (2014) (the liberal-construction rule was inapplicable because the statutory provision at issue was unambiguous and thus “need[ed] no construction, liberal or otherwise, to determine its meaning.”); *Riverview v Sibley Limestone*, 270 Mich App 627, 631; 716 NW2d 615 (2006) (noting that “[l]aws concerning a city must be liberally construed in its favor” under Const 1963, art 7, § 34, but that “the primary purpose of statutory interpretation is to give effect to legislative intent,” which is determined by the statutory language if it is unambiguous).

The Court of Appeals recently emphasized this important rule of statutory interpretation in *Michigan Association of Home Builders v. City of Troy*, 2024 Mich. App. LEXIS 8354 (2024) (Exhibit 27, hereto “MAHB”). In *MAHB*, the defendant city argued that a provision of the Headlee Amendment should be “liberally construed” in its favor under art. 7, Section 34 of the Constitution. The Court rejected defendant’s proposed construction, stating as follows:

The trial court stated that these two constitutional provisions must be read together and that a liberal construction in favor of defendant was required by Const 1963, art 7, § 34, which provides, in relevant part, “The provisions of this constitution and law concerning counties, townships, cities and villages shall be liberally construed in their favor.” **But the meaning of Const 1963, art 9, § 32 is plain. It unambiguously grants standing to taxpayers and does not refer to qualified electors. See *Hathcock*, 471 Mich at 468-469 (“This Court typically discerns the common understanding of constitutional text by applying each term’s plain meaning at the time of ratification.”). There is no need for construction, liberal or otherwise, to discern the meaning of the language of Const 1963, art 9, § 32. [*MAHB*, 2024 Mich. App. LEXIS 8354 at *27 (emphasis added).]**

For the reasons set forth below, the term “gross income” in the Charter cannot mean the same thing as “revenues,” (*see* Section III.C below) and “gross income” in Section 15.9(a) of the Charter must be interpreted to mean the Electric Utility’s gross revenues minus the cost of goods sold (*see* Section III.D below).

C. “GROSS INCOME” AS A MATTER OF LAW IS NOT THE SAME AS TOTAL “REVENUES.”

First, we address and dispose of the City’s primary argument that “revenues” are synonymous with “gross income” because, according to the City, the “two are used interchangeably in different sections of the Charter where the same budgetary topics are discussed.” City’s MSD Brief at p. 10. Contrary to the City’s arguments, the Charter’s separate use of the terms “revenues” and “gross income” in Chapter 15 of the Charter confirms that “gross income” as used in the Charter is **not** the same as “revenues.”

Consider the following: In Chapter 15 alone, the Charter refers to the “revenues” of the Electric Fund no less than **eight (8)** separate times. In contrast, the term “gross income” appears just **once** in the Chapter – in Section 15.9(a). *See* Exhibit 1 hereto. Given these separate delineations, the Court should reject the City’s argument that “revenues” are the same as “gross income,” because the use of two different terms in close proximity in the same Chapter of the Charter confirms that the people of the City, in the Charter, intended that those two terms have different meanings.

This principle of statutory interpretation was summarized by the Michigan Supreme Court in *United States Fid. Ins. & Guar. Co. v. Michigan Catastrophic Claims Ass’n*, 484 Mich. 1, 15, 795 N.W.2d 101 (2009), where the Court observed:

When the Legislature uses different words, the words are generally intended to connote different meanings. Simply put, “the use of different terms within similar statutes generally implies that different meanings were intended.” 2A Singer & Singer, *Sutherland Statutory Construction*, (7th ed), § 46:6, p 252. If the Legislature had intended the same meaning in both statutory provisions, it would have used the same word. [484 Mich. at 15 (emphasis added)].

In *Anaya v. Betten Chevrolet, Inc.*, 330 Mich. App. 210, 946 N.W.2d 560 (2019), the Court held that the Legislature’s separate use of the terms “customer” and “person” in a statutory scheme meant that the terms could not mean the same thing. There, the Court harmonized two provisions of the Motor Vehicle Service and Repair Act (“MVSRA”) as follows:

Defendants argue that plaintiff could not properly bring a claim under the MVSRA because he was not defendants’ customer or the owner of the vehicle. We disagree.

MCL 257.1336 creates a cause of action for a “**person**” injured as a result of a motor vehicle repair facility’s violation of the MVSRA. The plain language of MCL 257.1336 provides that any **person** who suffers damages or an injury can recover damages and reasonable attorney fees and costs for a repair facility’s violation of the MVSRA. It does not require that the injured person be a **customer** of the motor vehicle repair facility or the owner of the vehicle. Moreover, the statute’s definition of “person” makes no reference to **customers** or vehicle owners. See MCL 257.1302a(h) (defining “**person**” as “an individual, corporation, limited liability company, partnership, association, or any other legal entity”).

Additionally, another portion of the MVSRA, MCL 257.1331, creates a separate cause of action and limits recovery specifically to **customers**. In other words, MCL 257.1331 concerns a **customer’s** recovery, whereas MCL 257.1336 more broadly concerns a motor vehicle repair facility’s liability to **persons** for damages or injury resulting from violations of the MVSRA. **We presume that the Legislature’s use of different terms is intentional.** MCL 257.1336 does not impose a requirement that a plaintiff be a customer of a motor vehicle repair facility or the owner of the vehicle in order to bring a claim under that section of the MVSRA. [330 Mich. App. At 218-219 (emphasis added, internal citations omitted).]

Moreover, a court “reads the provisions of statutes reasonably and in context, and reads **subsections of cohesive statutory provisions together.**” *Detroit Pub Schs v Conn*, 308 Mich App 234, 248; 863 NW2d 373 (2014) (quotation marks and citation omitted). Here, the Court must read the various “subsections” Chapter 15 of the Charter together.

If, as the City now argues, “gross income” is the same as “revenues,” the City Charter would not contain the term “gross income” at all, but instead would have had **nine** references to “revenues” in Chapter 15 instead of just **eight** references. Here, the Charter’s use of “gross income” in limiting the amount of the PILOT Transfer Charges and its separate use (at least 8

times) of the term “revenues” in Chapter 15 must be deemed to be intentional and the terms cannot be interpreted to mean the same thing. Thus, the Court must conclude that “gross income” cannot be synonymous with “revenues.”

D. GIVEN THAT “GROSS INCOME” IS NOT SYNONYMOUS WITH “REVENUES,” THAT TERM MUST MEAN THE SPECIALIZED, GENERALLY-ACCEPTED ACCOUNTING, TAX AND FINANCIAL DEFINITION OF THE TERM – I.E., REVENUES MINUS THE DIRECT COSTS THE CITY INCURS IN PROVIDING ELECTRICITY TO ITS ELECTRIC CUSTOMERS.

If the term “gross income” **cannot** mean “revenues,” what does it mean? For the reasons discussed below “gross income” as used in § 15.9(a) of the Charter can **only** mean total revenues minus the “cost of goods sold.” This is the only interpretation that is consistent with the established understanding of the meaning of this technical term in the accounting, financial, and tax world.

1. “Gross Income” Is A Technical Term That Should Be Interpreted In Accordance With Its Established Technical Meaning.

The City claims that “[t]he Charter does not specifically define ‘gross income,’ nor does it define ‘gross revenue,’ ‘income,’ or ‘revenue’” and therefore “[o]rdinary dictionary meanings must therefore apply to these terms.” City’s MSD Brief at p. 9. Leaving aside the fact that the City never provides the Court with the “common and ordinary” meaning of “gross income,” (more on that below), the City’s argument ignores the fact that “gross income” is a technical term.

Courts give every word or phrase of a statute its plain and ordinary meaning unless a statutory term has a special, technical meaning or is defined by the statute itself. *Casco Twp v Secretary of State*, 472 Mich 566, 593 n 44; 701 NW2d 102 (2005). This Court must **not** assign a “plain and ordinary” meaning where “the Legislature has provided specific definitions or has used technical terms that have acquired a peculiar and appropriate meaning in the law.” *Mayor of Cadillac v Blackburn*, 306 Mich App 512, 516; 857 NW2d 529 (2014). Words and phrases which have acquired a technical meaning in the law are construed according to **that** meaning when they appear in statutes. *Krajewski v. Royal Oak*, 126 Mich. App. 695, 337 N.W.2d 635 (Mich. App. 1983).

The Michigan Legislature has codified this principle in MCL 8.3a, which provides:

§ 8.3a. Approved usage; technical words and phrases.

All words and phrases shall be construed and understood according to the common and approved usage of the language; but technical words and phrases, and such as may have acquired a peculiar and appropriate meaning in the law, shall be construed and understood according to such peculiar and appropriate meaning.

“Gross income” has acquired a peculiar and appropriate meaning in the law. *In re Wagner*, 808 F.2d 542, 546 (7th Cir. 1986) (holding that “gross income” is a “technical” term) (Exhibit 28 hereto). For the reasons set forth below, when applied to a municipal electric utility, “gross income” clearly and unambiguously means the total revenues of the utility minus the costs of goods sold. Because the City bases the PILOT Transfer Charge on the total revenues of the utility, the PILOT Transfer Charges grossly exceed the proper amounts authorized by the Charter, and thus the City has violated and continues to violate Section 15.9(a) of its Charter.

2. Basic Long-Standing Accounting And Financial Principles Confirm That The Technical Term “Gross Income” Is Not The Same As Total Revenues.

For almost a hundred years, the courts have recognized that “gross income” of a business enterprise in the accounting and financial world has meant revenues minus cost of goods sold. As the U.S. Board of Tax Appeals noted as early as 1927:

The statutory definition of gross income, as laid down in section 213(a) of the Revenue Act of 1918, does not differ from the accounting conception of gross income. In a merchandising business, such as that in which the petitioner is engaged, the “gains, profits, and income derived * * * from * * * sales” are represented by the excess of the aggregate selling price over the cost of goods sold. **This is a simple and elementary principle of accounting, which is generally understood, and needs no elucidation on the part of this Board.** [*W.S. Buck Mercantile Co. supra*, 6 B.T.A. at pp. 289-290 (emphasis added) (Exhibit 2 hereto).]

Importantly, this definition was well established at the time the City’s Charter was enacted in 1960, and therefore, would have been known to both the drafters of the Charter and the City’s voters who approved it. *See, e.g., Edenfield v. Commissioner*, 19 T.C. 13, 22 (U.S. Tax Court 1952) (Exhibit 13 hereto) (holding that “gross receipts and gross income “obviously” are “**not the same**”

and cost of goods sold “**must be deducted in arriving at gross income**”) (emphasis added); *Scales v. Commissioner*, 18 T.C. 1263, 1276 (U.S. Tax Court 1952) (Exhibit 14 hereto) (“In figuring business income involving the sale of goods, it is **axiomatic** that gross income is gross sales less cost of goods sold”) (emphasis added).

And this definition is not unique to tax law. In fact, numerous other courts interpreting the term “gross income” outside of the context of the Internal Revenue Code have held that it means revenues minus cost of good sold. For example, several bankruptcy courts have followed this definition in finding that “gross income from business” means gross profit (*i.e.*, gross receipts minus the cost of goods sold) and not merely gross receipts. *See In re Gossett*, 86 B.R. 941, 942 (Bankr. S.D. Ohio 1988) (Exhibit 15 hereto); *Matter of Faber*, 78 B.R. 934, 935 (Bankr. S.D. Iowa 1987) (Exhibit 16 hereto); *In re Pratt*, 78 B.R. 277, 280 (Bankr. D. Mont. 1987) (Exhibit 17 hereto). Further, as discussed in Section III.D.3.(b) below, specialized accounting and financial dictionaries are legion in defining “gross income” in this manner.

3. The City’s Reliance On Lay Dictionary Definitions Is Unavailing.

In order support its interpretation of the two-word term “gross income,” the City relies upon the 1960 edition of Webster’s New World Diction of the American Language (“Webster’s”), a lay dictionary. The City then takes one definition of “gross” and one definition of “income” to cobble together a unitary definition of “gross income.” *See* City MSD Br. at pp. 9-10.³

a) Lay Dictionaries Should Not Be Used To Interpret Technical Terms.

Above we demonstrated that, because “gross income” is a technical term, the alleged

³ The City’s citation to § 1.4 of the Charter to justify its reliance on the purported “ordinary dictionary meaning” of “gross income” cannot save its interpretation. That section merely provides that “[e]xcept as otherwise specifically defined herein or indicated by the context, words used in this charter shall have their ordinary dictionary meaning.” But § 1.4 of the Charter cannot save the City’s interpretation for at least two reasons. First, the need for a technical interpretation of “gross income” is “indicated by the context” of Section 15.9(a). Second, the Charter does not identify the types of dictionaries that should be consulted to determine the “ordinary meaning” of a term. If the “ordinary dictionary meaning” of “gross income” must be used, the meaning provided by technical dictionaries applicable to accounting and finance terms (and not lay dictionaries) should be used.

“common” meaning of the term, even if it could be divined, cannot guide the Court’s interpretation of the Charter. To begin with, the City relies solely on lay dictionaries to argue that “gross income” must mean “gross revenues.” But using lay dictionary definitions to construe technical words in a statute is generally disfavored. In *Woodward v. Custer*, 476 Mich. 545, 719 N.W.2d 1471 (2006), for example, the Supreme Court was tasked with interpreting the term “specialty,” as that term was used in a statute governing medical malpractice claims. While the Court held that dictionary definitions could be consulted in order to interpret the term, it eschewed the use of lay dictionaries. Instead, the Court held that **“because the term ‘specialty’ may have acquired a ‘peculiar and appropriate’ meaning in the medical field, it is appropriate to look to medical dictionaries to define the term ‘specialty.’”** *Id.* at 561 (emphasis added). *See also People v Thompson*, 477 Mich 146, 151-152; 730 NW2d 708 (2007) (“Regarding the term instigate, it is undisputed that this term has **not** acquired a unique, technical meaning under the law. Thus, resort to a **lay dictionary** to ascertain the term’s meaning is appropriate.”)

But even if the City could rely on common lay “dictionary definitions,” the City’s approach to defining “gross income” is inappropriate because it involves merely taking a definition of “gross” and a definition of “income,” to cobble together a separate definition of “gross income.” City’s Br. at p. 9. The Court should reject this methodology because it leads to “absurd” results.

This was made clear by the Court of Appeals in *Macomb County v. AFSCME Council 25 Locals 411 & 893*, 294 Mich. App. 149, 818 N.W.2d 384 (2011). There, the Court was tasked with interpreting the term “actuarial equivalence.” The dissenting judge interpreted the term by taking the one lay dictionary definition of “actuarial” and another separate lay dictionary definition of “equivalence” to derive a purported unitary definition of the two-word technical term. The majority rejected this approach to the interpretation of the two-word technical term as follows.

The dissent ignores the testimony and documentary evidence of the parties’ use of the term “actuarial equivalence” and instead elects to impose its own definition using a dictionary to

define the term despite the fact that the term “actuarial equivalence” cannot be found in the cited dictionary. Although undefined contract terms are generally interpreted in accordance with their “commonly used meaning,” *Frankenmuth Mutual Ins. Co. v. Masters*, 460 Mich. 105, 113-114; 595 N.W.2d 832 (1999), **courts are not to resort to a lay dictionary for specialized terms of art, particularly in technical fields in which professionals obtain advanced degrees**, see *People v Thompson*, 477 Mich 146, 151-152; 730 NW2d 708 (2007). For example, we give tax terms their specialized meanings. *Prod Credit Ass'n of Lansing v Dep't of Treasury*, 404 Mich 301, 312; 273 NW2d 10 (1978) (stating that “terms of art” should be interpreted “in accordance with the experience and understanding of those who would be expected to use and interpret the act”). Similarly, we routinely accept testimony about the meaning of medical and engineering terms of art.

Ignoring this rule, the dissent attempts to craft a definition by breaking the term into component parts, finding definitions for each word, and then rejoining them. The absurdity of attempting this with a technical term is evident when one considers medical terms such as “gall bladder.” The dictionary defines “gall” as “[b]itterness of feeling; rancor” and “[o]utrageous insolence[.]” and defines “bladder” as “[a]ny of various distensible membranous sacs...found in most animals and that serve as receptacles for fluid or gas.” *The American Heritage Dictionary of the English Language* (2001). Adopting the dissent’s approach to defining terms of art, the legally binding definition of “gall bladder” would be “a distensible membranous sac found in animals that serves as a receptacle for bitterness of feeling, rancor, and outrageous insolence.” [294 Mich. App. at 165, n. 7 (emphasis added)]⁴

Here, the City contends the Court must read each word individually and cobble together an interpretation of “gross income” that favors the City and ignores the statutory context and the technical dictionary definition. The City is wrong. Only by construing the whole term can the Court determine that the term has acquired a peculiar meaning.

b) Specialized Dictionaries Consistently Define “Gross Income” As Revenues Minus Cost of Goods Sold.

But if the Court is going to resort to dictionary definitions, the Court should eschew the lay dictionary advocated by the City in favor of dictionaries that define technical financial and

⁴ The Supreme Court ultimately reversed on other grounds the COA’s Opinion in *Macomb County v. AFCSME Council 24 Locals 411 & 893*, 494 Mich. 65, 833 N.W.2d 225 (2013). While the Supreme Court ultimately adopted the definition of “actuarial equivalent” advanced by Judge Markey in her COA dissent, the Court rejected her method of deriving the definition in FN 59, where the Court stated:

Macomb Co, 294 Mich App at 177 (Markey, P.J., dissent). Judge Markey interpreted the term "actuarial equivalent" by looking to the separate definitions of the terms "actuary" and "equivalent." However, as stated, the phrase "actuarial equivalence" is a term of art and as such has independent significance, as evidenced by its use in many similar retirement plans. [494 Mich. at 86, fn 59].

accounting terms.

One such authoritative dictionary is Shim and Siegel, *Dictionary of Accounting Terms* (5th Ed. 2010). That dictionary defines “gross income” as follows:

GROSS INCOME

Amount of money earned (which is collected or will be collected) from the sale of goods minus the cost of the goods sold; also called GROSS PROFIT or *gross margin*. For example, if sales total \$4000 and the cost of goods sold is \$1200, the gross income is \$2800 (\$4000 - \$1200). Gross profit less operating expenses equals net income. [Exhibit 18 hereto (emphasis in original).]

Numerous courts have relied upon the *Dictionary of Accounting Terms* to interpret technical financial and accounting terms. *See, e.g., United States Welding, Inc. v. B&C Steel, Inc.*, 261 P.3d 513, 515 (Colo. App. 2011) (Exhibit 19 hereto) (relying on the *Dictionary* to construe “gross profits” and “net profits”); *Tingey v. Haisch*, 159 Wn.2d 652, 152 P.3d 1020 (Wash. 2007) (Exhibit 20 hereto) (relying upon the *Dictionary* to interpret “accounts receivable” and stating that “[o]btaining the definition of ‘accounts receivable’ from a technical business dictionary is consistent with plain meaning analysis”); *AAA Northeast v. Port Authority of NY and NJ*, 221 F. Supp. 3d 374 (S.D.N.Y. 2016) (Exhibit 21 hereto) (relying on the *Dictionary* to construe the term “rate of return”).

Another authoritative source of the definition of “gross income” is Investopedia, a website that “provides information and advice about financial matters.” *See Caldwell v. City of San Francisco*, 2021 U.S. Dist. LEXIS 72358 at *15 n.1 (N.D. Cal. 2021) (Exhibit 22 hereto). Investopedia defines “gross income” of a business enterprise as follows:

Gross income for a company is interchangeable with gross margin or gross profit. A company’s gross income is found on the income statement. It’s the revenue from all sources minus the firm’s cost of goods sold (COGS). [Exhibit 23 hereto.]

Investopedia further defines “cost of goods sold” as “the direct costs associated with producing the goods a company sells, excluding indirect expenses such as distribution and sales costs.” *Id.* So “gross income” means gross revenues minus the direct costs associated with

producing the goods a company sells.”⁵

The courts recognize Investopedia as an authoritative source of definitions of financial and accounting terms. *See, e.g., Isakina v. ReAlpha Tech. Corp.*, 2023 U.S. Dist. LEXIS 198497 (S.D. Oh. 2023) (Exhibit 24 hereto) (relying on Investopedia to interpret the term “liquidity event”). In interpreting such terms, several courts have expressly taken judicial notice of Investopedia definitions. *See Padilla v. Cmty. Health Sys. Inc.*, 2022 U.S. Dist. LEXIS 147151 at *3, n.10 (M.D. Tenn. Aug. 17, 2022) (Exhibit 25 hereto) (“The Court is able to take sua sponte judicial notice of the definitions of investment terms which are publicly available on the Investopedia website” (citing cases)); *Luma v. Dib Funding, Inc.*, 2022 U.S. Dist. LEXIS 10528 at *15, n.14 (D. Md. Jan. 19, 2022) (Exhibit 26 hereto) (“We take judicial notice of definitions of ‘cryptocurrency’ provided by Investopedia”).

At the same time, Investopedia confirms that the City’s proposed definition of “gross income” to include all revenues is inapplicable in this context. Investopedia makes a clear distinction between “gross income” of individuals and “gross income” of businesses.

An individual’s gross income is their total earnings before taxes or other deductions are taken out. It includes income from all sources, not just from employment. It’s not limited to income that’s received in cash. It also includes property or services received. It’s typically referred to as gross pay when it appears on a paycheck.

Gross income for a company is interchangeable with gross margin or gross profit. A company’s gross income is found on the income statement. It’s the revenue from all sources minus the firm’s cost of goods sold (COGS). [Exhibit 23 hereto (emphasis added).]

The City’s proposed definition of “gross income” is functionally the same as the Investopedia definition of that term, **as that term is applied to individuals.** *See* City SD Br. at p. 9

⁵ There is no question that electricity is a “good” because it is tangible personal property. The Michigan Legislature has defined “tangible personal property” as “personal property that can be seen, weighed, measured, felt or touched or that is in any other manner perceptible to the senses and includes **electricity**, water, gas, steam, and prewritten computer software.” MCL 205.51a(g) (emphasis added). *See also Detroit Edison Co. v. Dept of Treasury*, 498 Mich. 28, 869 N.W.2d 810 (2015) (confirming that electricity is “tangible personal property” and constitutes a “finished good” once delivered to end-users).

(“gross’ means ‘total; entire; with no deductions; as, one’s gross income; opposed to net.’”) But it would be nonsensical to apply a definition of “gross income” that is uniquely applicable only to individuals to a business enterprise like the City’s Electric Utility.

The Investopedia definition of “gross income” applicable to businesses generally is fully consistent with the long-standing Treasury regulations under the Internal Revenue Code. For the reasons discussed below, the City’s Electric Utility clearly is such a business enterprise.

4. The City’s Electric Utility Is In The Business Of Supplying Electricity To Plaintiff and the Class.

Finally, the Court must deem the Electric Utility as a business enterprise for purposes of interpreting the term “gross income” in the Charter, because the Electric Utility has all of the markings of a business enterprise. In this regard, our Supreme Court has held that “[a] city holds and manages its municipal utility in a proprietary and *administrative* capacity, as distinguished from its exercise of governmental or *legislative* powers.” *Kalamazoo Municipal Utilities Assoc v City of Kalamazoo*, 345 Mich 318,334; 76 NW2d 1 (1956) (emphasis in original).

In *Andrews v. South Haven*, 187 Mich. 294, 153 N.W. 827 (1915), the Court observed:

The electric light plant which defendant owned and operated, although a municipal public utility, was a business concern or enterprise. In its operation and business management the city had the right and power to do those things naturally connected with and belonging to the running of such a business which a private corporation would have in the same connection. [187 Mich. at 299 (emphasis added).]

Finally, in *Boler v. Governor*, 324 Mich App 614, 625-26; 923 N.W.2d 287 (2018), the Court of Appeals recently observed the “business” nature of a municipal utility:

What is gleaned from these cases is that if a municipality is supplying a utility—or specifically, waterworks—to its citizens and the citizens are paying for the waterworks, the **municipality is operating the waterworks as a business, and it is doing so as a businessman or corporation**, not as a concern of the state government or as the arm of the state. [Emphasis added.]

While *Boler* dealt with a municipal water utility, its analysis is equally applicable to municipal electric utilities. Both types of utilities are “supplying a utility” to their citizens and “the citizens are

paying for” those utility services. Because the Electric Utility is properly characterized as a “business,” Section 15.9(a) of the Charter must be interpreted in reference to the well-established definition of “gross income” applicable to businesses.

CONCLUSION

For all of the foregoing reasons, the Court should grant Plaintiff’s Motion for Summary Disposition as to the City’s liability under Count I of the Complaint.

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Date: March 30, 2026

CERTIFICATE OF SERVICE

I hereby certify that on March 30, 2026, I filed the foregoing document, Plaintiff's Motion for Summary Disposition and Brief in Support with the Clerk of the Court for for the Branch County Circuit Court. I also delivered the document to all counsel of record via email, as previously stipulated to by the parties. Counsel was properly served at the following email addresses:

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Jamie Warrow

STATE OF MICHIGAN
BRANCH COUNTY CIRCUIT COURT

JASON MATE, individually and as
representative of a class of
similarly-situated persons and entities,

Plaintiff,

Case No. 2025-12507-CZ

Hon. Kirk A. Kashian
Acting Circuit Court Judge

v.

CITY OF COLDWATER, MICHIGAN
a municipal corporation, by and through THE
COLDWATER BOARD OF PUBLIC UTILITIES

Defendant.

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**INDEX OF EXHIBITS SUBMITTED IN SUPPORT OF
PLAINTIFF'S MOTION FOR SUMMARY DISPOSITION AS TO HIS CHARTER
VIOLATION CLAIM IN COUNT I OF THE CLASS ACTION COMPLAINT**

VOLUME I – EXHIBITS 1-17

<u>EXHIBIT</u>	<u>DESCRIPTION</u>
1.	City of Coldwater Charter Ch. 14 & 15
2.	<i>W. S. Buck Mercantile Co. v. Commissioner</i> 6 B.T.A. 285
3.	City of Coldwater Electric Utility System Revenue Bond Official Statement

4. FY 2025-2026 Annual Budget (Excerpts)

EXHIBIT

DESCRIPTION

5. City of Coldwater (FY 2025) Audited Financial Statements (Excerpts)
6. City of Coldwater Electric PILOT Payments to General Fund
7. City of Coldwater (FY 2020) Audited Financial Statements (Excerpts)
8. City of Coldwater (FY 2021) Audited Financial Statements (Excerpts)
9. City of Coldwater (FY 2022) Audited Financial Statements (Excerpts)
10. City of Coldwater (FY 2023) Audited Financial Statements (Excerpts)
11. City of Coldwater (FY 2024) Audited Financial Statements (Excerpts)
12. City of Coldwater FY2026 Annual Budget (Excerpts)
13. *Edenfield v. Commissioner* 19 T.C. 13
14. *Scales v. Commissioner* 18 T.C. 1263
15. *In re Gossett* 86 B.R. 941
16. *In re Faber* 78 B.R. 934
17. *In re Pratt* 78 B.R. 277

EXHIBIT – 1

Chapter CH. The Charter

CHAPTER 14. GENERAL PUBLIC UTILITY SERVICES

Section 14.1. General Powers Respecting Municipal Utilities.

The city shall have all the powers granted by law to acquire, construct, own, operate, improve, enlarge, extend, repair, and maintain public utilities, the source of supply of which may be either within or without the corporate limits of Branch County, including, but not by way of limitation, public utilities for supplying water and water treatment, sewage disposal and treatment, electric light and power, gas, steam, heat, or any of them, to the municipality and the inhabitants thereof, and outside the city to the extent limited or permitted by law.

Section 14.2. City's Water Supply and Sanitary Sewer Systems.

Except the utility plants, systems, and services which are placed under the direction and control of the Board of Public Utilities by this charter, the city's utility services and plants, and their appurtenances shall be under the general control of the Council and shall be managed by the City Manager, as the administrative agent of the Council. The City Manager shall employ such personnel as may be required for the efficient and proper operation of said systems.

Section 14.3. Rates.

- (a) The Council shall fix just and reasonable rates and such other charges as may be deemed advisable for supplying municipal utility services, to the inhabitants of the city except for water and electric services, which shall be fixed by the Board of Public Utilities. Discrimination in rates by the Council, within any classification of users, shall not be permitted, nor shall free service be permitted other than to the city, but higher rates may be charged for utility services delivered or furnished beyond the corporate limits of the city.
- (b) The rates and charges for any municipal utility shall be fixed on a basis at least adequate to compensate the city for the cost of such service and to make reasonable provision for the extension thereof according to the needs of the city. Transactions pertaining to the ownership and operation of each municipal utility shall be recorded in a separate group of accounts, which shall be classified in accordance with generally accepted accounting practices. Charges for all service furnished to, or rendered by, other city departments or administrative units shall be recorded, whether collected or not. An annual report shall be prepared to show the financial position of each utility and the results of its operation. A copy of such reports shall be available for inspection at the office of the Clerk.

Section 14.4. Collection of Municipal Utility Rates and Charges.

- (a) The Council shall provide by ordinance for the collection of rates and charges for public utility services furnished by the city. When any person fails or refuses to pay to the city any sums due on

utility bills, the service upon which such delinquency exists may be discontinued and suit may be brought for the collection thereof.

- (b) Except as otherwise provided by law, the city shall have a lien upon the premises to which utility services are supplied and, for such purposes, shall have all the powers granted to cities by law. The lien shall become effective immediately on the distribution or supplying of utility services to such premises. In each case where a lien to secure the payment of utility charges is not available to the city by operation of law or otherwise, the Council shall require that an adequate deposit be made by the person to whom city utility services are furnished, for the purpose of guaranteeing the collection of charges for such utility services.
- (c) Insofar as permitted by law, all unpaid charges for utility services to any such premises, which, on the 31 day of March of each year, have remained unpaid for a period of six months or more, shall be reported to the Council by the City Manager and the Board of Public Utilities at the first meeting thereof in the month of April. The Council thereupon shall order the publication in a newspaper of general circulation in the city of notice that all such unpaid utility charges not paid by the 30 day of April will be spread upon the city's tax roll against the premises to which such utility services were supplied or furnished, and such charges shall then be spread upon the city's tax roll and shall be collected in the same manner as the city taxes.

Section 14.5. Disposal of Municipal Utility Plants and Property.

The city shall not sell, exchange, lease, or in any way dispose of any property, easement, equipment, privilege, or asset needed to continue the operation of any municipal public utility, unless the proposition to do so is approved by at least 3/5 of the electors of the city voting on the question at a regular or special city election. All contracts, grants, leases, or other forms of transfer in violation of this section shall be void and of no effect as against the city. The restrictions of this section shall not apply to the sale or exchange of articles of machinery or equipment of any municipally owned public utility, which are no longer useful or which are replaced by new machinery or equipment, or to the leasing of property not necessary for the operation of the utility, or to the exchange of property or easements for other needed property or interests in property.

Section 14.6. Public Utility Franchises.

The city may grant a franchise to any person for the use of the streets, alleys, bridges, and other public places of the city for the furnishing of any public utility service to the city and its inhabitants. Franchises and renewals, amendments, and extensions thereof shall be granted only by ordinance. Public utility franchises shall include provisions for fixing rates and charges, and may provide for readjustments thereof at periodic intervals. The city may, with respect to any public utility franchise granted after the effective date of this charter, whether or not so provided in the granting ordinance:

- (1) Terminate the same for the violation of any of its provisions, for the misuse or non-use thereof, for failure to comply with any provision thereof, or any regulation imposed under authority of this section;
- (2) Require proper and adequate extension of plant and the maintenance thereof at the highest practicable standard of efficiency;
- (3) Establish reasonable standards of service and quality of products, and prevent unjust discrimination in service or rates;
- (4) Require continuous and uninterrupted service to the public in accordance with the terms of the franchise throughout the entire period thereof;
- (5) Impose other regulations determined by the Council to be conducive to the health, safety, welfare, and convenience of the public;

- (6) Require the public utility to permit joint use of its property and appurtenances located in the streets, alleys, bridges, and public places, by the city and other utilities, insofar as such joint use may be reasonably practicable and upon payment of reasonable rental therefor, and, in the absence of agreement, upon application by the public utility, provide for arbitration of the terms and conditions of such joint use and the compensation to be paid therefor;
- (7) Require the public utility to pay any part of the cost of improvement or maintenance of streets, alleys, bridges, and public places, that arises from its use thereof, and to protect and save the city harmless from all damages arising from such use;
- (8) Require the public utility to file with the City Manager such drawings and maps of the location and nature of its facilities, as the Council may request.

Section 14.7. Limitations on the Granting of Franchises.

No franchise shall be granted by the city for a term exceeding 30 years and no exclusive franchise shall ever be granted. Each franchise shall include a provision requiring the franchise to take effect within one year after the adoption of the ordinance granting it, except in the case of grants to take effect at the end of an existing franchise. An irrevocable franchise and any extension or amendment of such franchise may not be granted by the city, unless the ordinance granting such franchise has first received the affirmative vote of at least 3/5 of the electors of the city voting thereon at a regular or special city election. An irrevocable franchise ordinance may be approved by the Council, for referral to the electorate, only after a public hearing has been held thereon and after the grantee named therein has filed with the Clerk his unconditional acceptance of all the terms of the franchise. No special election for such purpose may be ordered by the Council, unless the expense of holding such election has first been paid to the Treasurer by the grantee.

Section 14.8. Procedure for Granting Franchises.

Every ordinance granting a franchise, license, or right to occupy or use streets, alleys, bridges, or public places shall remain on file with the Clerk for public inspection in its final form for at least 30 days before the final adoption thereof, or the approval thereof for referral to the electorate.

Section 14.9. Sale or Assignment of Franchises.

The grantee of a franchise may not sell, assign, sublet, or allow another to use the same, unless the Council gives its consent. Nothing in this section shall limit the right of the grantee of any public utility franchise to mortgage its property or franchise, nor shall restrict the rights of the purchaser, upon foreclosure sale, to operate the same, except that such mortgagee or purchaser shall be subject to the terms of the franchise and provisions of this chapter.

Section 14.10. Plans of Facilities in Streets and Public Places.

The Council may, by ordinance, require, as a condition to the placing or installment thereof, that each public utility conducting a business in the city file with the City Manager a duplicate copy of layout plans of pipes, conduits, and other facilities which are to be placed on, under, or above the surface of the city's streets, alleys, bridges, and public places.

CHAPTER 15. BOARD OF PUBLIC UTILITIES

Section 15.1. City Utilities.

The city's electric, water, and sewage utility facilities and services shall constitute a department of the city government. Such utilities of the city shall be under the control and direction of a board, to be known as the Board of Public Utilities. The Board shall be composed of five members who shall be appointed by the Mayor, subject to the approval of the Council, for terms of five years each, with the terms of one member expiring in each year. Board members may be removed by the Council for inefficiency, neglect of duty, or malfeasance in office. The term of office of each member of the Board shall commence on the day of the first regular meeting of the Board next following the date of his appointment, except that the term of office of any person who is appointed to fill a vacancy shall commence on the date of his appointment. The Board shall organize at its regular meeting held in the month of July, and shall elect one of its members President. The Board shall hold at least one regular meeting in each month at a meeting place designated by the Board with the approval of the Council. Special meetings may be called at the request of the President or of any two members in the manner provided in this charter for calling special meetings of the Council. All meetings of the Board shall be open to the public. The Board shall keep a journal of its meetings, and its proceedings shall be filed with the Clerk as a public record. Within 15 days the Board shall designate its Secretary. Members of the Board shall not receive any compensation, but shall be allowed reasonable expenses when actually incurred by them upon authority of the Board.

Section 15.2. Appointee of the Board of Public Utilities.

The Board shall appoint a Director who shall be responsible to the Board and serve at its pleasure. The Board shall set his compensation. The Director shall have control and direction of and be responsible for the supervision of all of the utility facilities and the properties of the city pertinent thereto which are entrusted to the Board, and shall be responsible for the economical and proper operation and maintenance thereof. As the administrative agent of the Board, he shall have the control and direction of the employees of the Board, subject to the provisions of this charter.

Section 15.3. Responsibilities of Board.

Subject to the general direction of the Council, the Board of Public Utilities shall have charge of the city's electric services, water supply services, and sanitary sewers and sewage disposal facilities, and shall organize and conduct the affairs of the city's systems for the construction, generation, maintenance, purchase, extension, and distribution of electric light and power and water, and of the construction, extension, maintenance, and operation of the city's sanitary sewer and sewage disposal system and facilities, in a manner consistent with the best practices therefor. The Board shall make contracts concerning the electric, water, and sewage facilities of the city, subject to the overall control of the Council relating to all departments of the city.

Section 15.4. Purchases and Sale of Personal Property.

The Board of Public Utilities shall establish the procedures for the purchase and sale of personal property which may, in whole or in part, be through the officer charged with the functions of making purchases for the city. Subject to the approval of the Council, the Board shall provide the dollar limit within which purchases of personal property may be made without the necessity of securing competitive bids, and the dollar limit within which purchases may be made by the Director without the necessity of Board approval.

Section 15.5. Property of the Board.

The Board shall have the power to acquire property, and interest in property, both real and personal, in the name of the city, for its purposes, and shall have the power to dispose of personal property by sale, exchange, or lease. The Board may dispose of real property or any interest therein by sale, exchange,

lease, or otherwise, upon the approval thereof by the affirmative vote of not less than six members of the Council, and subject to the limitations on the sale of property by the city contained in Sections 13.3 and 14.5 of this charter.

Section 15.6. Power of Board.

- (a) The Board shall have full power and authority to fix all rates for electricity, water, and sewage disposal services, which shall become effective 30 days after the same have been approved by the Council and filed with the Clerk as a public record. Such rates shall not be fixed any lower than will produce the revenue required to pay all operating, maintenance, depreciation, and obsolescence expenses of the city's electric, water, and sewer and sewage disposal utility systems, together with a sufficient amount to provide for necessary expansions and extensions.
- (b) The Board and the Council shall agree upon rates and conditions upon which the Board will furnish electricity and services for street lighting and other city uses, and water and sewage disposal services used by the city.

Section 15.7. Appropriations to the Board.

- (a) The Board of Public Utilities shall submit to the City Manager the itemized estimates required by Section 7.2. of this charter. The City Manager shall include such estimates in the budget proposal submitted to the Council, without change or recommendation on his part, except that he may make recommendations concerning such parts thereof as directly affect or relate to departments of the city for which he is responsible. The Council shall consider such estimates in the same manner as the estimates of other departments of the city when it adopts the budget of the city for the ensuing fiscal year of the city and the appropriation for such fiscal year shall include the operation, maintenance, extension, and improvement of the utilities of the city which are entrusted to the Board.
- (b) No appropriations of money shall be made by the Council for the operating expenses of the city's utility facilities entrusted to the Board, other than to pay for utility services actually used by the city, if it is agreed between the Board and the Council that such payment shall be made. No free service of electricity, water, or sewage disposal shall be furnished by the city's utility services to any person, public or private, or to any public agency or instrumentality, other than the city.

Section 15.8. Board Fund Control.

- (a) Subject to the provisions of this charter, and the general accounting procedures of the city which shall be consistent with and meet any requirements of law, the Board shall have and exercise control over all of its funds. Such funds and revenues shall be in a bank account separate from other city funds. Except as provided in Section 15.9 to 15.13 inclusive, such funds shall be used only to defray the cost of operating the city's electric plant or plants and distribution systems, water plant and system, and sewage plant and system, necessary overhead, plant and system extensions, debt service, and other incidental and pertinent expenses of operating, maintaining, improving, extending, and changing the electric, water, and sewage and sewage disposal plants and systems, including allowance for depreciation and obsolescence. All checks drawn for the payment of money, under authority of the Board, shall be signed by the City Treasurer in addition to the signature of any person authorized by the Board to sign such checks.

Section 15.9. Payments to the City.

- (a) The Board of Public Utilities shall, annually, pay to the Treasurer for the use and benefit of the city, 6 1/2% of the gross income of the department, which payment shall be in recognition of and compensation for all benefits received from the city in the use of city streets, services, and facilities and shall constitute a part of the expenses of the administration and operation of the utilities of the city required to be paid under the first priority of Section 15.12 (a).
- (b) Notwithstanding other provisions of this chapter, except when otherwise provided by Section 15.12 (b) of this chapter, the Board shall have power to transfer to the city such sums of money as it may deem proper and under such terms and conditions as the Board and the Council may mutually agree upon.

Section 15.10. Loans to the Board of Public Utilities.

The Council shall have power to loan money to the Board of Public Utilities from funds of the city which are not appropriated or budgeted for expenditure within the term of such loan. Each such loan shall be based upon the payment of reasonable interest by the Board, to be determined by the Council, and the repayment thereof to the city in substantially equal annual or other periodic installments.

Section 15.11. Utility Reserve Fund.

- (a) There is hereby created a public utility reserve fund in the amount of 15% of the undepreciated original cost of the utilities and facilities of the city entrusted to the Board, which reserve fund shall be maintained for the purpose of accumulating and holding available such money which, in addition to insurance carried by the city, may be deemed by the Board of Public Utilities to be prudently necessary for the protection, improvement, replacement, and extension of the city's public utilities and facilities entrusted to the Board. Such fund shall not be allowed to fall below the sum of 5% of the undepreciated original cost of the said utilities and facilities, as estimated by the Board and approved by the Council, including the value of any fire, wind, explosion, or other disaster type of insurance carried on the utilities and their facilities. The Council may, at any time, at the request or with the consent of the Board, and for so long as it deems desirable, increase the amount held and reserved in the city's public utility fund to a sum larger than the amount required to be maintained by this section.
- (b) Moneys placed in the city public utility reserve fund shall not be used for any purpose other than the purpose of the fund, as stated in this section, unless the proposition to do so is approved by a majority of the electors of the city who are the owners of property which is assessed for taxes by the city, and the lawful husbands and wives of such persons, voting on such proposition at a regular or special election. This subsection shall not prohibit the investment and reinvestment of such moneys in any manner permitted by law.

Section 15.12. Distribution of Revenues of City Utilities.

- (a) The revenues of each utility of the city shall be devoted to the following purposes in the order listed: First, to the expense of administration and operation of each utility, and the maintenance thereof as may be necessary to preserve it and its facilities in good repair and working order; second, such of the remaining amount of the revenues as may be required for the principal and interest on any indebtedness against the utility; third, of the remaining amount of the revenues, an amount shall each year, be placed in the city's public utility reserve fund or funds which shall be sufficient to maintain the said fund at the per cent level established by Section 15.11 of this chapter, or such higher level as may be established under Section 15.11 (a) or for any reserve fund established for any bond issue, so long as any of the bonds thereof remain unpaid: Provided, that, in case of the depletion of the city's public utility reserve fund below the level so established, or if there exists any debt from the city to such fund, no funds shall be devoted to the next (fourth) purpose, until such

level has been restored or such debt repaid, or both; and fourth, unless otherwise required by law, the balance of such revenues shall be placed in the fund created by Section 15.13.

- (b) In the event that the city shall issue bonds under the provisions of Act 94 of the Public Acts of 1933, as amended, or under the provisions of any other legislative authority authorizing the issuance of bonds based upon the revenue of a public utility, and to the extent that it has issued any such bonds, the provisions of this section, and of Section 15.13 shall be subject to the provisions of such act and any ordinance adopted in accordance therewith.

Section 15.13. Uses and Distribution of Utility Funds Under Fourth Purpose.

All revenues of the City's utility operations which are placed in the funds of the city in accordance with the fourth provision of Section 15.12 shall be placed in a fund which is hereby created to be known as the capital public improvement fund, to be used solely to defray the cost or a part of the cost of capital public improvements of the city. No moneys shall be expended from the capital public improvement fund, except to alleviate disaster, unless the proposition to do so is placed before the people of the city by a vote of not less than six members of the Council and is then approved by a vote of not less than a majority of the electors of the city voting on such proposition at a regular or special election, who are the owners of property assessed for taxes by the city, and the lawful husbands or wives of such persons.

Section 15.14. Operating Personnel.

The director shall have power to employ all personnel deemed by him to be necessary for carrying on the supervision, operation, maintenance, and general conduct of the utilities of the city entrusted to the Board. Such salaries and hourly rates of pay as are established within the department shall be consistent with the salaries and rates of pay established by the Council for city employees performing comparable work, but shall not be so limited for other employees of the Board.

Section 15.15. Annual Report of Board of Public Utilities.

An annual report shall be prepared by the Board within 60 days after the completion of the annual audit, made under the provisions of Section 7.14 of this charter, which report shall clearly show the financial position of the utility systems of the city entrusted to the Board by a profit and loss statement, balance sheet, and such other information as may be pertinent thereto. Such annual report shall be published in a manner determined by the Board, and one copy thereof shall be filed with the Clerk, one with the Public Library, and one with each newspaper published in the city.^[1]

[1] *Editor's Note: The Schedule Chapter that immediately followed is included as an attachment to this Charter.*

EXHIBIT – 2



Cited

As of: March 29, 2026 6:05 PM Z

W. S. Buck Mercantile Co. v. Commissioner

United States Board of Tax Appeals

February 21, 1927, Promulgated

Docket Nos. 86, 2007.

Reporter

6 B.T.A. 285 *; 1927 BTA LEXIS 3556 **

APPEALS OF W. S. BUCK MERCANTILE CO.

Syllabus

[1]** 1. Petitioner is engaged in the merchandise business on the installment sales plan. At the close of each operating year it set up on its books an account designated "Reserve for cost to collect bad accounts," and, in its income and profits-tax returns for such years, deducted from its gross income the amounts so added to the reserve as collection expense. *Held*, that such method of accounting does not clearly reflect income.

2. Evidence of abnormalities in income or invested capital *held* insufficient to entitle petitioner to relief under the provisions of section 328 of the Revenue Act of 1918.

Counsel: *Battle McCardle, Esq.*, for the petitioner.

Briggs G. Simpich, Esq., for the Commissioner.

Opinion by: LANSDON

Opinion

[*285] These are appeals from determinations by the Commissioner of deficiencies in income and profits taxes for the years 1918, 1919, and 1920, in the amounts of \$3,206.37, \$4,596.73, and \$7,690.51, respectively. The issues are: (1) The addition, by the Commissioner, to the net income reported for the years 1918, 1919, and 1920, of the amounts of \$7,362.76, \$12,027.98, and \$17,499.33, respectively, deducted by the petitioner as anticipated cost **[**2]** of collection and losses, in future years, of the outstanding accounts receivable at the close of each year; and (2) whether petitioner is entitled to have its profits taxes for the year 1918 determined in accordance with the provisions of sections 327 and 328 of the Revenue Act of 1918. Except for the issue of special assessment, which applies

to the year 1918 only, the facts and issues, except as to the amounts involved, are identical for all years; therefore, by agreement of counsel, the appeals were consolidated and heard together.

FINDINGS OF FACT.

Petitioner, a Kansas corporation with its principal office at Kansas City, was organized on or about July 11, 1917, for the purpose of taking over that part, known as the Lincoln (Nebraska) branch, of the business theretofore conducted by the Price Mercantile Co. Throughout the years under consideration, it was engaged in the retail sale, on the installment plan, of house furnishings, such as bedspreads, blankets, clocks, lace curtains, rugs, silverware, and table linens. The business policies, as they related to sales, collections, and methods of accounting, were precisely the same as those in effect during the ownership of **[**3]** the business by its immediate predecessor.

Generally, petitioner's sales are made through solicitors or agents who canvass industrial centers and country districts, going from **[*286]** home to home, selling direct to the purchaser. The goods are usually carried on trucks by the agents, and delivery is made upon payment by the purchaser of the initial payment and reconveying title to the petitioner by deed of trust, without investigation as to the financial standing of the purchaser. The purchasers are usually of the laboring class, which is more or less transient.

Salesmen are employed on a salary and commission basis. The initial payments for each sale, as received, are applied in their entirety by the petitioner to the payment of the salesman's commission until the said commission has been paid in full. The salesman is held responsible for the sale, and accountable for the goods delivered, but after the purchaser makes the first installment payment, the salesman is relieved of any further responsibility for any loss which may occur through failure of the purchaser to meet subsequent installment payments. Should the purchaser default in the first payment, the salesman **[**4]** is required to stand one-half of any loss which may result from the transaction.

The average sale seldom exceeds the sum of \$25. The initial payment usually is from 5 to 10 per cent of the selling price, the balance being paid in weekly installments. The weekly installments are fixed in such amounts that the account will be paid within six months.

Not more than 5 per cent of the total installment payments are made by mail or at the petitioner's offices. The balance of the collections are made by the petitioner's collectors. The latter are employed on a salary and commission basis, the commission being computed at a fixed percentage of the collectible accounts on the collector's books. Frequently collectors find it necessary to make more than one call upon a customer to collect an installment which has become due.

It is the accounting practice of the petitioner to charge off, as bad debts, accounts of customers residing within the limits of territory covered by a city collector, after failure to make installment payments for a period of 60 days. In the cases of customers residing in districts covered by rural collectors, the accounts are charged off as bad debts after **[**5]** 90 days have elapsed from the date of the last installment payment. If, and when, further collections of installment payments are made upon accounts previously charged off as bad, these accounts are restored on the books. Only the net amount, representing the difference between the total accounts charged off and the total accounts restored, in any year, has been claimed as a deduction for bad debts in income-tax returns.

[*287] The merchandise sold by the petitioner is subject to rapid and considerable wear and tear. It has been the petitioner's experience that repossessed merchandise is usually in such condition that its because of failure to meet installment payments, the customer's because of failure to meet installment payments, the customer's account is credited with the amount of the unpaid balance of the selling price, and, at the same time, a like amount is charged on the books as the cost of repossessed merchandise. If the repossessed merchandise is still on hand at the close of the year, it is included in the inventory at its original cost.

The petitioner's books of account have been maintained in accordance with the accrual method of accounting, and the net **[**6]** income reported in the income-tax returns, for the three years under consideration, has been computed in accordance with that method.

At the time of taking over the business, the petitioner, following in principle the accounting practice of the predecessor owner, set up in its books of account an account designated "Reserve for cost to collect and bad accounts," in the amount of \$5,061.46, which represented 26 per cent of the book value of the accounts receivable taken over. Thereafter, and during the

years under consideration, the petitioner has added annually to this reserve an amount equal to 26 per cent of the increase in the accounts receivable outstanding at the close of the year. The amounts thus added to the reserve each year have been deducted from income in the petitioner's tax returns as collection expense. The amounts so deducted are, for the year 1918, \$7,362.76; for the year 1919, \$12,027.98; and for the year 1920, \$17,499.33. The accounts receivable outstanding at the close of the year 1921 were, in the aggregate, \$20,932.38 less than the aggregate outstanding at the close of 1920; hence, the petitioner reduced the reserve by the sum of \$5,441.55, or 26 per cent **[**7]** of the decrease, which it included in taxable net income for that year. Upon audit of the petitioner's income and profits-tax returns for the years involved, the Commissioner added the amounts so deducted to gross income for each of the several, respective, taxable years.

The purpose for which this reserve account was established was to provide a reserve out of each year's earnings, to take care of (1) the cost of collecting, in a later year, the accounts receivable outstanding at the close of each year, (2) such of those accounts which may in a later year prove to be worthless, and (3) losses which may be sustained in a later year upon the sale, at less than cost, of repossessed merchandise. This accounting practice has been adopted by at least two competitor companies. The following shows the condition of the reserve account at the close of each of the years under consideration, and the manner in which it was built up: /kaccounts receivable) 4,380.74

Amount credited to reserve at time of taking over the business \$5,061.46

Amount added to reserve in 1917 (26% of increase of \$16,848.98 in accounts receivable) 4,380.74

Amount of reserve at close of 1917 9,442.20

Amount **[**8]** added to reserve in 1918 (26% of increase of \$28,182.35 in accounts receivable) 7,362.76

Amount of reserve at close of 1918 16,804.96

Amount added to reserve in 1919 (26% of increase of \$46,397.45 in accounts receivable) 12,027.98

Amount of reserve at close of 1919 28,832.94

Amount added to reserve in 1920 (26% of increase of \$67,308.12 in accounts receivable) 17,499.33

Amount of reserve at close of 1920 46,332.27

[*288] The entire collection expense incurred in each of the years under consideration, and the total bad debts charged off

on the books during each of those years, have been claimed as deductions in the petitioner's income-tax returns.

From the date of organization until at or about October 1, 1919, the business of petitioner company was carried on at the personal residence of its secretary. During that period the petitioner maintained no other place for the transaction of its affairs. The facilities of the secretary's residence, such as light and telephone, were used in the conduct of petitioner's business. During the period stated, no rental was paid to the secretary for the use of his residence and its facilities for office purposes.

Until June 1, 1918, the [**9] secretary was in the employ of the predecessor owner of the business, notwithstanding which he attended to a considerable part of petitioner's business affairs, matters of office routine, and keeping the books of account. For these services he was paid, during the first five months of the year 1918, compensation at the rate of \$120 per month.

Prior to the organization of the petitioner, its president had been employed for approximately twenty years by the predecessor owner of the business, as general manager. His compensation, including commissions, was from \$10,000 to \$12,000. During the first five months of 1918, he devoted his entire time to petitioner's business affairs, and during that period, was paid compensation at the rate of \$250 per month. His salary has since been increased to \$16,000 per annum.

The gross sales shown by the return for the year 1918 amounted to \$227,402.18. The total deduction claimed in that return, as compensation of officers, is \$8,100.

During the year 1918, the total capital stock outstanding was \$50,000, and the petitioner's average indebtedness for the last nine months of that year was \$59,192.47.

[*289] OPINION.

LANSDON: It [**10] should be stated at the outset, that while the petitioner was engaged, during all of the years under consideration, in the sale of merchandise on the installment plan, the appeal raises no question as to its right to compute its net income on the installment basis. The books of account were maintained in accordance with the accrual method of accounting; the net income reported in the returns of the several years under consideration was computed in accordance with that same method; and the petitioner contends that no other method of accounting will clearly reflect its net income.

The first issue raised is whether the additions made to the "Reserve for cost to collect and bad debts," in each of the years under consideration, represent unrealized profits which should be excluded from gross income, or, in the alternative, whether

the amounts thus set aside to the reserve in each year constitute allowable deductions in computing taxable net income. The petitioner contends that a portion of the annual increase in accounts receivable represents unrealized profits and should be excluded from gross income, because, in a later year, there will be expenses incurred in the collection of these [**11] accounts and some of the accounts will prove to be worthless. It submits an alternative contention, that the annual additions to the reserve are allowable deductions from income, under the provisions of section 234(a)(4) of the Revenue Act of 1918, as losses sustained during the taxable year, and not compensated for by insurance, or otherwise.

The accrual method of accounting requires that at the end of every accounting period all income which has been earned must be accounted for as income accrued in that period. This is true notwithstanding that the income is not due and will not be collected until some future date. *Appeal of Owen-Ames-Kimball Co.*, 5 B.T.A. 921. The increase in the accounts receivable, in any one of the years under consideration, resulted from sales transactions entered into and completed within the year. All of the incidents which entitled or required the petitioner, under the method of accounting employed, to accrue these accounts receivable and the profits represented thereby on its books of account, had taken place before the close of the year. There remained nothing further to be done on the part of the petitioner lawfully to entitle [**12] it to receive the full amount of these accounts. The acts of sale and the performance by the petitioner of all of its obligations under the sales contracts, determined the earning of the income. There can hardly be any question that the income represented by the increase in the accounts receivable in each of the years under consideration was earned in those respective years. The statutory definition of gross income, as [*290] laid down in section 213(a) of the Revenue Act of 1918, does not differ from the accounting conception of gross income. In a merchandising business, such as that in which the petitioner is engaged, the "gains, profits, and income derived * * * from * * * sales" are represented by the excess of the aggregate selling price over the cost of goods sold. This is a simple and elementary principle of accounting, which is generally understood, and needs no elucidation on the part of this Board. If the income is to be reduced in some manner by the estimated expenses of collecting it at some time in the future and the estimated amount thereof which may not be collected, then, the reduction must take the form of a statutory deduction from income, authority for [**13] which must be found under the provisions of section 214(a) or section 234(a) of the Revenue Act of 1918. The estimated amounts, if actually earned, can not be excluded from gross income on the ground that they are unrealized profits.

It is apparent from the mere reading of the provisions of section

214(a)(4) of the Revenue Act of 1918, and the corresponding provisions of section 234 applicable to corporate taxpayers, upon which the petitioner relies as authority for its alternative contention that the annual additions to the reserve are proper deductions from gross income as losses, that those sections afford no basis for its contention. Both of the sections referred to provide for the deduction of "Losses sustained *during the taxable year*," and not of losses which may or may not be sustained in some future year. Nor do we upon examination of the provisions of those entire sections - and they constitute the whole authority for the deduction of business expenses - find any basis for the deduction of these annual additions to the reserve. On the contrary, we find that the deduction to be allowed for bad debts is the total "debts ascertained to be worthless and charged off **[**14]** within the taxable year," and in the case of business expenses "all the ordinary and necessary expenses paid or incurred during the taxable year." There was no ascertainment during the taxable years in question that a portion of the outstanding accounts receivable, at the close of each of those years, were worthless; nor were the expenses incident to the collection of those accounts at some future date, paid or incurred within the taxable years. See [Appeal of Morrison-Ricker Mfg. Co., 2 B.T.A. 1008](#).

Certain facts were developed by testimony during the hearing which, though not so indicated at the time by counsel, were apparently intended to show that the petitioner was entitled to have its profits taxes for the year 1918 determined under the special relief provisions of the applicable act. Those facts are entirely too meager and insufficient to warrant a conclusion that there existed, during the year 1918, any abnormalities affecting net income or invested **[*291]** capital to such an extent as to work upon the petitioner an exceptional hardship which, if true, would have entitled it, under the provisions of section 327(d) of the Revenue Act of 1918, to have **[**15]** its profits tax liability determined in accordance with section 328 of the Act. Therefore, the relief for which petitioner prays must be denied.

Judgment will be entered for the Commissioner.

PHILLIPS dissents.

End of Document

EXHIBIT – 3

NEW ISSUE - BOOK ENTRY ONLY

**Ratings (1): S&P Global Ratings Assured Guaranty Municipal Corp.: AA (Insured)
Moody's: A3 (Underlying)**

In the opinion of Miller, Canfield, Paddock and Stone, P.L.C., Bond Counsel, under existing law, assuming compliance with certain covenants by the City of Coldwater (the "City"), interest on the City's Electric Utility System Revenue Bonds, Series 2020A (the "Series A Bonds") is excludable from gross income for federal income tax purposes. Interest on the City's Electric Utility System Revenue Bonds, Series 2020B (Federally Taxable) (the "Series B Bonds") is not excluded from gross income for federal income tax purposes. The Series A Bonds and the Series B Bonds (collectively, the "Bonds") and the interest thereon are exempt from all taxation by the State of Michigan or by any taxing authority within the State of Michigan except estate taxes and taxes on gains realized from the sale, payment or other disposition thereof. See "TAX MATTERS" herein and "Appendix D – Bond Counsel's Forms of Approving Opinions".

THE SERIES A BONDS HAVE BEEN DESIGNATED AS "QUALIFIED TAX-EXEMPT OBLIGATIONS" FOR PURPOSES OF DEDUCTION OF INTEREST EXPENSE BY FINANCIAL INSTITUTIONS PURSUANT TO SECTION 265(b)(3) OF THE CODE.

**CITY OF COLDWATER
COUNTY OF BRANCH, STATE OF MICHIGAN
\$5,320,000**



**ELECTRIC UTILITY SYSTEM REVENUE BONDS, SERIES 2020A
\$11,765,000**

ELECTRIC UTILITY SYSTEM REVENUE BONDS, SERIES 2020B (FEDERALLY TAXABLE)

Date of Issue..... June 1, 2020

Due.....As shown on inside cover

The Bonds are to be issued pursuant to Act 94 of the Public Acts of Michigan, 1933, as amended ("Act 94") for the purpose of (i) paying all or a portion of the cost of acquiring and constructing additions, extensions and improvements to the City's Electric Utility System (the "System") (ii) funding a Bond Reserve Account, and (iii) paying the cost of issuance. See "THE BONDS – Purpose" herein.

Interest on the Bonds will be payable February 1, 2021 and semi-annually thereafter each August 1 and February 1. The Bonds are issued in fully registered form in denominations of \$5,000 or any integral multiple thereof for each maturity. The Bonds are issuable only as fully registered bonds without coupons and, when issued, will be registered in the name of Cede & Co., as Bondholder and nominee for The Depository Trust Company ("DTC"), New York, New York. DTC will act as securities depository for the Bonds. Purchases of beneficial interests in the Bonds will be made in book-entry form in the denomination of \$5,000 or any multiple thereof. Purchasers of beneficial interests in the Bonds (the "Beneficial Owners") will not receive certificates representing their beneficial interest in Bonds purchased. So long as Cede & Co. is the Bondholder, as nominee of DTC, references herein to the Bondholders or registered owners shall mean Cede & Co., as aforesaid, and shall not mean the Beneficial Owners of the Bonds. See "BOOK-ENTRY-ONLY SYSTEM" herein.

The scheduled payment of principal of and interest on the Bonds when due will be guaranteed under an insurance policy to be issued concurrently with the delivery of the Bonds by **ASSURED GUARANTY MUNICIPAL CORP.** Please see "Appendix F - Bond Insurance and Specimen Policies" herein.



A maturity schedule for each series of the Bonds is set forth on the inside of this cover page.

The Bonds are offered subject to prior sale, when as and if issued by the City and accepted by the Underwriter, subject to the approving opinions of Miller, Canfield, Paddock and Stone, P.L.C., Detroit, Michigan, Bond Counsel, a copy of which opinions will be provided with the Bonds. Certain legal matters will be passed upon for the Underwriter by Dickinson Wright PLLC, Troy, Michigan. The City expects to have the Bonds ready for delivery through DTC in New York, New York on or about June 1, 2020.

This cover page contains certain information for quick reference only. It is not intended to be a summary of the terms of these bond issues. Investors are instructed to read the entire Official Statement to obtain information essential to the making of an informed investment decision.



The date of this Official Statement is May 7, 2020.

(1) For an explanation of the ratings see "BOND RATINGS" herein.

CITY OF COLDWATER

Form of Government

The City was incorporated as a city by the legislature of the State of Michigan on February 28, 1861 and subsequently as a home rule city under Act 279, Public Acts of Michigan of 1909, as amended (the "Home Rule City Act") on November 8, 1960. The City has a Council- Manager form of government. The legislative body is the City Council which consists of eight members plus the Mayor serving as executive head of the Council. The chief administrative officer of the City is the City Manager who is selected by the City Council and serves at its pleasure.

COLDWATER BOARD OF PUBLIC UTILITIES

History and Organization

The Coldwater Board of Public Utilities (the "Board"), established by a vote of the electorate in 1891, acting for and on behalf of the City, oversees operations of the Electric, Water and Wastewater and Telecommunication Systems of the City and beyond City limits. The Board is composed of five members, appointed by the Mayor, subject to City Council approval, for terms of five years each, with the terms of one member expiring each year. The Board appoints a Director, who is responsible to the Board. The Director has control and direction of and is responsible for the supervision of all of the utility facilities and the properties of the City pertinent thereto which are entrusted to the Board and is responsible for the economical and proper operation and maintenance of all of the utility facilities and properties.

	Term Expiration Date
<u>Board of Public Utilities</u>	
Christopher Stevens, President	05/25
Scott Ohm, Vice President	05/23
Travis Machan	05/21
Terry Whelan	05/24
John Wellet	05/22

	Number of Years Utility Experience
<u>Administrative and Supervisory Staff</u>	
Jeffrey W. Budd, CPA, Director	20
Jim Odneal, Engineering Manager	20
John Springhall, Electric Superintendent	31

Jeff Budd, Director, joined the staff of the City of Coldwater in 1999 as the Finance Director/Treasurer. Mr. Budd was promoted to City Manager in May 2010. He became the Assistant Director of the Coldwater Board of Public Utilities in January 2017 and was hired as its Director in October 2017. His previous work experience was in public accounting. He holds a B.A. degree in Accountancy from Western Michigan University.

ELECTRIC UTILITY SYSTEM

System History

The Board is a municipal utility formed by City Charter to generate and distribute electricity, pump and distribute the City water supply, and operate and maintain the wastewater collection and treatment system and by ordinance to operate a municipally owned telecommunications system providing television services, internet and other data services under the direction and management of an appointed non-partisan five member Board.

Started in 1888 as a privately-owned utility with a generating plant furnishing municipal street lighting, Coldwater had one of the very first electric systems in the State of Michigan. As an indicator of just how early it was; Edison developed the first efficient lamp in 1879.

In 1891, the City of Coldwater purchased The Coldwater Light, Power and Fuel Company for \$25,000 and moved the generating plant from its original location on West Chicago Street to a new location on Bennett Street. The Plant on Bennett Street was operational until 1986.

By the year 1900, it had become a booming local industry, struggling to keep up with the increasing demands for electric service. At that time the only electric service available was lighting. Sputtering arc lights for the street corners and for commercial establishments, 16 and 32 candle power carbon filament lamps for residences. Electricity in Coldwater and elsewhere in that day was generally sold at so much per lamp per month. The electric service meter was just in the process of development; hence the recording of energy used was impossible. The accurate recording of energy used was not important because most electric plants operated only during the hours of darkness and in some cases only from sundown until midnight.

As of 1910, the original bonded indebtedness on the plant was paid from the revenues of the System. Since that time expansion of the System has been paid for from revenues of the System. In order to continue to provide needed energy, the Board has joined forces with four other municipalities to create and own the Michigan South Central Power Agency (the "Agency") whose goal is to ensure the supply of needed energy to the member municipalities at the lowest cost to the consumer.

Joint Agency Participation

Michigan South Central Power Agency

The City and four other Michigan municipalities listed below are members of the Agency. The Agency was formed to undertake the planning, financing, development, acquisition and operations of projects for the generation, transmission and transformation of electric power and energy to supply the present and future needs of its member municipalities.

The Agency's member municipalities are the Cities of Coldwater, Hillsdale and Marshall, and the Villages of Clinton and Union City. Each is a municipal corporation organized under the laws of the State of Michigan and each owns and operates its own municipal electric system.

The ownership shares of each of the members municipalities in the Agency are as follows:

City of Coldwater	53.90%
City of Hillsdale	17.30%
City of Marshall	20.19%
Village of Clinton	6.31%
Village of Union City	<u>2.30%</u>
	<u>100.00%</u>

Each of the member municipalities has entered into (a) a Power Sales Contract with the Agency for the supply of electricity from the Agency and (b) a Substation Agreement with the Agency for services provided by the Agency to the member municipality with respect to Substation Facilities. Each member municipality has also entered into an Economic Dispatch Agreement with the Agency providing for the dispatch by the Agency of electricity from certain existing generating facilities of the member municipalities on an economic basis.

During 2014, the Agency entered into purchase power agreements with N.E.W. Hydro, LLC to secure long-term hydro power supply for a twenty-year term. The agreements are for 5.75 MW from two hydro units located on the Menominee River in Menominee, Michigan and another 3.64 MW from two hydro units located in Oconto Falls on the Oconto River in Wisconsin.

Also, in 2014, the Agency entered into what is called Project IV. Project IV consists of three natural gas fired peaking units capable of producing 13 MW of power. This \$16 million project was funded with a floating rate bond with an option to fix the rate in the future. Coldwater is the only participant in Project IV.

Effective June 1, 2016, the Agency retired and decommissioned its 55 MW coal fired electric generating plant due to industry changes and environmental factors influencing the market to the point where the Agency concluded that the Endicott coal generation facility no longer provided the most economical power resource to its members. Some of the generation loss has been made up by contractual agreements that the Agency has purchased from outside providers, with the remaining power coming from market purchases. Including Project IV mentioned above, the Agency still operates 33.9 MW of peaking generation, related transmission switching systems and other facilities. The Agency's total operating revenues for the year ended June 30, 2019 were \$52,454,104 with total assets at June 30, 2019 of \$48,448,455.

American Municipal Power

During 2004 the Agency began a relationship with American Municipal Power of Ohio (AMP) in order to facilitate the Agency's MISO (Midcontinent Independent System Operator, Inc.) market participation. As part of this partnership the Agency is able to utilize the services of AMP's energy control center. This arrangement has allowed the Agency to avoid creating and staffing its own control center.

The relationship with AMP has broadened to include the acceptance of the Agency's members as full AMP members in July 2006 and services such as power supply planning and resource management, including the Agency's members participation in a 12 MW share of the Prairie State Energy Campus, a 44 MW share of the American Municipal Power Fremont Energy Center (AFEC), and 9.465 MW of three AMP Hydro projects consisting of five hydro generating locations on existing lock and dam facilities located on the Ohio River. The Agency also receives 1.2 MW of power from an AMP Solar Project. During 2019 the Agency contracted with AMP for administrative and management services.

AMPGS

Until November 2009, AMP had been developing a 960 MW twin unit, supercritical boiler, coal-fired, steam and electric generating facility, to be known as the American Municipal Power Generating Station (“*AMPGS*”), in Meigs County, in southeastern Ohio, on the Ohio River. AMP had planned for AMPGS to enter commercial operation in 2014 at a total capital cost of approximately \$3 billion. In the fourth quarter of 2009, however, the estimated capital costs increased by 37% and Bechtel Power Corporation (“*Bechtel*”), the EPC (engineer, procure and construct) contractor, would not guarantee that the costs would not continue to escalate. As a result of the estimated cost increases and prior to the commencement of major construction at the project site, the 81 AMP Members that had subscribed for capacity from AMPGS (“*AMPGS Participants*”) voted to cease development of AMPGS as a coal fired project.

In August 2016, AMP and Bechtel engaged in court-ordered mediation to resolve disputes raised in litigation relating to the cancellation of the AMPGS Project. Following the mediation, AMP and Bechtel reached a comprehensive settlement which resolved all claims. The terms of such settlement are confidential.

As of January 1, 2020, \$14,317,620 on AMP’s Line of Credit was allocable to the stranded costs recoverable from the AMPGS Participants and \$36,859,610 on AMP’s Line of Credit was allocable to plant held for future use.

The City of Coldwater recognized its portion of the AMPGS costs in 2014. As of December 31, 2019, Coldwater had remaining outstanding liabilities of \$500,245 and \$1,504,593 for its share of the stranded costs and plant held for future use.

Prairie State Energy Campus (PSEC)

On December 20, 2007, AMP acquired a 23.26% undivided ownership interest (the “*PSEC Ownership Interest*”) in the Prairie State Energy Campus (“*PSEC*”), a two-unit, supercritical coal-fired power plant designed to have a net rated capacity of approximately 1,582 MW and associated facilities in southwest Illinois. The PSEC Ownership Interest is held by AMP 368 LLC, a single-member Delaware limited liability company (“*AMP 368 LLC*”). AMP is the owner of the sole membership interest in AMP 368 LLC. Construction of the PSEC commenced in October 2007. Unit 1 of the PSEC commenced operations in the second quarter of 2012 and Unit 2 of the PSEC commenced operations in the fourth quarter of 2012.

From July 2008 through September 2010, AMP issued five series of Prairie State Energy Campus Revenue Bonds (collectively, the “*Initial Prairie State Bonds*”) to finance PSEC project costs and PSEC related expenses. The Initial Prairie State Bonds consist of tax-exempt, taxable and tax advantaged Build America Bonds issued in the original aggregate principal amount of \$1,696,800,000. In 2015, 2017 and 2019, AMP issued bonds (the “*Prairie State Refunding Bonds*” and, together with the Initial Prairie State Bonds, the “*Prairie State Bonds*”) to refund all of the callable tax-exempt Initial Prairie State Bonds issued in 2008 and 2009, certain of callable outstanding Initial Prairie State Bonds issued as Build America Bonds and certain of the bonds issued in 2015 to refund the Initial Prairie State Bonds. As of January 1, 2020, AMP had \$1,495,245,000 aggregate principal amount of Prairie State Bonds outstanding.

AMP sells the power and energy from the PSEC Ownership Interest pursuant to a take-or-pay power sales contract (the “*Prairie State Power Sales Contract*”) with 68 Members (the “*Prairie State Participants*”). The Prairie State Bonds are net revenue obligations of AMP, secured by a master trust indenture, payable primarily from the payments to be made by the Prairie State Participants under the terms of the Prairie State Power Sales Contract.

The City of Coldwater has executed a take-or-pay power sales contract with AMP as a participant of the PSEC of 9,952 kW or 2.7% kW of capacity and associated energy from the PSEC.

AMP Fremont Energy Center (AFEC)

On July 28, 2011, AMP acquired from FirstEnergy Generation Corporation (“*FirstEnergy*”) the Fremont Energy Center (“*AFEC*”), a combined cycle, natural gas fueled electric generating plant, then nearing completion of construction and located in Fremont, Sandusky County, Ohio. Following completion of the commissioning and testing, AMP declared AFEC to be in commercial operation as of January 20, 2012. AFEC has a capacity of 512 MW (unfired)/675 MW (fired) and consists of two combustion turbines, two heat recovery steam generators and one steam turbine and condenser.

AMP subsequently sold a 5.16% undivided ownership interest in AFEC to the Michigan Public Power Agency and entered into a power sales contract with the Central Virginia Electric Cooperative for the output associated with a 4.15% undivided ownership interest in AFEC. The output of AFEC associated with the remaining 90.69% undivided ownership interest (the “*90.69% Interest*”) is sold to AMP Members pursuant to a take-or-pay power sales contract with 86 of its Members (the “*AFEC Power Sales Contract*”).

In 2012, to provide permanent financing for the 90.69% Interest, AMP issued, in two series, \$546,085,000 of its AMP Fremont Energy Center Project Revenue Bonds (the “*2012 AFEC Bonds*”), consisting of taxable and tax-exempt obligations. The AFEC Bonds are net revenue obligations of AMP, secured by a master trust indenture and payable from amounts received by AMP under the AFEC Power Sales Contract. In 2017, AMP issued bonds (the “*AFEC Refunding Bonds*” and, together with the 2012 AFEC Bonds, the “*AFEC Bonds*”) to refund a portion of the 2012 AFEC Bonds. As of January 1, 2020, \$489,280,000 aggregate principal amount of AFEC Bonds was outstanding.

The City of Coldwater has executed a take-or-pay power sales contract with AMP as a participant of the AFEC of 18,055 kW or 3.88% kW of capacity and associated energy from the AFEC.

Combined Hydroelectric Projects

AMP owns and operates three hydroelectric projects, the Cannelton, the Smithland and the Willow Island hydroelectric generating facilities (the “*Combined Hydroelectric Projects*”), all on the Ohio River, with an aggregate generating capacity of approximately 208 MW. Each of the Combined Hydroelectric Projects is in commercial operation and consists of run-of-the-river hydroelectric generating facilities on existing Army Corps dams and includes associated transmission facilities. AMP holds the licenses from FERC for the Combined Hydroelectric Projects.

To provide financing for, or refinance certain obligations incurred in respect of, the Combined Hydroelectric Projects, AMP has issued eight series of its Combined Hydroelectric Projects Revenue Bonds (the “*Combined Hydroelectric Bonds*”), in an original aggregate principal amount of \$2,354,485,000 and consisting of taxable, tax-exempt and tax advantaged obligations (Build America Bonds, Clean Renewable Energy Bonds and New Clean Renewable Energy Bonds). The Combined Hydroelectric Bonds are secured by a master trust indenture and payable from amounts received by AMP under a take-or-pay power sales contract with 79 of its Members. As of January 1, 2020, \$2,194,396,471 aggregate principal amount of the Combined Hydroelectric Bonds and approximately \$31.1 million aggregate principal amount of subordinate obligations, consisting of notes evidencing draws on the Line of Credit, were outstanding under the indenture securing the Combined Hydroelectric Bonds.

On August 14, 2017, AMP filed a lawsuit in the U.S. District Court for the Southern District of Ohio against Voith Hydro, Inc. (“*Voith*”), which was the supplier of major powerhouse equipment, including the turbines and generators for the Combined Hydroelectric Projects and the Meldahl Project.

In the lawsuit, AMP alleges, among other things that Voith failed to deliver equipment on a timely basis and that certain of the equipment delivered was materially defective, causing significant delays. AMP has alleged proven damages of at least \$40 million. On October 16, 2017, Voith filed its answer, denying each of AMP's claims, and asserting two counterclaims seeking the payment of amounts it claims are due under the contract, amounts currently held by AMP as purported liquidated damages and \$40 million in damages, plus interest and legal fees. On December 1, 2017, AMP filed its answer to the Voith counterclaims, denying all liability to Voith.

As part of the initial disclosures, AMP listed 70 potential witnesses and \$90 million in gross damages, while Voith listed over 100 potential witnesses and \$65 million in gross damages. A scheduling order has been established which provides for the conclusion of discovery in June 2020, but no trial date has been set.

Subject to market conditions, AMP may issue bonds to refund certain of its callable outstanding Combined Hydroelectric Bonds in the first quarter of 2020.

The City of Coldwater has executed a take-or-pay power sales contract with AMP as a participant of the Combined Hydroelectric Projects of 6,496 kW or 3.12% of capacity and associated energy from the Combined Hydroelectric Projects.

Meldahl Hydroelectric Project

AMP owns and, together with the City of Hamilton, Ohio, an AMP Member, developed and constructed a 108.8 MW, three-unit hydroelectric generation facility on the Captain Anthony Meldahl Locks and Dam, an existing Army Corps dam on the Ohio River, and related equipment and associated transmission facilities (the "*Meldahl Project*"). The Meldahl Project is operated by the City of Hamilton.

In order to finance the construction of the Meldahl Project and related costs, AMP issued seven series of its Meldahl Hydroelectric Project Revenue Bonds ("*Meldahl Bonds*") in an original aggregate principal amount of \$820,185,000 consisting of taxable, tax-exempt and tax advantaged obligations (Build America Bonds, Clean Renewable Energy Bonds and New Clean Renewable Energy Bonds). The Meldahl Bonds are secured by a master trust indenture and payable from amounts received by AMP under a take-or-pay power sales contract with 48 of its Members. As of January 1, 2020, \$675,680,000 aggregate principal amount of the Meldahl Bonds and approximately \$3.6 million aggregate principal amount of subordinate obligations, consisting of notes evidencing draws on the Line of Credit, were outstanding under the indenture securing the Meldahl Bonds.

The City of Coldwater has executed a take-or-pay power sales contract with AMP as a participant of the Meldahl Project of 1,794 kW or 1.71% of capacity and associated energy from the Meldahl Project.

Greenup Hydroelectric Project

In connection with the development of the Meldahl Project, Hamilton agreed to sell and AMP agreed to purchase a 48.6% undivided ownership interest (the "*AMP Interest*") in the Greenup Hydroelectric Facility. On May 11, 2016, AMP issued \$125,630,000 aggregate principal amount of its Greenup Hydroelectric Project Revenue Bonds, Series 2016A (the "*Greenup Bonds*") and, with a portion of the proceeds thereof, acquired the AMP Interest. The Greenup Bonds are secured by a separate power sales contract that has been executed by the same Members (with the exception of Hamilton, which retained title to a 51.4% ownership interest in the Greenup Hydroelectric Facility) that executed the Meldahl Power Sales Contract. As of January 1, 2020, \$124,035,000 aggregate principal amount of the Greenup Bonds was outstanding and approximately \$0.9 million aggregate principal amount of subordinate obligations, consisting of notes evidencing draws on the Line of Credit were outstanding under the indenture securing the Greenup Bonds.

The City of Coldwater has executed a take-or-pay power sales contract with AMP as a participant of the Greenup Project of 1,175 kW or 3.45% of capacity and associated energy from the Greenup Project.

Solar Electricity Prepayment Project

In 2016, AMP entered into the NextEra PPA pursuant to the terms of which AMP agreed to purchase and a subsidiary of NextEra agreed to sell all of the power and energy generated by solar generation facilities (each, a “*System*”), each of which is located behind the meter of an AMP Member’s Electric System. Under the terms of the NextEra PPA, AMP is required to prepay for twenty-five years of energy to be generated by each System at a “*P90*” confidence interval, meaning that, in any given year, the probability of exceeding such level of production is ninety percent (90%), and assuming a 0.5% degradation factor. Fourteen Systems with a rated capacity of approximately 46.45 MW have entered commercial operation and AMP made the initial prepayments associated with such Systems with the proceeds of draws on its Line of Credit.

On January 31, 2019, AMP issued \$55,195,000 of its Solar Electricity Prepayment Project Revenue Bonds, Series 2019A (the “*Solar Prepayment Bonds*”) to refinance draws on its Line of Credit associated with the first 13 Systems, with a rated capacity of approximately 36.83 MW. Such Solar Prepayment Bonds are secured by a trust indenture (the “*Solar Indenture*”) and payable from amounts received by AMP under a take-and-pay power sales contract with 22 of its Members. As of January 1, 2020, \$55,195,000 aggregate principal amount of the 2019 Solar Prepayment Bonds were outstanding under the Solar Indenture and approximately \$24.0 million aggregate principal amount was on the Line of Credit, which represent prepayments already made under the NextEra PPA and will be refinanced by additional bonds issued under the Solar Indenture, and certain developmental costs. Amounts on the Line of Credit are payable as a subordinate obligation under the Solar Indenture.

The City of Coldwater has executed a take-or-pay power sales contract with AMP as a participant of the Solar Project of 1,208 kW or 1.996% of capacity and associated energy from the Solar Project.

Purchased Power and Load History
Purchased Power, Sales and System Losses (1)
Fiscal Years Ended June 30

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Generation	-	-	-	-	-
Agency Power	<u>527,740,188</u>	<u>478,005,431</u>	<u>416,118,679</u>	<u>421,980,442</u>	<u>389,610,632</u>
Total Gross Energy	<u>527,740,188</u>	<u>478,005,431</u>	<u>416,118,679</u>	<u>421,980,442</u>	<u>389,610,632</u>
Total Energy Uses	<u>521,504,184</u>	<u>474,743,933</u>	<u>410,053,389</u>	<u>416,966,902</u>	<u>382,594,804</u>
Energy Losses	6,236,004	3,261,498	6,065,290	5,013,540	7,015,828
Percent Losses	1.2%	.7%	1.5%	1.2%	1.8%

(1) Units = Kilowatt-hours (kWh)

Electrical Load History (1)
Fiscal Years Ended June 30

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
System Demand	102,481	92,944	81,595	82,343	79,874
Annual Load Factor	58.8%	58.7%	58.2%	58.3%	55.7%

(1) Units = Kilowatts (kW)

SOURCE: City of Coldwater

System Rates and Charges

The Coldwater City Council is empowered by the City Charter to approve rates and charges for utility services set by the Board of the System. No application to, or approval of, any state or federal regulatory agency is required.

The current rate policy is to set its rates on a cost of service basis is determined by net fixed assets plus working capital, inventory, City Charter reserve requirements and 6-1/2 percent PILOT to the City.

The following rates and charges per kilowatt hour (“kWh”) for residential, commercial and industrial secondary service, and commercial and industrial primary service are currently in effect and have historically accounted for over 97% of the System’s gross revenues. In addition, the electric utility has a separate rate schedule for street lighting.

Monthly Electric Rates of the System

Residential service: "A"

Customer Charge	\$10.75 per customer
Energy Charge	\$.0963 per kWh

General Business Service: "B"

Customer Charge	\$16.50 per customer
Energy Charge	\$.1163 per kWh

General Commercial Service: "C"

Customer Charge	\$35.00 per customer
Energy Charge	\$.0517 per kWh
Capacity Charge	\$14.40 per kW of billing demand

General Commercial Service: "ED-C"

Customer Charge	\$35.00 per customer
Energy Charge	Same rate as Rate C discounted 16% - \$.043428
Capacity Charge	Same rate as Rate C discounted 16% - \$12.096

Industrial Service: "D"

Customer Charge	\$100.00 per customer
Energy Charge – Summer Season	\$.0527 per kWh
Energy Charge – Winter Season	\$.0517 per kWh
Capacity Charge – Summer Season	\$13.15 per kW of billing demand
Capacity Charge – Winter Season	\$11.50 per kW of billing demand

Industrial Service: "ED-D"

Customer Charge	\$100.00 per customer
Energy Charge – Summer Season	Same rate as Rate D discounted 12% - \$.046376 per kWh
Energy Charge – Winter Season	Same rate as Rate D discounted 12% - \$.045496 per kWh
Capacity Charge – Summer Season	Same rate as Rate D discounted 12% - \$11.572 per kW of billing demand
Capacity Charge – Winter Season	Same rate as Rate D discounted 12% - \$10.12 per kW of billing demand

Industrial Service: "D-2"

Customer Charge	\$350.00 per customer
Energy Charge – Summer Season	\$.0536 per kWh for 68% of the billing demand multiplied by hours in the billing period, plus \$.0457 for remaining kWh.
Energy Charge – Winter Season	\$.0530 per kWh for 68% of the billing demand multiplied by hours in the billing period, plus \$.0427 for remaining kWh.
Capacity Charge – Summer Season	\$13.15 per kW of billing demand
Capacity Charge – Winter Season	\$11.50 per kW of billing demand

Industrial Service: "T"

Customer Charge	\$365.00 per customer
Energy Charge – Summer Season	\$.0536 per kWh for 68% of the billing demand multiplied by hours in the billing period, plus \$.0457 for remaining kWh.
Energy Charge – Winter Season	\$.0530 per kWh for 68% of the billing demand multiplied by hours in the billing period, plus \$.0427 for remaining kWh.
Capacity Charge – Summer Season	\$10.40 per kW of billing demand
Capacity Charge – Winter Season	\$8.75 per kW of billing demand

Special Contract: "S-C" Rate can apply to any commercial or industrial customer which meets the three requirements where (i) service is provided at primary voltage; (ii) new full requirements customers with a minimum billing demand of 3,000KVA or more; or (iii) existing full requirements customers adding 3,000KVA to their existing load as long as this new load is separately metered. There is currently one customer who has a special contract.

A Power Factor Adjustment will be applied to the capacity charge for rates “D”, “ED-D”, and “D-2” whenever the average power factor during the billing period is above .899 or below .800.

A Power Supply Cost Adjustment shall apply to all rate schedules except for non-metered rates and special contract rates. The Power Supply Cost Adjustment is calculated from a base energy charge of \$.0603 per kWh from the monthly energy cost from the Michigan South Central Power Agency.

All rates effective April 1, 2019.

Summer season rates are in effect from June to September; winter season rates are in effect from October to May.

Residential electric customers of the System currently are paying approximately the same as the customers of the nearby investor owned utility, Consumers Power Company.

Service Area and Customers

The System served 7,230 customers as of June 2019; up from 7,192 in June 2018. The service of the System has an estimated population of 18,000 people and includes the City and parts of the Townships of Coldwater, Batavia and Girard, all located in Branch County. Power from the Agency is transmitted via Consumers Power Company’s transmission system by three 138 KV interconnected circuits. The System’s electric distribution system consists of 4800/8320 and 7960/13800 volt feeder lines supplying all of its customers.

Collection and Enforcement

All users of the System are billed monthly by the Board. The billings, based on actual meter readings, are mailed to users in four cycles, on a weekly basis, except for heavy industrial users who are billed on the last day of the month. Electrical service is disconnected when the unpaid balance is two months past due. Further collection attempts are made by the Board’s internal staff. The Board contracts with a collection agency as needed.

Labor Relations and Personnel Matters

As of January 2020, the Electric Department employed 21 persons working only in this department. Administrative and clerical employees are shared with the Water, Wastewater, and Telecommunications Departments. Taken as a whole, the Board represents one of the City’s oldest industries and furnishes employment to approximately 54 people.

Insurance Coverage

As a member of the Michigan Municipal League the Board carries full multi-peril insurance coverage underwritten by Meadowbrook Insurance. Coverage includes comprehensive general liability and business automobile liability to \$5,000,000 each occurrence. Blanket real and personal property insurance in the amount of \$78.7 million is issued to the Board covering all risk of direct loss to full replacement cost above a \$5,000 deductible.

System Statistics

**Number and Percent of Customers by Classification
Fiscal Years Ended June 30**

<u>Classification by Number</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Residential	5,818	5,736	5,536	5,552	5,531
Commercial/ Industrial	1,213	1,257	1,160	1,178	1,175
Outdoor Lights	199	199	202	209	208
Total	<u>7,230</u>	<u>7,192</u>	<u>6,898</u>	<u>6,939</u>	<u>6,914</u>

<u>Classification by Percent</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Residential	80.5%	79.7%	80.3%	80.0%	80.0%
Commercial/Industrial	16.8%	17.5%	16.8%	17.0%	17.0%
Outdoor Lights	2.7%	2.8%	2.9%	3.0%	3.0%
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

**Average Number and Percent of Customers by Location
Fiscal Years Ended June 30**

<u>Classification by Number</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Inside City	6,077	6,054	5,790	5,821	5,787
Outside City	1,153	1,138	1,108	1,118	1,127
Total	<u>7,230</u>	<u>7,192</u>	<u>6,898</u>	<u>6,939</u>	<u>6,914</u>

<u>Classification by Percent</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Inside City	84.1%	84.2%	83.9%	83.9%	83.7%
Outside City	15.9%	15.8%	16.1%	16.1%	16.3%
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

**MWH Sold and Percent Sold by Classification
Fiscal Years Ended June 30**

<u>Classification by Number</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Residential	42.1	40.5	40.4	38.8	39.1
Commercial/Industrial	479.4	434.2	369.6	378.2	343.5
Total	<u>521.5</u>	<u>474.7</u>	<u>410.0</u>	<u>417.0</u>	<u>382.6</u>

<u>Classification by Percent</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Residential	8.1%	8.5%	9.9%	9.3%	10.2%
Commercial/Industrial	91.9%	91.5%	90.1%	90.7%	89.8%
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

SOURCE: City of Coldwater

**Electric Sales Revenue and Percent of Revenues by Classification
Fiscal Years Ended June 30**

Classification by Number	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Residential	\$4,871	\$4,842	\$4,871	\$4,371	\$4,759
Commercial/Industrial	<u>37,793</u>	<u>35,992</u>	<u>31,520</u>	<u>29,268</u>	<u>29,244</u>
Total (1)	<u>\$42,664</u>	<u>\$40,834</u>	<u>\$36,391</u>	<u>\$33,639</u>	<u>\$34,003</u>

Classification	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Residential	11.4%	11.9%	13.4%	13.0%	14.0%
Industrial	<u>88.6%</u>	<u>88.1%</u>	<u>86.6%</u>	<u>87.0%</u>	<u>86.0%</u>
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

(1) In thousands

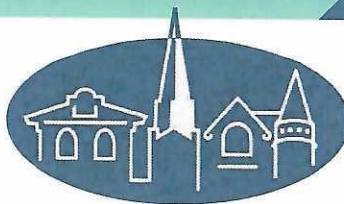
Major Electric Customers (by usage) For Fiscal Year Ended June 30, 2019

<u>Customer</u>	<u>Description</u>	<u>Megawatt Hours</u>	<u>% of Total</u>	<u>Dollar Amount</u>	<u>% of Total</u>
Maroa Farms	Greenhouse	112.283	21.5%	\$ 6,379,968	15.0%
Clemens Food Group	Pork Processing	82.403	15.8	5,887,023	13.8
Asama Manufacturing (1)	Auto Parts	79.838	15.3	6,533,473	15.3
H.C. Starck	Metal Fabrication	21.454	4.1	1,798,939	4.2
Voltek	Foam Product	19.888	3.8	1,478,089	3.5
Real Alloy Specification (1)	Aluminum	14.899	2.9	1,104,810	2.6
Darling International	Rendering	10.865	2.1	856,131	2.0
Walmart Distribution	Distribution	10.502	2.0	832,473	1.9
Bluewater Thermal Sol	Tubing	9.872	1.9	760,374	1.8
Real Alloy Recycling (1)	Recycling	<u>8.725</u>	<u>1.7</u>	<u>642,675</u>	<u>1.5</u>
Total		<u>370.729</u>	<u>71.1%</u>	<u>\$26,273,955</u>	<u>61.6%</u>

SOURCE: City of Coldwater

(1) Temporarily suspended operations due to the COVID-19 crisis and related executive orders issued by Michigan Governor Whitmer. See "POTENTIAL IMPACT OF THE COVID – 19 CRISIS" herein.

EXHIBIT – 4



COLDWATER
MICHIGAN • 1861

ANNUAL BUDGET

FY 2025-2026

One Grand St. | Coldwater, MI 49036 | 517.279.9501 | Coldwater.org



May 27, 2025

TO: Mayor Kramer and Councilmembers

FROM: Keith Baker, City Manager

RE: **Fiscal Year 2025-26 Budget**

The City of Coldwater presents the following operational budgets for City Council approval for the 2026 fiscal year. These budgets include the City's general operating funds, special revenue funds, tax increment financing authorities of the Downtown Development and Local Development Funds, and budgets for the Coldwater Board of Public Utilities.

As specified in the City Charter, the budgets presented have been vetted by the City Council through a budget review and have been subject to public scrutiny through a required public hearing process. City Council is being asked to adopt the following budgets for the ensuing fiscal year.

Financial Status

The City began the current fiscal year with a budget that showed a deficit of \$57,000. The budget was amended twice during the year to account for unanticipated changes in revenues and expenses. The first amendment included increases in grant revenue. Budgeted expenditures were also increased to account for costs associated with the grants, staffing, and a security project affecting public works and both indoor and outdoor recreation areas. Contractual legal charges were increased and additional funding was allocated to the Coldwater school system to assist with operations at the aquatic center.

The second budget amendment accounted for the distribution of funds by the State related to adult use marijuana facilities. Revenues were increased to account for continued higher interest earnings and permit revenues as well as additional grant funding and sponsorship revenues. Revenue decreases included a reduction in the estimate of state revenue sharing payments. Expenditures were increased to account for a significant sidewalk project on N Willowbrook road as well for contractual legal costs and costs associated with grant funding. Expenditures were also increased to account for an additional payment being made to the City's pension plan. Expenditures were decreased to account for staff positions that were open for extended periods. Additionally, a truck was removed from the budget and

contractual municipal service costs were reduced to account for the changes in project timing. Transfers to other Funds were increased as well as the City Council elected to set aside the marijuana tax revenue received from the State. Those funds will be used for future City projects.

While various components in the budget have changed during the year the final approved budget deficit of \$60,000 is very similar to the original. One difference from the prior year is that the State of Michigan wasn't able to provide the City with an estimate of an additional distribution from the State's Local Community Stabilization Authority (LCSA). The distribution was received after our final budget amendment. With the additional late year revenue, the City is expecting final operating results to exceed budgeted estimates. The results will leave the City with a fund balance of over \$6.7 million, or roughly 49% of expenditures.

The State's phased in elimination of manufacturing personal property tax is complete. Starting with the 2017 fiscal year, personal property taxes on eligible manufacturing property for all businesses began to be phased out and be replaced by an assessment that the State collects directly from the company. For Coldwater, this has meant that personal property values are \$21.4 million lower than in the 2014 base year. The lost revenue will be reimbursed to the City by the State, but it is only guaranteed to a certain level. This change was done to encourage the growth of manufacturing within Michigan. However, while the State has been reimbursing local governments for lost revenue, it has greatly reduced the potential of new personal property tax revenue because the State reimbursement is capped at near the amount of personal property revenue received in 2014 and only includes some of the industrial growth that has occurred after that time. There is a 10-year phase in of additional personal property growth into the reimbursement that began in 2022 so over time the post 2014 industrial growth should be factored into the State's reimbursement. In the nine years since the State started the manufacturing personal property tax phase out, the State overestimated the needed reimbursements. Some municipalities such as Coldwater have received payments greater than their losses. Currently, the surplus distribution by the State's Local Community Stabilization Authority (LCSA) occurs in late May. Coldwater's 2025 surplus distribution was \$602,000. Because of uncertainty with attempting to forecast LCSA surplus funds, the expectation for 2026 is that the State would reimburse the City at a similar level to 2025 personal property tax replacement level with minimal surplus distribution.

The amount that the State distributes from sales tax collections in the form of revenue sharing was initially forecasted by the Michigan Department of Treasury to be \$1,600,000 for the 2025 fiscal year. Those estimates have been slightly adjusted by the State and as of their January 2025 revenue sharing conference the City is currently expecting to receive roughly \$1,575,000. For 2026, we are estimating the state shared revenue will be \$1,600,000.

The City, like other municipalities, is labor intensive with roughly two-thirds of our expenses tied to wages and benefits. We look closely at controlling personnel costs. We have improved and streamlined work processes using technology to create efficiencies and reduce overall costs. We work hard to maintain appropriate staffing levels and continue to manage wages and benefits

to balance the needs of our employees within the reality of our revenue base.

Our general government capital spending in the current year was spread among a variety of areas. Road and utility infrastructure for phase one of the Western Meadows subdivision was completed. On Willowbrook road a sidewalk was constructed to assist in connecting a new residential development to the US 12 corridor. Late in the spring construction began on phase one of the Rotary Park project on the City's West side while another recreation project was wrapping up at Waterworks Park. In Public Safety two police patrol vehicles have been put into service along with a new pickup truck for the Fire department. The Municipal Services department is expecting delivery of an International truck late in the fiscal year. Additionally, the department purchased a utility task vehicle (UTV) and various improvements were made at the municipal services yard and at the Oak Grove cemetery. Resurfacing of pickleball courts and the refinishing of the two wooden courts inside the Dr. Browne Recreation Center helped to improve our recreation facilities and the late year addition of a sound system at the Monroe Street festival area should improve the experience for residents attending downtown events.

In the 2026 fiscal year the City will continue with phase one of the multi-year Rotary Park project. This early phase includes a new public restroom facility, a new and expanded boat launch, fishing access and improved parking. That project will be paid for using funds from the State of Michigan's adult use Marijuana tax revenue distribution. In Public Safety, the purchase of two patrol vehicles will continue the normal rotation of police vehicles. Body cameras will be purchased and the mobile computer terminals (MCT's) that are part of our patrol fleet will be replaced. Another International plow truck along with a wheeled excavator will be purchased by the Municipal Services department. At Oak Grove Cemetery a chip and seal project delayed from the prior year is expected to occur in the fall.

As we look ahead to the future, large capital needs will continue. The City continually evaluates capital purchases and delays expenditures with consideration to the overall budget. Like the equipment that was purchased in the 2025 fiscal year, many of the needed equipment items are 15-20 years old and are costly to maintain. Additionally, the City has an aging public works facility that is in significant need of repairs. We work with all departments so that we can prioritize our capital needs and plan accordingly.

Infrastructure

Like all Michigan municipalities, the City and its Board of Public Utilities continue to be faced with the problem of aging infrastructure. Much of the underground pipe that catacomb the City was installed more than 50 years ago. While this infrastructure has served the City well, there is a point where it will need to be replaced.

The cost to replace the existing roads and related underground infrastructure is enormous. While there is a capital improvement plan in place, rising costs and the condition of the infrastructure is always a concern. The coordination of our above ground and below ground infrastructure needs is extremely important. That coordination is a strong factor in choosing

street projects.

Outside of special sources like bonds, most of the City's revenue for roadwork comes from Act 51 funding provided by the State of Michigan. Based on the most recent projections from the Michigan Department of Transportation, the City is forecasting Act 51 funding to be \$1,900,000 in the 2026 fiscal year. ACT 51 funding has increased significantly in the last decade, however, at the same time, road preservation costs have increased and road conditions have continued to deteriorate. In November, 2024, the residents of Coldwater approved a millage allowing the City to borrow \$5 million dollars. These funds will be utilized over the upcoming construction seasons allowing the City to do a number of additional road projects.

During the 2025 fiscal year a mill and fill project covering several streets in the commercial district on the City's far east side along with Fawn River Drive was completed. Like the mill and fill projects of the previous two years these streets were picked to avoid areas where the Water department was working as it continued a three-year Drinking Water project focusing on replacing lead and copper water lines. This project is being funded by a \$3 million grant through the State's Drinking Water State Revolving Fund (DWSRF). Other significant projects included chip seal work in the 4th Ward industrial park, micro-sealing work over various local streets and a shoulder extension on Grahl Drive to allow better foot traffic in the area of the senior center.

2026 fiscal year road projects will include significant work on N Clay Street, the north three blocks of which will be a complete reconstruction with new water main. Phase two of the Butters Avenue project will occur. This time the southern section from Race to Garfield will be repaved. Mill and fill work will also occur on portions of S. Clay, Sauk River Drive and other streets. Micro sealing will also be done on a number of streets to extend their lives. Another project currently in the planning stages is expansion of our wastewater treatment facility. The project is necessary due to the overall growth of our system. It is anticipated that the City would do a large debt issuance possibly late in the 2026 fiscal year. The funding for the debt will come from Wastewater system revenues which have been gradually increased over time in anticipation of this project.

Fiscal Year 2026

Our initial 2026 fiscal year budget shows a deficit of \$197,000. Included in that figure is \$712,000 of capital spending and \$100,000 of sidewalk work.

Property taxes for the average City residential home owner will increase by 3.1%. The rate at which property tax values in Michigan change is determined by an inflation rate multiplier that is based on annual changes in the US consumer price index (CPI). Overall, total property tax revenues for the City are expected to increase more than the CPI index thanks to new development. The real property component of property taxes will increase by 4.9% while the now much smaller personal property component will also increase bringing the overall increase to 5.7%. Personal property tax related revenue has declined significantly over the last decade because of the phase out of manufacturing personal property taxes as well as the

exemption of personal property taxes for small business owners. To date, this decline has been made up by reimbursements from the State's Local Community Stabilization Authority (LCSA). Including those reimbursements, we expect revenues related to property taxes to be roughly \$5.4 million in 2026. That figure is net of any adult use marijuana payments from the State.

The City of Coldwater is fortunate to have our own electric, water, wastewater and telecommunication utility systems. The Coldwater Board of Public Utilities provides the second largest source of revenue to the City in the form of a payment in lieu of taxes (PILOT). PILOT revenue will increase by approximately 1% to \$3.77 million in the 2026 fiscal year. The 2026 PILOT figure is calculated based on utility revenues from the 2024 fiscal year.

State shared revenue for the 2026 fiscal year is currently estimated at \$1,600,000. The funding from the State includes payments for the prison population at the Lakeland Correctional Facility that will be subsequently distributed to Coldwater Township. The budget figure above includes those payments. State shared revenue payments are based on the 2020 census.

The City Charter allows for a levy of up to 1-3/4 mills to be used to fund the retirement costs of City employees. The City Council will once again levy 1-1/3 mills for 2026. This will raise approximately \$556,000 in funds to offset the cost of the City's retirement programs.

On the expenditure side, 2026 fiscal year spending is expected to be very similar to 2025 levels. Overall capital spending, including sidewalks, is expected to be similar as well. General government staffing is expecting to be consistent with overall wages expected to be approximately 4% higher. Similar to past years due to natural employee turnover there were several positions not filled for periods of time during 2025. To be conservative we have budgeted for full employment in 2026.

Over 60% of the City's regular total expenditures are for wages and benefits. It takes a large number of people to maintain the streets, plow the snow, police the neighborhoods, provide recreational programming, enforce property maintenance ordinances and respond to fires. One way the City has chosen to manage costs is by capping the cost of health care to match annual caps provided by the State. Another way has been to close the old-style defined benefit pension plans. The City and its Board of Public Utilities closed their defined benefit plans between 1997 and 2002. All new employees hired since that time are on 401(k) style plans that do not result in legacy costs to the community. Even though the defined benefit plans are long closed and a majority of current employees are not benefiting from them, the City still has costly obligations. The City has worked with the Municipal Employees Retirement System of Michigan (MERS) which administers the City's defined benefit pension to plan for the long-term stability of the City's plans. In their experience study completed in 2017, MERS increased their long-term assumptions regarding longevity while reducing their assumed investment rate of return. The effect of these changes was to significantly increase the required amount to be paid in to our plans over the next decade. During 2018, we signed an agreement with MERS to extend the time of the plan's amortization period. At the same time, we increased our 2018 payments

above the minimum requirements and have continued that practice over the last eight years to build up a surplus over the minimum amount. That surplus will be used in later years to partially offset anticipated significant increases in the required payments. MERS has continued to reduce their long-term rate of return assumption, doing this again in 2019, 2022 and 2023. In 2020, updated demographic assumptions were adopted by MERS to reflect changes in mortality and length of retirement. That was followed in 2022 with the enactment of a “Dedicated Gains” policy to take advantage of strong market performances in 2019 - 2021.

By the end of 2025 fiscal year, the City is planning to have contributed \$903,000 into the closed defined benefit plan for its general government employees. For the 2026 fiscal year we have \$853,000 budgeted as the general government defined benefit contribution. That amount will be reviewed early in the new fiscal year when we receive the latest actuarial report. The City’s Board of Public Utilities has a separate defined benefit plan. \$950,000 of additional funds are budgeted from the four utility funds to make the required payments into that plan.

We have witnessed tremendous increases to required payments over the last decade and expect to see the same when we receive the projections for 2027. While these payments will continue to be consequential, there is some good news for Coldwater. Our plans have been closed for over 20 years and while there are still many former employees drawing retirement benefits, those numbers decrease slightly each year. Our legacy plan costs combined with the 401K style defined contribution costs for employees hired over the last 25 years are significant, but the long-term viability of our plans is positive when compared to other municipalities that still have open pension plans.

Conclusion

With the late year LCSA surplus payment received after the last budget amendment the City is expecting a surplus in the 2025 fiscal year while early budget projections show a small deficit for the 2026 fiscal year. The City is in a financially strong position over the short term with an operating fund balance reserve of over 49% of expenditures.

Being a public power community continues to be a factor in our ability to respond to changes in State related revenues. PILOT from our utility operations continues to provide a stable revenue stream. Market rates for electricity pushed higher in 2022 and 2023 due to world-wide market conditions and have remained elevated through the first 10 months of the 2025 fiscal year. These market conditions have caused higher power cost adjustments which increase the charges to our customers. The hope is that these increases reverse however that sediment doesn’t match the projections that we see for 2026. While higher power costs add additional PILOT revenue, they are an overall negative to our utility operation because of the stress that higher costs have on our industrial customer base.

As we look beyond the current year, we continue to see an expansion of our real property base. Several of our large industrial employers are in various stages of expansion. Our largest employer has just broken ground on an expansion that will result in an estimated 300 new

manufacturing positions. With this growth we anticipate the construction of another significant apartment complex and possibly other smaller housing developments. These developments, will add to the tax base but will also challenge us to serve our residents with increased demands not only on our utility system, but to our police, fire, and municipal services. Another concern is the fact that the City will be facing a Headlee tax reduction for the 2026 fiscal year that will reduce its operating millage from 11.5642 mills to 11.4439. Because of additions to our tax base the \$55,000 reduction in property taxes is manageable in the current budget, however this is a permanent reduction so it will impact the City each year going forward.

With increases in the City's population and the expansion of our industrial base the City has seen an increase in overall revenue, but we understand that forecasted economic slowdowns could cause those increases to dry up. That, coupled with the expectation that excess LCSA funding will eventually go away or at least significantly decrease, means that we should not expect increases in our state funding levels in the future. State law limits the ability of local government to raise revenue. Therefore, we must be wise with our limited funding mechanisms in order to pay for the increasing demands on our services and infrastructure. The City will need to continue to examine our costs and establish priorities as we determine what we can do and what services we are able to provide our residents. We will continue to work to limit debt and to budget conservatively to maintain a strong financial position.

EXHIBIT – 5

**CITY OF COLDWATER
BRANCH COUNTY, MICHIGAN**

FINANCIAL STATEMENTS

JUNE 30, 2025

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF NET POSITION JUNE 30 2025

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecom- munications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES							
ASSETS							
Current assets:							
Cash and investments	\$ 16,792,040	\$ 3,094,224	\$ 10,304,084	\$ 824,813	\$ 304,487	\$ 277,586	\$ 31,597,234
Accounts receivable	5,234,519	1,020,075	708,822	226,442	68,545	-	7,258,403
Inventories	-	113,486	-	-	-	-	113,486
Prepaid and other assets	26,154	22,774	20,560	3,324	-	282	73,094
Total current assets	22,052,713	4,250,559	11,033,466	1,054,579	373,032	277,868	39,042,217
Noncurrent assets:							
Investment in Power Agency	15,696,594	-	-	-	-	-	15,696,594
Restricted assets	-	70,554	818,729	-	-	-	889,283
Capital assets, less accumulated depreciation	41,079,829	17,040,721	25,930,215	866,431	87,486	-	85,004,682
Total noncurrent assets	56,776,423	17,111,275	26,748,944	866,431	87,486	-	101,590,559
Total assets	78,829,136	21,361,834	37,782,410	1,921,010	460,518	277,868	140,632,776
DEFERRED OUTFLOWS OF RESOURCES							
Total assets and deferred outflows of resources	473,782	213,796	213,798	73,084	-	-	974,460
LIABILITIES AND NET POSITION							
Total assets and deferred outflows of resources	\$79,302,918	\$21,575,630	\$37,996,208	\$ 1,994,094	\$ 460,518	\$ 277,868	\$ 141,607,236
LIABILITIES AND NET POSITION							
Current liabilities:							
Accounts payable	\$ 3,228,554	\$ 360,371	\$ 193,066	\$ 77,411	-	\$ 1,920	\$ 3,861,322
Accrued expenditures	1,637,160	46,301	243,537	17,060	324	3,738	1,948,120
Bonds and notes payable, due within one year	940,000	396,719	1,167,682	-	-	-	2,504,401
Total current liabilities	5,805,714	803,391	1,604,285	94,471	324	5,658	8,313,843
Noncurrent liabilities:							
Bonds and notes payable, due in more than one year	15,825,000	1,031,716	11,578,087	-	-	-	28,434,803
Unearned revenue	-	1,378,106	-	63,646	-	-	1,441,752
Premium on bonds payable	285,143	36,709	269,194	-	-	-	591,046
Net pension liability	1,523,145	743,375	743,071	223,631	-	-	3,233,222
Compensated absences	173,933	104,097	74,379	60,374	231	9,762	422,776
Total noncurrent liabilities	17,807,221	3,294,003	12,664,731	347,651	231	9,762	34,123,599
Total liabilities	23,612,935	4,097,394	14,269,016	442,122	555	15,420	42,437,442
NET POSITION							
Investment in capital assets, net of related debt	24,314,829	15,612,286	13,184,446	866,431	87,486	-	54,065,478
Restricted	-	70,554	818,729	-	-	262,448	1,151,731
Unrestricted	31,375,154	1,795,396	9,724,017	685,541	372,477	-	43,952,585
Total net position	\$55,689,983	\$17,478,236	\$23,727,192	\$ 1,551,972	\$ 459,963	\$ 262,448	\$ 99,169,794

See Notes to Financial Statements

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION FOR THE YEAR ENDED JUNE 30, 2025

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecommunications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
REVENUES							
Charges for services	\$ 51,067,427	\$ 4,619,138	\$ 6,594,772	\$ 2,867,774	\$ 779,071	\$ 110,500	\$ 66,038,682
OPERATING EXPENSES							
Purchased power	34,908,916	-	-	-	-	-	34,908,916
Power plant	21,597	-	-	-	-	-	21,597
Natural gas plant	605,772	-	-	-	-	-	605,772
Distribution	2,332,309	677,186	-	1,739,143	-	-	4,748,638
Substation	258,060	-	-	-	-	-	258,060
Sanitation	-	-	-	-	755,391	-	755,391
Metering and lighting	1,001,197	-	-	-	-	-	1,001,197
Wells	-	105,247	-	-	-	-	105,247
Treatment	-	1,077,171	1,495,815	-	-	-	2,572,986
Collection system	-	-	363,750	-	-	-	363,750
Customer service	320,898	-	778,842	82,266	-	-	403,164
Administration	2,124,916	781,314	-	527,785	-	-	4,212,857
Public works	-	-	-	-	-	307,023	307,023
Payments in lieu of taxes	3,035,268	253,548	361,896	72,240	-	-	3,722,952
Depreciation	2,262,494	841,364	1,363,079	238,264	20,000	-	4,725,201
Total operating expenditures	46,871,427	3,735,830	4,363,382	2,659,698	775,391	307,023	58,712,751
OPERATING INCOME	4,196,000	883,308	2,231,390	208,076	3,680	(196,523)	7,325,931
NONOPERATING REVENUES (EXPENSES)							
Investment income (unrealized gain/loss)	899,647	104,825	429,575	12,222	13,739	17,766	1,477,774
Interest expense	(583,200)	(54,556)	(525,719)	-	-	-	(1,163,475)
Gain (loss) on investments	170,142	-	-	-	-	-	170,142
Gain (loss) on sale of fixed assets	24,448	769	9,364	2,523	-	-	37,104
Miscellaneous income	107,735	11,177	11,210	13,535	-	-	143,657
Total nonoperating revenues (expenses)	618,772	62,215	(75,570)	28,280	13,739	17,766	665,202
INCOME (LOSS) BEFORE TRANSFERS AND CONTRIBUTIONS	4,814,772	945,523	2,155,820	236,356	17,419	(178,757)	7,991,133
TRANSFERS							
Transfers from (to) other funds	(50,000)	-	-	-	-	100,000	50,000
CHANGE IN NET POSITION	4,764,772	945,523	2,155,820	236,356	17,419	(78,757)	8,041,133
NET POSITION - BEGINNING	50,890,927	16,532,713	21,571,372	1,315,616	442,544	341,205	91,094,377
Contribution in aid of construction	34,284	-	-	-	-	-	34,284
NET POSITION - ENDING	\$ 55,689,983	\$ 17,478,236	\$ 23,727,192	\$ 1,551,972	\$ 459,963	\$ 262,448	\$ 99,169,794

See Notes to Financial Statements

CITY OF COLDWATER

NOTES TO FINANCIAL STATEMENTS – Continued FOR THE YEAR ENDED JUNE 30, 2025

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

PROPERTY TAX REVENUE

The City's property taxes are levied each August 1 and based on the taxable valuation of property as of the preceding December 31. Taxes are considered delinquent on March 1 of the following year, at which time penalties and interest are assessed.

The City's 2024 tax was levied and collectible on August 1, 2024 and is recognized as revenue in the year ended June 30, 2025, when the proceeds of the levy are budgeted and available for the financing of operations.

The 2024 taxable valuation of the City totaled \$425 million, a portion of which is abated and a portion of which is captured by the LDFA and DDA. Taxes levied consisted of 11.5642 mills for operating purposes, 1.3333 mills for the retirement system, and 1.0 mills for roadway construction. This resulted in \$4.4 million for general operating and approximately \$523,000 and \$419,000 for retirement and roadways. These amounts are reported in the respective General, Retirement and Road Debt Service Funds in the financial statements.

Tax Abatements - Industrial property tax abatements are granted in the State of Michigan under Public Act 198, as amended, to promote economic development, creation of jobs, and new or improvement facilities. The industrial facilities tax (IFT) exemption must be approved by both the local unit (after public hearing is held) and the State of Michigan. IFT exemptions can cover real and/or personal property. By State law, the exemption must be applied for no later than six months after commencement of the project, and must be accompanied by a written agreement between the taxpayer and the local unit. An exemption allows for taxation on IFT property at 50% of the local property tax millage rate for a period of 1 to 12 years. Accordingly, such agreements meet the criteria of "tax abatements" under GASB Statement No. 77. Property taxes abated by the City in fiscal year 2025 amounted to \$718,014.

ASSETS, LIABILITIES, DEFERRED OUTFLOWS/INFLOWS OF RESOURCES, AND NET POSITION:

Cash and Investments – Cash and cash equivalents include cash on hand, demand deposits, and short-term investments with maturity of three months or less when acquired. Investments are stated at costs, which approximates fair market value.

Receivables and Payables – In general, outstanding balances between funds are reported as "due from/to other funds." Activities between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as "advances from/to other funds." Any residual balances outstanding between the governmental activities and the business-type activities are reported in the government wide financial statements as "internal balances".

CITY OF COLDWATER

**NOTES TO FINANCIAL STATEMENTS – Continued
FOR THE YEAR ENDED JUNE 30, 2025**

NOTE D – CAPITAL ASSETS – Continued

BUSINESS-TYPE ACTIVITIES

GROUP:	Balance July 1, 2024	Additions	Disposals	Balance June 30, 2025
Capital assets, not being depreciated:				
Land	\$ 1,736,608	\$ 498,246	\$ -	\$ 2,234,854
Work in progress	1,400,609	856,944	602,691	1,654,862
Total	<u>3,137,217</u>	<u>1,355,190</u>	<u>602,691</u>	<u>3,889,716</u>
Capital assets, being depreciated:				
Land improvements	570,882	-	-	570,882
Utility systems	101,867,232	3,348,908	509,921	104,706,219
Buildings	38,642,832	-	3,564	38,639,268
Office equipment	989,115	-	38,479	950,636
Vehicles	3,579,234	610,846	191,801	3,998,279
Machinery and equipment	4,994,738	90,456	85,149	5,000,045
Total assets being depreciated	<u>150,644,033</u>	<u>4,050,210</u>	<u>828,914</u>	<u>153,865,329</u>
Total assets	153,781,250	5,405,400	1,431,605	157,755,045
ACCUMULATED DEPRECIATION:				
Electric	22,856,517	2,262,494	192,563	24,926,448
Telecommunications	8,535,846	238,264	545,681	8,228,429
Rubbish	92,514	20,000	-	112,514
Water	13,623,365	841,364	58,328	14,406,401
Waste water	23,745,834	1,363,079	32,342	25,076,571
Total accumulated depreciation	<u>68,854,076</u>	<u>4,725,201</u>	<u>828,914</u>	<u>72,750,363</u>
Net capital assets	<u>\$84,927,174</u>	<u>\$ 680,199</u>	<u>\$ 602,691</u>	<u>\$ 85,004,682</u>

EXHIBIT – 6

**Coldwater Board of Public Utilities
Electric PILOT Payments to General Fund**

Note -The gross operating income for the year ending June 30, 2020 is used to determine the monthly pilot and franchise payments to the General Fund for the 2022 Fiscal year (7/1/21 - 6/30/22)

FY Revenue basis for calculation		2014-15 6/30/2015	2015-16 06/30/2016	2016-17 6/30/2017	2017-18 6/30/2018	2018-19 6/30/2019	2019-20 6/30/2020
Equals PILOT Expense for FY -		Fiscal 2017	Fiscal 2018	Fiscal 2019	Fiscal 2020	Fiscal 2021	Fiscal 2022
GL Acct No	Account Title						
582.000.6000	RESIDENTIAL SALES - A	4,378,037	4,364,342	4,561,406	4,607,402	4,780,367	4,866,744
582.000.6002	RESIDENTIAL OUTDOOR LIGHTS-OLR	6,913	6,578	5,805	5,116	5,015	5,305
582.000.6003	COMMERCIAL SALES - B	1,953,337	1,950,321	2,057,668	2,132,757	2,019,278	1,934,354
582.000.6004	COMMERCIAL SALES - C	2,453,840	2,376,897	2,467,536	2,908,764	4,042,803	2,427,218
582.000.6005	INDUSTRIAL SALES - D/D2	9,782,142	9,940,444	10,107,292	9,922,573	9,699,399	9,992,504
582.000.6006	SPECIAL CONTRACT SALES - SC	2,963,279	3,598,745	3,381,664	3,812,941	5,444,325	4,653,095
582.000.6007	ECON DEVELOPMENT RATE - ED	316,895	1,376,070	1,253,910	5,748,614	5,849,684	5,722,639
582.000.6008	BUSINESS OUTDOOR LIGHTS - OL	97,507	104,894	100,865	97,875	95,202	93,061
582.000.6009	SPECIAL INDUSTRY - TOU RATE	7,758,048	7,867,567	7,836,615	7,874,931	7,806,922	6,829,826
582.000.6010	MUNICIPAL STREET LIGHTING	221,711	176,620	127,988	127,600	128,248	128,357
582.000.6011	MUNICIPAL TRAFFIC SIGNALS	16,823	16,840	16,823	18,207	16,823	16,823
582.000.6012	RENTAL INCOME ON ELECTRIC PROP	37,972	38,333	39,057	61,169	153,183	98,110
582.000.6013	POWER SUPPLY COST ADJUSTMENT	3,181,617	1,111,655	3,418,278	2,242,350	1,687,712	1,050,375
582.000.6014	SERVICE CONNECTION FEES	29,530	32,084	27,085	38,855	33,958	29,695
582.000.6015	SERVICE RECONNECTION FEES	3,750	3,675	4,350	3,904	4,270	3,110
582.000.6016	SURGE PROTECTION PROGRAM INCOM	5,488	5,427	5,430	5,306	5,195	5,166
582.000.6017	HOME APPLIANCE WARRANTY PROGRM	8,682	9,380	6,645	27,299	50,623	60,729
582.000.6225	PENALTIES ON CUSTOMER ACCOUNTS	40,388	48,818	75,633	71,318	62,155	46,577
582.000.6230	CONTRACTED SERVICE INCOME	468,930	244,265	571,165	635,974	296,887	380,162
582.000.6940	ECOSMART CHOICE REVENUE	297	140	115	89	60	44
582.000.6950	ENERGY OPTIMIZATION REVENUE	267,269	350,767	308,207	474,428	464,752	389,543
582.000.6951	WEB METERING INCOME	11,040	15,498	17,085	16,764	17,110	12,708
TOTAL OPERATING REVENUE		34,003,496	33,639,361	36,390,624	40,834,235	42,663,971	38,746,142
582.675.7277	UNCOLLECTABLE ACCOUNTS	(62,212)	(46,080)	(52,139)	(317,225)	(51,920)	(19,139)
582.680.6947	BAD DEBT INCOME	9,521	17,124	13,205	80,773	20,446	11,438
PILOT Basis		32,855,452	32,689,483	35,174,622	39,138,941	41,421,537	37,585,293
		6/30/2017	6/30/2018	6/30/2019	6/30/2020	6/30/2021	6/30/2022
PILOT Expense (6.5% of Basis)		2,135,604	2,124,816	2,286,350	2,544,031	2,692,400	2,443,044
Electric PILOT		2,135,604	2,124,816	2,286,350	2,544,031	2,692,400	2,443,044
Water PILOT		164,100	169,556	177,781	214,191	225,792	220,965
Wastewater PILOT		185,102	208,360	219,097	295,333	324,432	344,185
Telecom PILOT		137,523	142,680	139,600	129,935	90,038	77,515
PILOT payments to General Fund		2,622,329	2,645,413	2,822,828	3,183,490	3,332,661	3,085,709
PILOT received by the General Fund		2,622,324	2,645,412	2,822,820	3,183,492	3,332,664	3,085,716

EXHIBIT – 7

**CITY OF COLDWATER
BRANCH COUNTY, MICHIGAN**

FINANCIAL STATEMENTS

JUNE 30, 2020

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF NET POSITION JUNE 30, 2020

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecommunications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES							
ASSETS							
Current assets:							
Cash and investments	\$ 11,196,309	\$ 2,209,396	\$ 4,726,823	-	\$ 201,873	\$ 368,531	\$ 18,702,932
Accounts receivable	4,048,493	355,778	587,321	149,252	32,412	-	5,173,256
Inventories	-	118,579	-	-	-	-	118,579
Due from other funds	67,202	-	-	-	-	-	67,202
Prepaid and other assets	45,093	24,197	16,572	43,976	-	562	130,400
Total current assets	15,357,097	2,707,950	5,330,716	193,228	234,285	369,093	24,192,369
Noncurrent assets:							
Investment in Power Agency	15,462,442	-	-	-	-	-	15,462,442
Restricted assets	3,259,193	99,184	1,470,286	-	-	-	4,828,663
Capital assets, less accumulated depreciation	39,404,504	16,278,034	29,878,394	2,153,917	187,486	-	87,902,335
Total noncurrent assets	58,126,139	16,377,218	31,348,680	2,153,917	187,486	-	108,193,440
Total assets	73,483,236	19,085,168	36,679,396	2,347,145	421,771	369,093	132,385,809
	252,451	113,938	113,939	38,945	-	-	519,273
Total assets and deferred outflows of resources	\$ 73,735,687	\$ 19,199,106	\$ 36,793,335	\$ 2,386,090	\$ 421,771	\$ 369,093	\$ 132,905,082
DEFERRED OUTFLOWS OF RESOURCES							
LIABILITIES AND NET POSITION							
LIABILITIES							
Current liabilities:							
Accounts payable	\$ 4,479,843	\$ 83,824	\$ 120,384	\$ 80,317	-	\$ 74,158	\$ 4,838,526
Accrued expenditures	1,103,319	70,035	324,479	41,600	437	4,710	1,544,580
Bonds and notes payable, due within one year	990,000	354,952	977,849	-	-	-	2,322,801
Total current liabilities	6,573,162	508,811	1,422,712	121,917	437	78,868	8,705,907
Noncurrent liabilities							
Bonds and notes payable, due in more than one year	20,290,000	2,928,206	17,049,197	-	-	-	40,267,403
Advance to other funds	-	-	-	67,202	-	-	67,202
Premium on bonds payable	401,464	48,121	352,883	-	-	-	802,468
Net pension liability	2,633,608	1,243,419	1,243,114	389,351	-	-	5,509,492
Compensated absences	189,804	95,918	69,463	50,841	205	5,075	411,306
Total noncurrent liabilities	23,514,876	4,315,664	18,714,657	507,394	205	5,075	47,057,871
Total liabilities	30,088,038	4,824,475	20,137,369	629,311	642	83,943	55,763,778
NET POSITION							
Investment in capital assets, net of related debt	18,124,504	12,994,876	11,851,348	2,153,917	187,486	-	45,312,131
Restricted	3,259,193	99,184	1,470,286	-	-	285,150	5,113,813
Unrestricted	22,263,952	1,280,571	3,334,332	(397,138)	233,643	-	26,715,360
Total net position	\$ 43,647,649	\$ 14,374,631	\$ 16,655,966	\$ 1,756,779	\$ 421,129	\$ 285,150	\$ 77,141,304

See Notes to Financial Statements

CITY OF COLDWATER

**PROPRIETARY FUNDS
STATEMENT OF REVENUES, EXPENSES
AND CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2020**

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecommunications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
REVENUES							
Charges for services	\$ 38,746,142	\$ 3,455,071	\$ 5,503,427	\$ 2,521,095	\$ 550,071	\$ 109,875	\$ 50,885,681
OPERATING EXPENSES							
Purchased power	28,545,710	-	-	-	-	-	28,545,710
Power plant	18,571	-	-	-	-	-	18,571
Natural gas plant	106,929	-	-	-	-	-	106,929
Distribution	1,530,578	499,899	-	1,526,891	-	-	3,557,368
Substation	80,370	-	-	-	-	-	80,370
Sanitation	-	-	-	-	540,607	-	540,607
Metering and lighting	920,102	-	-	-	-	-	920,102
Wells	-	59,879	-	-	-	-	59,879
Treatment	-	712,738	1,139,682	-	-	-	1,852,420
Collection system	-	-	184,033	-	-	-	184,033
Customer service	417,330	-	-	70,153	-	-	487,483
Administration	2,675,614	916,445	975,144	490,691	-	-	5,057,894
Public works	-	-	-	-	-	164,824	164,824
Payments in lieu of taxes	2,544,036	214,188	295,332	129,936	-	-	3,183,492
Depreciation	1,371,722	779,868	1,525,495	435,899	12,514	-	4,125,498
Total operating expenditures	38,210,962	3,183,017	4,119,686	2,653,570	553,121	164,824	48,885,180
OPERATING INCOME	535,180	272,054	1,383,741	(132,475)	(3,050)	(54,949)	2,000,501
NONOPERATING REVENUES (EXPENSES)							
Investment income	295,441	22,677	93,196	-	5,058	6,297	422,669
Interest expense	(268,307)	(92,748)	(703,749)	-	-	-	(1,064,804)
Gain (loss) on investments	932,270	-	-	-	-	-	932,270
Gain (loss) on sale of fixed assets	(13,565)	(10,636)	(8,213)	-	-	-	(32,414)
Miscellaneous income	79,515	15,429	9,470	18,066	-	-	122,480
Total nonoperating revenues (expenses)	1,025,354	(65,278)	(609,296)	18,066	5,058	6,297	380,201
INCOME (LOSS) BEFORE TRANSFERS AND CONTRIBUTIONS	1,560,534	206,776	774,445	(114,409)	2,008	(48,652)	2,380,702
TRANSFERS							
Transfers from (to) other funds	(50,000)	-	-	-	-	100,000	50,000
CHANGE IN NET POSITION	1,510,534	206,776	774,445	(114,409)	2,008	51,348	2,430,702
NET POSITION - BEGINNING	42,102,313	14,101,015	15,794,630	1,871,188	419,121	233,802	74,522,069
Contribution in aid of construction	34,802	66,840	86,891	-	-	-	188,533
NET POSITION - ENDING	\$ 43,647,649	\$ 14,374,631	\$ 16,655,966	\$ 1,756,779	\$ 421,129	\$ 285,150	\$ 77,141,304

See Notes to Financial Statements

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF CASH FLOWS FOR THE YEAR ENDED JUNE 30, 2020

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecommunications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
CASH FLOWS FROM OPERATING ACTIVITIES							
Cash received from customers	\$ 38,127,380	\$ 3,466,242	\$ 5,486,778	\$ 2,559,101	\$ 550,561	\$ 109,875	\$ 50,299,937
Payments made to suppliers	(33,194,198)	(1,010,485)	(1,268,931)	(1,673,243)	(529,650)	(33,622)	(37,710,129)
Payments made to employees	(3,350,798)	(1,307,915)	(1,245,860)	(799,372)	(14,470)	(124,856)	(6,843,271)
Net cash provided by operating activities	1,582,384	1,147,842	2,971,987	86,486	6,441	(48,603)	5,746,537
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES							
Transfers in (out)	(50,000)	-	-	-	-	100,000	50,000
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES							
Principal and interest paid on capital debt	(438,307)	(443,734)	(1,637,362)	-	-	-	(2,519,403)
Proceeds on bonds	17,085,000	-	-	-	-	-	17,085,000
Premium on bonds	185,212	-	-	-	-	-	185,212
Contribution in aid of construction	34,802	66,840	86,891	-	-	-	188,533
Proceeds on sale of assets	92,276	-	-	-	-	-	92,276
Purchase of capital assets	(19,253,131)	(616,066)	(404,175)	(86,486)	(200,000)	-	(20,559,858)
Net cash provided by (used in) capital and related financing activities	(2,294,148)	(992,960)	(1,954,646)	(86,486)	(200,000)	-	(5,528,240)
CASH FLOWS FROM INVESTING ACTIVITIES							
Interest received on investments	295,441	22,677	93,196	-	5,058	6,297	422,669
Change in investments	(80,074)	(23,462)	24,641	-	-	-	(78,895)
Net cash provided by investing activities	215,367	(785)	117,837	-	5,058	6,297	343,774
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(546,397)	154,097	1,135,178	-	(188,501)	57,694	612,071
CASH AND CASH EQUIVALENTS - BEGINNING	11,742,706	2,055,299	3,591,645	-	390,374	310,837	18,090,861
CASH AND CASH EQUIVALENTS - ENDING	\$ 11,196,309	\$ 2,209,396	\$ 4,726,823	\$ -	\$ 201,873	\$ 368,531	\$ 18,702,932

See Notes to Financial Statements

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF CASH FLOWS - Continued FOR THE YEAR ENDED JUNE 30, 2020

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecom- munications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
BALANCE SHEET CLASSIFICATION OF CASH AND CASH EQUIVALENTS							
Cash and investments	\$ 11,196,309	\$ 2,209,396	\$ 4,726,823	\$ -	\$ 201,873	\$ 368,531	\$ 18,702,932
Restricted cash and investments	3,259,193	99,184	1,470,286	-	-	-	4,828,663
Less amounts classified as investments	(3,259,193)	(99,184)	(1,470,286)	-	-	-	(4,828,663)
Total cash and cash equivalents	\$ 11,196,309	\$ 2,209,396	\$ 4,726,823	\$ -	\$ 201,873	\$ 368,531	\$ 18,702,932
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES							
Operating income (loss)	\$ 535,180	\$ 272,054	\$ 1,383,741	\$ (132,475)	\$ (3,050)	\$ (54,949)	\$ 2,000,501
Adjustments to reconcile operating income to net cash from operating activities:							
Miscellaneous income	79,515	15,429	9,470	18,066	-	-	122,480
Depreciation	1,371,722	779,868	1,525,495	435,899	12,514	-	4,125,498
Amortization	(14,638)	(2,282)	(16,738)	-	-	-	(33,658)
Changes in assets and liabilities:							
Receivables	(698,277)	(4,258)	(26,119)	19,940	490	-	(708,224)
Inventories	-	249	-	-	-	-	249
Prepays and other assets	31,314	2,021	5,182	(37,225)	-	(562)	730
Deferred outflows	185,286	83,595	83,595	28,579	-	-	381,055
Due from other governmental units	-	-	-	-	-	-	-
Due from (to) other funds	236,873	-	-	(236,873)	-	-	-
Accounts payable	(115,965)	23,460	27,859	(21,353)	(3,581)	268	(89,312)
Accrued expenditures	(32,313)	(26,556)	(17,490)	12,194	16	1,565	(62,584)
Net pension liability	(64,764)	(29,003)	(29,003)	(8,873)	-	-	(131,643)
Compensated absences	68,451	33,265	25,995	8,607	52	5,075	141,445
Net cash provided by operating activities	\$ 1,582,384	\$ 1,147,842	\$ 2,971,987	\$ 86,486	\$ 6,441	\$ (48,603)	\$ 5,746,537

See Notes to Financial Statements

EXHIBIT – 8

**CITY OF COLDWATER
BRANCH COUNTY, MICHIGAN**

FINANCIAL STATEMENTS

JUNE 30, 2021

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF NET POSITION JUNE 30, 2021

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecommunications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES							
ASSETS							
Current assets:							
Cash and investments	\$ 8,596,160	\$ 2,132,996	\$ 5,301,205	\$ 124,938	\$ 213,516	\$ 314,853	\$ 16,683,668
Accounts receivable	4,284,266	416,974	599,421	182,288	48,219	1,405	5,532,573
Inventories	-	121,504	-	-	-	-	121,504
Prepaid and other assets	58,374	23,094	16,377	16,455	-	3,945	118,245
Total current assets	12,938,800	2,694,568	5,917,003	323,681	261,735	320,203	22,455,990
Noncurrent assets:							
Investment in Power Agency	14,357,169	-	-	-	-	-	14,357,169
Restricted assets	445,064	58,969	1,189,863	-	-	-	1,693,896
Capital assets, less accumulated depreciation	43,592,211	16,348,928	29,476,916	1,750,635	167,486	-	91,336,176
Total noncurrent assets	58,394,444	16,407,897	30,666,779	1,750,635	167,486	-	107,387,241
Total assets	71,333,244	19,102,465	36,583,782	2,074,316	429,221	320,203	129,843,231
DEFERRED OUTFLOWS OF RESOURCES							
Total assets and deferred outflows of resources	\$71,438,212	\$19,149,850	\$36,631,168	\$ 2,090,511	\$ 429,221	\$ 320,203	\$ 130,059,165
LIABILITIES AND NET POSITION							
LIABILITIES							
Current liabilities:							
Accounts payable	\$ 4,464,270	\$ 164,669	\$ 93,758	\$ 102,388	\$ -	\$ -	\$ 4,825,085
Accrued expenditures	1,243,427	70,900	321,714	38,534	537	5,216	1,680,328
Bonds and notes payable, due within one year	845,000	364,678	1,013,122	-	-	-	2,222,800
Total current liabilities	6,552,697	600,247	1,428,594	140,922	537	5,216	8,728,213
Noncurrent liabilities							
Bonds and notes payable, due in more than one year	19,445,000	2,563,529	16,036,075	-	-	-	38,044,604
Premium on bonds payable	378,200	45,838	336,145	-	-	-	760,183
Net pension liability	2,340,338	1,111,044	1,110,739	344,107	-	-	4,906,228
Compensated absences	183,733	92,059	61,341	40,543	282	6,797	384,755
Total noncurrent liabilities	22,347,271	3,812,470	17,544,300	384,650	282	6,797	44,095,770
Total liabilities	28,899,968	4,412,717	18,972,894	525,572	819	12,013	52,823,983
NET POSITION							
Investment in capital assets, net of related debt	23,302,211	13,420,721	12,427,719	1,750,635	167,486	-	51,068,772
Restricted	445,064	58,969	1,189,863	-	-	308,190	2,002,086
Unrestricted	18,790,969	1,257,443	4,040,692	(185,696)	260,916	-	24,164,324
Total net position	\$42,538,244	\$14,737,133	\$17,658,274	\$ 1,564,939	\$ 428,402	\$ 308,190	\$ 77,235,182

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION FOR THE YEAR ENDED JUNE 30, 2021

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecommunications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
REVENUES							
Charges for services	\$ 40,744,852	\$ 3,715,130	\$ 5,586,028	\$ 2,352,760	\$ 606,213	\$ 109,248	\$ 53,114,231
OPERATING EXPENSES							
Purchased power	30,783,826	-	-	-	-	-	30,783,826
Power plant	26,757	-	-	-	-	-	26,757
Natural gas plant	547,994	-	-	-	-	-	547,994
Distribution	1,769,328	602,638	-	1,498,947	-	-	3,870,913
Substation	192,488	-	-	-	-	-	192,488
Sanitation	-	-	-	-	580,125	-	580,125
Metering and lighting	1,039,320	-	-	-	-	-	1,039,320
Wells	-	95,284	-	-	-	-	95,284
Treatment	-	804,369	1,094,335	-	-	-	1,898,704
Collection system	-	-	188,986	-	-	-	188,986
Customer service	375,215	-	-	90,753	-	-	465,968
Administration	1,780,702	787,468	820,673	481,731	-	-	3,870,574
Public works	-	-	-	-	-	188,476	188,476
Payments in lieu of taxes	2,692,404	225,792	324,432	90,036	-	-	3,332,664
Depreciation	1,815,555	788,384	1,545,480	403,282	20,000	-	4,572,701
Total operating expenditures	41,023,589	3,303,935	3,973,906	2,564,749	600,125	188,476	51,654,780
OPERATING INCOME	(278,737)	411,195	1,612,122	(211,989)	6,088	(79,228)	1,459,451
NONOPERATING REVENUES (EXPENSES)							
Investment income	100,231	13,087	49,936	94	1,185	2,268	166,801
Interest expense	(693,427)	(84,691)	(673,451)	-	-	-	(1,451,569)
Gain (loss) on investments	(419,117)	-	-	-	-	-	(419,117)
Gain (loss) on sale of fixed assets	88,052	5,926	160	1,600	-	-	95,738
Miscellaneous income	114,114	16,985	13,541	18,455	-	-	163,095
Total nonoperating revenues (expenses)	(810,147)	(48,693)	(609,814)	20,149	1,185	2,268	(1,445,052)
INCOME (LOSS) BEFORE TRANSFERS AND CONTRIBUTIONS	(1,088,884)	362,502	1,002,308	(191,840)	7,273	(76,960)	14,399
TRANSFERS							
Transfers from (to) other funds	(50,000)	-	-	-	-	100,000	50,000
CHANGE IN NET POSITION	(1,138,884)	362,502	1,002,308	(191,840)	7,273	23,040	64,399
NET POSITION - BEGINNING	43,647,649	14,374,631	16,655,966	1,756,779	421,129	285,150	77,141,304
Contribution in aid of construction	29,479	-	-	-	-	-	29,479
NET POSITION - ENDING	\$ 42,538,244	\$ 14,737,133	\$ 17,658,274	\$ 1,564,939	\$ 428,402	\$ 308,190	\$ 77,235,182

See Notes to Financial Statements

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF CASH FLOWS FOR THE YEAR ENDED JUNE 30, 2021

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecommunications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
CASH FLOWS FROM OPERATING ACTIVITIES							
Cash received from customers	\$ 40,623,193	\$ 3,670,919	\$ 5,587,469	\$ 2,338,179	\$ 590,406	\$ 107,843	\$ 52,918,009
Payments made to suppliers	(35,962,872)	(1,289,923)	(1,441,589)	(1,494,695)	(565,725)	(127,153)	(40,881,957)
Payments made to employees	(3,241,828)	(1,217,704)	(1,106,715)	(720,240)	(14,223)	(136,636)	(6,437,346)
Net cash provided by operating activities	1,418,493	1,163,292	3,039,165	123,244	10,458	(155,946)	5,598,706
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES							
Transfers in (out)	(50,000)	-	-	-	-	100,000	50,000
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES							
Principal and interest paid on capital debt	(1,683,427)	(439,642)	(1,651,300)	-	-	-	(3,774,369)
Contribution in aid of construction	29,479	-	-	-	-	-	29,479
Proceeds on sale of assets	88,052	5,926	1,600	1,600	-	-	97,178
Purchase of capital assets	(6,003,262)	(859,278)	(1,145,442)	-	-	-	(8,007,982)
Net cash provided by (used in) capital and related financing activities	(7,569,158)	(1,292,994)	(2,795,142)	1,600	-	-	(11,655,694)
CASH FLOWS FROM INVESTING ACTIVITIES							
Interest received on investments	100,231	13,087	49,936	94	1,185	2,268	166,801
Change in investments	3,500,285	40,215	280,423	-	-	-	3,820,923
Net cash provided by investing activities	3,600,516	53,302	330,359	94	1,185	2,268	3,987,724
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(2,600,149)	(76,400)	574,382	124,938	11,643	(53,678)	(2,019,264)
CASH AND CASH EQUIVALENTS - BEGINNING	11,196,309	2,209,396	4,726,823	-	201,873	368,531	18,702,932
CASH AND CASH EQUIVALENTS - ENDING	\$ 8,596,160	\$ 2,132,996	\$ 5,301,205	\$ 124,938	\$ 213,516	\$ 314,853	\$ 16,683,668
PROPRIETARY FUNDS							

See Notes to Financial Statements

CITY OF COLDWATER

FOR THE YEAR ENDED JUNE 30, 2021

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecommunications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
Cash and investments	\$ 8,596,160	\$ 2,132,996	\$ 5,301,205	\$ 124,938	\$ 213,516	\$ 314,853	\$ 16,683,668
Restricted cash and investments	445,064	58,969	1,189,863	-	-	-	1,693,896
Less amounts classified as investments	(445,064)	(58,969)	(1,189,863)	-	-	-	(1,693,896)
Total cash and cash equivalents	\$ 8,596,160	\$ 2,132,996	\$ 5,301,205	\$ 124,938	\$ 213,516	\$ 314,853	\$ 16,683,668

BALANCE SHEET CLASSIFICATION OF CASH AND CASH EQUIVALENTS

RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES

Operating income (loss)	\$ (278,737)	\$ 411,195	\$ 1,612,122	\$ (211,989)	\$ 6,088	\$ (79,228)	\$ 1,459,451
Adjustments to reconcile operating income to net cash from operating activities:							
Miscellaneous income	114,114	16,985	13,541	18,455	-	-	163,095
Depreciation	1,815,555	788,384	1,545,480	403,282	20,000	-	4,572,701
Amortization	(23,264)	(2,283)	(16,738)	-	-	-	(42,285)
Changes in assets and liabilities:							
Receivables	(235,773)	(61,196)	(12,100)	(33,036)	(15,807)	(1,405)	(359,317)
Inventories	-	(2,925)	-	-	-	-	(2,925)
Prepays and other assets	(13,281)	1,103	195	27,521	-	(3,383)	12,155
Deferred outflows	147,483	66,553	66,553	22,750	-	-	303,339
Due from (to) other funds	67,202	-	-	(67,202)	-	-	-
Accounts payable	(15,573)	80,845	(26,626)	22,071	-	(74,158)	(13,441)
Accrued expenditures	140,108	865	(2,765)	(3,066)	100	506	135,748
Net pension liability	(293,270)	(132,375)	(132,375)	(45,244)	-	-	(603,264)
Compensated absences	(6,071)	(3,859)	(8,122)	(10,298)	77	1,722	(26,551)
Net cash provided by operating activities	\$ 1,418,493	\$ 1,163,292	\$ 3,039,165	\$ 123,244	\$ 10,458	\$ (155,946)	\$ 5,598,706

See Notes to Financial Statements

EXHIBIT – 9

**CITY OF COLDWATER
BRANCH COUNTY, MICHIGAN**

FINANCIAL STATEMENTS

JUNE 30, 2022

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF NET POSITION JUNE 30, 2022

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecom- munications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES							
ASSETS							
Current assets:							
Cash and investments	\$ 9,891,107	\$ 2,415,171	\$ 6,237,025	\$ 189,247	\$ 226,753	\$ 299,474	\$ 19,258,777
Accounts receivable	4,264,713	418,522	592,914	202,035	52,430	-	5,530,614
Inventories	-	125,424	-	-	-	-	125,424
Prepaid and other assets	45,457	23,577	18,715	16,557	-	28,985	133,291
Total current assets	14,201,277	2,982,694	6,848,654	407,839	279,183	328,459	25,048,106
Noncurrent assets:							
Investment in Power Agency	14,861,675	-	-	-	-	-	14,861,675
Restricted assets	106,617	60,190	1,215,263	-	-	-	1,382,070
Capital assets, less accumulated depreciation	43,419,959	16,179,157	28,624,098	1,411,506	147,486	-	89,782,206
Total noncurrent assets	58,388,251	16,239,347	29,839,361	1,411,506	147,486	-	106,025,951
Total assets	72,589,528	19,222,041	36,688,015	1,819,345	426,669	328,459	131,074,057
DEFERRED OUTFLOWS OF RESOURCES	(72,557)	(33,298)	(33,297)	(13,985)	-	-	(153,137)
Total assets and deferred outflows of resources	\$72,516,971	\$19,188,743	\$36,654,718	\$1,805,360	\$426,669	\$328,459	\$130,920,920
LIABILITIES AND NET POSITION							
LIABILITIES							
Current liabilities:							
Accounts payable	\$ 4,371,267	\$ 278,163	\$ 314,863	\$ 70,550	\$ 2	\$ -	\$ 5,034,845
Accrued expenditures	1,313,692	75,430	313,093	37,387	665	5,965	1,746,232
Bonds and notes payable, due within one year	870,000	368,972	1,055,028	-	-	-	2,294,000
Total current liabilities	6,554,959	722,565	1,682,984	107,937	667	5,965	9,075,077
Noncurrent liabilities							
Bonds and notes payable, due in more than one year	18,575,000	2,194,557	14,981,047	-	-	-	35,750,604
Premium on bonds payable	354,936	43,556	319,407	-	-	-	717,899
Net pension liability	1,997,651	956,943	956,638	294,035	-	-	4,205,267
Compensated absences	151,932	81,888	62,213	43,893	532	5,306	345,764
Total noncurrent liabilities	21,079,519	3,276,944	16,319,305	337,928	532	5,306	41,019,534
Total liabilities	27,634,478	3,999,509	18,002,289	445,865	1,199	11,271	50,094,611
NET POSITION							
Investment in capital assets, net of related debt	23,974,959	13,615,628	12,588,023	1,411,506	147,486	-	51,737,602
Restricted	106,617	60,190	1,215,263	-	-	317,188	1,699,258
Unrestricted	20,800,917	1,513,416	4,849,143	(52,011)	277,984	-	27,389,449
Total net position	\$44,882,493	\$15,189,234	\$18,652,429	\$1,359,495	\$425,470	\$317,188	\$80,826,309

See Notes to Financial Statements

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION FOR THE YEAR ENDED JUNE 30, 2022

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecommunications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
REVENUES							
Charges for services	\$ 42,913,616	\$ 3,872,890	\$ 5,600,164	\$ 2,519,114	\$ 654,062	\$ 111,145	\$ 55,670,991
OPERATING EXPENSES							
Purchased power	32,553,909	-	-	-	-	-	32,553,909
Power plant	22,094	-	-	-	-	-	22,094
Natural gas plant	454,124	-	-	-	-	-	454,124
Distribution	1,965,602	677,969	-	1,674,300	-	-	4,317,871
Substation	68,208	-	-	-	-	-	68,208
Sanitation	-	-	-	-	634,516	-	634,516
Metering and lighting	969,395	-	-	-	-	-	969,395
Wells	-	80,817	-	-	-	-	80,817
Treatment	-	783,671	1,130,578	-	-	-	1,914,249
Collection system	-	-	250,406	-	-	-	250,406
Customer service	330,520	-	-	114,615	-	-	445,135
Administration	1,905,259	789,811	788,031	521,755	-	-	4,004,856
Public works	-	-	-	-	-	197,844	197,844
Payments in lieu of taxes	2,443,044	220,968	344,184	77,520	-	-	3,085,716
Depreciation	1,937,866	814,425	1,465,258	364,129	20,000	-	4,601,678
Total operating expenditures	42,650,021	3,367,661	3,978,457	2,752,319	654,516	197,844	53,600,818
OPERATING INCOME	263,595	505,229	1,621,707	(233,205)	(454)	(86,699)	2,070,173
NONOPERATING REVENUES (EXPENSES)							
Investment income (unrealized gain/loss)	19,945	4,913	4	1,093	(2,478)	(4,303)	19,174
Interest expense	(668,810)	(77,893)	(640,619)	-	-	-	(1,387,322)
Gain (loss) on investments	593,027	-	-	-	-	-	593,027
Gain (loss) on sale of fixed assets	449,937	-	-	-	-	-	449,937
Miscellaneous income	139,730	19,852	13,063	26,668	-	-	199,313
Total nonoperating revenues (expenses)	533,829	(53,128)	(627,552)	27,761	(2,478)	(4,303)	(125,871)
INCOME (LOSS) BEFORE TRANSFERS AND CONTRIBUTIONS	797,424	452,101	994,155	(205,444)	(2,932)	(91,002)	1,944,302
TRANSFERS							
Transfers from (to) other funds	(50,000)	-	-	-	-	100,000	50,000
CHANGE IN NET POSITION	747,424	452,101	994,155	(205,444)	(2,932)	8,998	1,994,302
NET POSITION - BEGINNING	42,538,244	14,737,133	17,658,274	1,564,939	428,402	308,190	77,235,182
Contribution in aid of construction	1,596,825	-	-	-	-	-	1,596,825
NET POSITION - ENDING	\$ 44,882,493	\$ 15,189,234	\$ 18,652,429	\$ 1,359,495	\$ 425,470	\$ 317,188	\$ 80,826,309

See Notes to Financial Statements

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF CASH FLOWS FOR THE YEAR ENDED JUNE 30, 2022

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecommunications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
CASH FLOWS FROM OPERATING ACTIVITIES							
Cash received from customers	\$ 43,072,899	\$ 3,891,194	\$ 5,619,734	\$ 2,526,035	\$ 649,851	\$ 112,550	\$ 55,872,263
Payments made to suppliers	(37,735,268)	(1,211,550)	(1,274,319)	(1,452,420)	(613,620)	(81,909)	(42,369,086)
Payments made to employees	(3,206,935)	(1,313,936)	(1,118,018)	(985,399)	(20,516)	(141,717)	(6,786,521)
Net cash provided by operating activities	2,130,696	1,365,708	3,227,397	88,216	15,715	(111,076)	6,716,656
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES							
Transfers in (out)	(50,000)	-	-	-	-	100,000	50,000
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES							
Principal and interest paid on capital debt	(1,513,810)	(442,571)	(1,653,741)	-	-	-	(3,610,122)
Contribution in aid of construction	1,596,825	-	-	-	-	-	1,596,825
Proceeds on sale of assets	606,694	-	-	-	-	-	606,694
Purchase of capital assets	(1,922,371)	(644,654)	(612,440)	(25,000)	-	-	(3,204,465)
Net cash provided by (used in) capital and related financing activities	(1,232,662)	(1,087,225)	(2,266,181)	(25,000)	-	-	(4,611,068)
CASH FLOWS FROM INVESTING ACTIVITIES							
Interest received on investments	19,945	4,913	4	1,093	(2,478)	(4,303)	19,174
Change in investments	426,968	(1,221)	(25,400)	-	-	-	400,347
Net cash provided by investing activities	446,913	3,692	(25,396)	1,093	(2,478)	(4,303)	419,521
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,294,947	282,175	935,820	64,309	13,237	(15,379)	2,575,109
CASH AND CASH EQUIVALENTS - BEGINNING	8,596,160	2,132,996	5,301,205	124,938	213,516	314,853	16,683,668
CASH AND CASH EQUIVALENTS - ENDING	\$ 9,891,107	\$ 2,415,171	\$ 6,237,025	\$ 189,247	\$ 226,753	\$ 299,474	\$ 19,258,777

See Notes to Financial Statements

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF CASH FLOWS - Continued FOR THE YEAR ENDED JUNE 30, 2022

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecommunications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
BALANCE SHEET CLASSIFICATION OF CASH AND CASH EQUIVALENTS							
Cash and investments	\$ 9,891,107	\$2,415,171	\$ 6,237,025	\$ 189,247	\$226,753	\$ 299,474	\$19,258,777
Restricted cash and investments	106,617	60,190	1,215,263	-	-	-	1,382,070
Less amounts classified as investments	(106,617)	(60,190)	(1,215,263)	-	-	-	(1,382,070)
Total cash and cash equivalents	<u>\$ 9,891,107</u>	<u>\$2,415,171</u>	<u>\$ 6,237,025</u>	<u>\$ 189,247</u>	<u>\$226,753</u>	<u>\$ 299,474</u>	<u>\$19,258,777</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES							
Operating income (loss)	\$ 263,595	\$ 505,229	\$ 1,621,707	\$ (233,205)	\$ (454)	\$ (86,699)	\$ 2,070,173
Adjustments to reconcile operating income to net cash from operating activities:							
Miscellaneous income	139,730	19,852	13,063	26,668	-	-	199,313
Depreciation	1,937,866	814,425	1,465,258	364,129	20,000	-	4,601,678
Amortization	(23,264)	(2,282)	(16,738)	-	-	-	(42,284)
Changes in assets and liabilities:							
Receivables	19,553	(1,548)	6,507	(19,747)	(4,211)	1,405	1,959
Inventories	-	(3,920)	-	-	-	-	(3,920)
Prepays and other assets	12,917	(483)	(2,338)	(102)	-	(25,040)	(15,046)
Deferred outflows	177,525	80,683	80,683	30,180	-	-	369,071
Due from (to) other funds	-	-	-	-	-	-	-
Accounts payable	(93,003)	113,494	221,105	(31,838)	2	-	209,760
Accrued expenditures	70,265	4,530	(8,621)	(1,147)	128	749	65,904
Net pension liability	(342,687)	(154,101)	(154,101)	(50,072)	-	-	(700,961)
Compensated absences	(31,801)	(10,171)	872	3,350	250	(1,491)	(38,991)
Net cash provided by operating activities	<u>\$ 2,130,696</u>	<u>\$1,365,708</u>	<u>\$ 3,227,397</u>	<u>\$ 88,216</u>	<u>\$ 15,715</u>	<u>\$ (111,076)</u>	<u>\$ 6,716,656</u>

See Notes to Financial Statements

EXHIBIT – 10

**CITY OF COLDWATER
BRANCH COUNTY, MICHIGAN**

FINANCIAL STATEMENTS

JUNE 30, 2023

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF NET POSITION JUNE 30, 2023

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecommunications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES							
ASSETS							
Current assets:							
Cash and investments	\$ 10,847,984	\$ 2,123,087	\$ 6,703,446	\$ 204,281	\$ 259,975	\$ 363,099	\$ 20,501,872
Accounts receivable	4,481,573	592,093	748,982	227,139	54,030	-	6,103,817
Inventories	-	144,216	-	-	-	-	144,216
Prepaid and other assets	30,650	21,241	15,267	18,649	-	1,039	86,846
Total current assets	15,360,207	2,880,637	7,467,695	450,069	314,005	364,138	26,836,751
Noncurrent assets:							
Investment in Power Agency Restricted assets	14,720,645	-	-	-	-	-	14,720,645
Capital assets, less accumulated depreciation	82,532	63,368	1,260,007	-	-	-	1,405,907
Total noncurrent assets	43,050,325	16,060,861	27,824,064	1,248,168	127,486	-	88,310,904
Total assets	57,853,502	16,124,229	29,084,071	1,248,168	127,486	-	104,437,456
73,213,709	19,004,866	36,551,766	1,698,237	441,491	364,138	-	131,274,207
714,086	322,234	322,235	110,153	-	-	-	1,468,708
DEFERRED OUTFLOWS OF RESOURCES							
Total assets and deferred outflows of resources	\$73,927,795	\$19,327,100	\$36,874,001	\$ 1,808,390	\$ 441,491	\$ 364,138	\$ 132,742,915
LIABILITIES AND NET POSITION							
LIABILITIES							
Current liabilities:							
Accounts payable	\$ 3,962,115	\$ 118,491	\$ 98,792	\$ 96,714	\$ 7,331	\$ 881	\$ 4,284,324
Accrued expenditures	1,321,314	43,183	267,443	12,596	-	2,523	1,647,059
Bonds and notes payable, due within one year	895,000	378,698	1,093,502	-	-	-	2,367,200
Total current liabilities	6,178,429	540,372	1,459,737	109,310	7,331	3,404	8,298,583
Noncurrent liabilities							
Bonds and notes payable, due in more than one year	17,680,000	1,815,859	13,887,545	-	-	-	33,383,404
Premium on bonds payable	331,671	41,273	302,669	-	-	-	675,613
Net pension liability	2,504,710	1,186,311	1,186,006	375,045	-	-	5,252,072
Compensated absences	172,855	76,237	67,849	45,672	114	14,717	377,444
Total noncurrent liabilities	20,689,236	3,119,680	15,444,069	420,717	114	14,717	39,688,533
Total liabilities	26,867,665	3,660,052	16,903,806	530,027	7,445	18,121	47,987,116
NET POSITION							
Investment in capital assets, net of related debt	24,475,325	13,866,304	12,843,017	1,248,168	127,486	-	52,560,300
Restricted	82,532	63,368	1,260,007	-	-	346,017	1,751,924
Unrestricted	22,502,273	1,737,376	5,867,171	30,195	306,560	-	30,443,575
Total net position	\$47,060,130	\$15,667,048	\$19,970,195	\$ 1,278,363	\$ 434,046	\$ 346,017	\$ 84,755,799

See Notes to Financial Statements

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION FOR THE YEAR ENDED JUNE 30, 2023

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecommunications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
REVENUES							
Charges for services	\$ 48,071,322	\$ 4,015,047	\$ 5,766,088	\$ 2,707,702	\$ 668,099	\$ 1,110,265	\$ 61,338,523
OPERATING EXPENSES							
Purchased power	35,102,504	-	-	-	-	-	35,102,504
Power plant	24,524	-	-	-	-	-	24,524
Natural gas plant	369,155	-	-	-	-	-	369,155
Distribution	2,156,738	748,237	-	1,833,626	-	-	4,738,601
Substation	97,253	-	-	-	-	-	97,253
Sanitation	-	-	-	-	644,853	-	644,853
Metering and lighting	1,086,740	-	-	-	-	-	1,086,740
Wells	-	81,997	-	-	-	-	81,997
Treatment	-	853,820	1,227,611	-	-	-	2,081,431
Collection system	-	-	249,843	-	-	-	249,843
Customer service	227,014	-	-	72,135	-	-	299,149
Administration	1,875,591	789,907	759,786	538,766	-	-	3,964,050
Public works	-	-	-	-	-	194,070	194,070
Payments in lieu of taxes	2,574,180	237,516	349,260	72,540	-	-	3,233,496
Depreciation	2,082,811	815,526	1,447,954	287,708	20,000	-	4,653,999
Total operating expenditures	45,596,510	3,527,003	4,034,454	2,804,775	664,853	194,070	56,821,665
OPERATING INCOME	2,474,812	488,044	1,731,634	(97,073)	3,246	(83,805)	4,516,858
NONOPERATING REVENUES (EXPENSES)							
Investment income (unrealized gain/loss)	444,146	37,664	169,158	4,432	5,330	12,634	673,364
Interest expense	(681,440)	(70,649)	(598,987)	-	-	-	(1,351,076)
Gain (loss) on investments	(121,686)	-	-	-	-	-	(121,686)
Gain (loss) on sale of fixed assets	2,813	9,425	-	-	-	-	12,238
Miscellaneous income	105,578	13,330	15,961	11,509	-	-	146,378
Total nonoperating revenues (expenses)	(250,589)	(10,230)	(413,868)	15,941	5,330	12,634	(640,782)
INCOME (LOSS) BEFORE TRANSFERS AND CONTRIBUTIONS	2,224,223	477,814	1,317,766	(81,132)	8,576	(71,171)	3,876,076
TRANSFERS							
Transfers from (to) other funds	(50,000)	-	-	-	-	100,000	50,000
CHANGE IN NET POSITION	2,174,223	477,814	1,317,766	(81,132)	8,576	28,829	3,926,076
NET POSITION - BEGINNING	44,882,493	15,189,234	18,652,429	1,359,495	425,470	317,188	80,826,309
Contribution in aid of construction	3,414	-	-	-	-	-	3,414
NET POSITION - ENDING	\$ 47,060,130	\$ 15,667,048	\$ 19,970,195	\$ 1,278,363	\$ 434,046	\$ 346,017	\$ 84,755,799

See Notes to Financial Statements

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF CASH FLOWS FOR THE YEAR ENDED JUNE 30, 2023

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecommunications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
CASH FLOWS FROM OPERATING ACTIVITIES							
Cash received from customers	\$ 47,960,040	\$ 3,854,806	\$ 5,625,981	\$ 2,694,107	\$ 666,499	\$ 110,265	\$ 60,911,698
Payments made to suppliers	(41,053,375)	(1,827,018)	(1,076,162)	(1,572,649)	(617,394)	(25,643)	(46,172,241)
Payments made to employees	(3,128,972)	(1,226,932)	(1,905,877)	(986,486)	(21,213)	(133,631)	(7,403,111)
Net cash provided by operating activities	3,777,693	800,856	2,643,942	134,972	27,892	(49,009)	7,336,346
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES							
Transfers in (out)	(50,000)	-	-	-	-	100,000	50,000
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES							
Principal and interest paid on capital debt	(1,551,440)	(439,621)	(1,654,015)	-	-	-	(3,645,076)
Contribution in aid of construction	3,413	-	-	-	-	-	3,413
Proceeds on sale of assets	2,813	9,425	-	-	-	-	12,238
Purchase of capital assets	(1,713,177)	(697,230)	(647,920)	(124,370)	-	-	(3,182,697)
Net cash provided by (used in) capital and related financing activities	(3,258,391)	(1,127,426)	(2,301,935)	(124,370)	-	-	(6,812,122)
CASH FLOWS FROM INVESTING ACTIVITIES							
Interest received on investments	444,146	37,664	169,158	4,432	5,330	12,634	673,364
Change in investments	43,429	(3,178)	(44,744)	-	-	-	(4,493)
Net cash provided by investing activities	487,575	34,486	124,414	4,432	5,330	12,634	668,871
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	956,877	(292,084)	466,421	15,034	33,222	63,625	1,243,095
CASH AND CASH EQUIVALENTS - BEGINNING	9,891,107	2,415,171	6,237,025	189,247	226,753	299,474	19,258,777
CASH AND CASH EQUIVALENTS - ENDING	\$ 10,847,984	\$ 2,123,087	\$ 6,703,446	\$ 204,281	\$ 259,975	\$ 363,099	\$ 20,501,872

See Notes to Financial Statements

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF CASH FLOWS - Continued FOR THE YEAR ENDED JUNE 30, 2023

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecommunications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
BALANCE SHEET CLASSIFICATION OF CASH AND CASH EQUIVALENTS							
Cash and investments	\$ 10,847,984	\$ 2,123,087	\$ 6,703,446	\$ 204,281	\$ 259,975	\$ 363,099	\$ 20,501,872
Restricted cash and investments	82,532	63,368	1,260,007	-	-	-	1,405,907
Less amounts classified as investments	(82,532)	(63,368)	(1,260,007)	-	-	-	(1,405,907)
Total cash and cash equivalents	<u>\$ 10,847,984</u>	<u>\$ 2,123,087</u>	<u>\$ 6,703,446</u>	<u>\$ 204,281</u>	<u>\$ 259,975</u>	<u>\$ 363,099</u>	<u>\$ 20,501,872</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES							
Operating income (loss)	\$ 2,474,812	\$ 488,044	\$ 1,731,634	\$ (97,073)	\$ 3,246	\$ (83,805)	\$ 4,516,858
Adjustments to reconcile operating income to net cash from operating activities:							
Miscellaneous income	105,578	13,330	15,961	11,509	-	-	146,378
Depreciation	2,082,811	815,526	1,447,954	287,708	20,000	-	4,653,999
Amortization	(23,264)	(2,283)	(16,738)	-	-	-	(42,285)
Changes in assets and liabilities:							
Receivables	(216,860)	(173,571)	(156,068)	(25,104)	(1,600)	-	(573,203)
Inventories	-	(18,792)	-	-	-	-	(18,792)
Prepays and other assets	14,807	2,336	3,448	(2,092)	-	27,946	46,445
Deferred outflows	(786,643)	(355,532)	(355,532)	(124,138)	-	-	(1,621,845)
Due from (to) other funds	-	-	-	-	-	-	-
Accounts payable	(409,152)	(159,672)	(216,071)	26,164	7,329	881	(750,521)
Accrued expenditures	7,622	(32,247)	(45,650)	(24,791)	(665)	(3,442)	(99,173)
Net pension liability	507,059	229,368	229,368	81,010	-	-	1,046,805
Compensated absences	20,923	(5,651)	5,636	1,779	(418)	9,411	31,680
Net cash provided by operating activities	<u>\$ 3,777,693</u>	<u>\$ 800,856</u>	<u>\$ 2,643,942</u>	<u>\$ 134,972</u>	<u>\$ 27,892</u>	<u>\$ (49,009)</u>	<u>\$ 7,336,346</u>

See Notes to Financial Statements

EXHIBIT – 11

**CITY OF COLDWATER
BRANCH COUNTY, MICHIGAN**

FINANCIAL STATEMENTS

JUNE 30, 2024

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF NET POSITION JUNE 30, 2024

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecommunications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES							
ASSETS							
Current assets:							
Cash and investments	\$ 14,074,307	\$ 2,715,269	\$ 8,206,273	\$ 418,254	\$ 271,963	\$ 354,854	\$ 26,040,920
Accounts receivable	4,699,552	524,459	686,791	243,897	63,844	-	6,218,543
Inventories	-	121,043	-	-	-	-	121,043
Prepaid and other assets	32,343	17,673	18,007	18,544	-	1,011	87,578
Total current assets	18,806,202	3,378,444	8,911,071	680,695	335,807	355,865	32,468,084
Noncurrent assets:							
Investment in Power Agency	15,065,584	-	-	-	-	-	15,065,584
Restricted assets	-	67,050	1,320,827	-	-	-	1,387,877
Capital assets, less accumulated depreciation	41,295,562	15,879,932	26,642,901	1,001,293	107,486	-	84,927,174
Total noncurrent assets	56,361,146	15,946,982	27,963,728	1,001,293	107,486	-	101,380,635
Total assets	75,167,348	19,325,426	36,874,799	1,681,988	443,293	355,865	133,848,719
DEFERRED OUTFLOWS OF RESOURCES	548,003	247,289	247,290	84,533	-	-	1,127,115
Total assets and deferred outflows of resources	\$75,715,351	\$19,572,715	\$37,122,089	\$1,766,521	\$443,293	\$355,865	\$134,975,834
LIABILITIES AND NET POSITION							
LIABILITIES							
Current liabilities:							
Accounts payable	\$ 3,143,658	\$ 87,824	\$ 85,429	\$ 86,669	\$ 22	\$ 544	\$ 3,404,146
Accrued expenditures	1,504,564	45,126	255,884	12,503	260	2,396	1,820,733
Bonds and notes payable, due within one year	915,000	387,424	1,141,776	-	-	-	2,444,200
Total current liabilities	5,563,222	520,374	1,483,089	99,172	282	2,940	7,669,079
Noncurrent liabilities							
Bonds and notes payable, due in more than one year	16,765,000	1,428,435	12,745,769	-	-	-	30,939,204
Premium on bonds payable	308,407	38,991	285,931	-	-	-	633,329
Net pension liability	2,008,336	962,321	962,016	298,475	-	-	4,231,148
Compensated absences	179,459	89,881	73,912	53,258	467	11,720	408,697
Total noncurrent liabilities	19,261,202	2,519,628	14,067,628	351,733	467	11,720	36,212,378
Total liabilities	24,824,424	3,040,002	15,550,717	450,905	749	14,660	43,881,457
NET POSITION							
Investment in capital assets, net of related debt	23,615,562	14,064,073	12,755,356	1,001,293	107,486	-	51,543,770
Restricted	-	67,050	1,320,827	-	-	341,205	1,729,082
Unrestricted	27,275,365	2,401,590	7,495,189	314,323	335,058	-	37,821,525
Total net position	\$50,890,927	\$16,532,713	\$21,571,372	\$1,315,616	\$442,544	\$341,205	\$91,094,377

See Notes to Financial Statements

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION FOR THE YEAR ENDED JUNE 30, 2024

	Electric Fund	Water Fund	Water Fund	Waste Water Fund	Nonmajor Telecommunications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
REVENUES								
Charges for services	\$ 48,363,459	\$ 4,530,455	\$ 6,209,603	\$ 2,869,520	\$ 736,473	\$ 110,831	\$ 62,820,341	
OPERATING EXPENSES								
Purchased power	33,895,568	-	-	-	-	-	33,895,568	
Power plant	20,878	-	-	-	-	-	20,878	
Natural gas plant	733,790	-	-	-	-	-	733,790	
Distribution	2,043,719	808,847	-	1,899,376	-	-	4,751,942	
Substation	197,288	-	-	-	-	-	197,288	
Sanitation	-	-	-	-	720,599	-	720,599	
Metering and lighting	1,015,832	-	-	-	-	-	1,015,832	
Wells	-	89,669	-	-	-	-	89,669	
Treatment	-	967,052	1,554,788	-	-	-	2,521,840	
Collection system	-	-	379,194	-	-	-	379,194	
Customer service	259,406	-	-	76,391	-	-	335,797	
Administration	2,037,500	776,260	761,888	533,732	-	-	4,109,380	
Public works	-	-	-	-	-	233,317	233,317	
Payments in lieu of taxes	2,712,120	246,960	352,560	73,248	-	-	3,384,888	
Depreciation	2,245,482	825,101	1,364,371	272,331	-	20,000	4,727,285	
Total operating expenditures	45,161,583	3,713,889	4,412,801	2,855,078	740,599	233,317	57,117,267	
OPERATING INCOME	3,201,876	816,566	1,796,802	14,442	(4,126)	(122,486)	5,703,074	
NONOPERATING REVENUES (EXPENSES)								
Investment income (unrealized gain/loss)	820,469	90,304	358,603	8,520	12,624	17,674	1,308,194	
Interest expense	(625,269)	(62,875)	(569,040)	-	-	-	(1,257,184)	
Gain (loss) on investments	233,275	-	-	-	-	-	233,275	
Gain (loss) on sale of fixed assets	8,636	5,650	-	-	-	-	14,286	
Contribution in aid of construction	143,120	-	-	-	-	-	143,120	
Miscellaneous income	98,690	16,020	14,812	14,291	-	-	143,813	
Total nonoperating revenues (expenses)	678,921	49,099	(195,625)	22,811	12,624	17,674	585,504	
INCOME (LOSS) BEFORE TRANSFERS AND CONTRIBUTIONS	3,880,797	865,665	1,601,177	37,253	8,498	(104,812)	6,288,578	
TRANSFERS								
Transfers from (to) other funds	(50,000)	-	-	-	-	100,000	50,000	
CHANGE IN NET POSITION	3,830,797	865,665	1,601,177	37,253	8,498	(4,812)	6,338,578	
NET POSITION - BEGINNING	47,060,130	15,667,048	19,970,195	1,278,363	434,046	346,017	84,755,799	
NET POSITION - ENDING	\$ 50,890,927	\$ 16,532,713	\$ 21,571,372	\$ 1,315,616	\$ 442,544	\$ 341,205	\$ 91,094,377	

See Notes to Financial Statements

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF CASH FLOWS FOR THE YEAR ENDED JUNE 30, 2024

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecom- munications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
CASH FLOWS FROM OPERATING ACTIVITIES							
Cash received from customers	\$ 48,244,170	\$ 4,614,109	\$ 6,286,606	\$ 2,867,053	\$ 726,659	\$ 110,831	\$ 62,849,428
Payments made to suppliers	(40,780,536)	(1,696,640)	(2,044,954)	(1,653,526)	(705,762)	(64,981)	(46,946,399)
Payments made to employees	(3,119,416)	(1,331,814)	(1,190,858)	(982,618)	(21,533)	(171,769)	(6,818,008)
Net cash provided by operating activities	4,344,218	1,585,655	3,050,794	230,909	(636)	(125,919)	9,085,021
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES							
Transfers in (out)	(50,000)	-	-	-	-	100,000	50,000
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES							
Principal and interest paid on capital debt	(1,520,269)	(441,573)	(1,662,542)	-	-	-	(3,624,384)
Contribution in aid of construction	143,120	-	-	-	-	-	143,120
Proceeds on sale of assets	8,636	5,650	-	-	-	-	14,286
Purchase of capital assets	(490,719)	(644,172)	(183,208)	(25,456)	-	-	(1,343,555)
Net cash provided by (used in) capital and related financing activities	(1,859,232)	(1,080,095)	(1,845,750)	(25,456)	-	-	(4,810,533)
CASH FLOWS FROM INVESTING ACTIVITIES							
Interest received on investments	820,469	90,304	358,603	8,520	12,624	17,674	1,308,194
Change in investments	(29,132)	(3,682)	(60,820)	-	-	-	(93,634)
Net cash provided by investing activities	791,337	86,622	297,783	8,520	12,624	17,674	1,214,560
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	3,226,323	592,182	1,502,827	213,973	11,988	(8,245)	5,539,048
CASH AND CASH EQUIVALENTS - BEGINNING	10,847,984	2,123,087	6,703,446	204,281	259,975	363,099	20,501,872
CASH AND CASH EQUIVALENTS - ENDING	\$ 14,074,307	\$ 2,715,269	\$ 8,206,273	\$ 418,254	\$ 271,963	\$ 354,854	\$ 26,040,920

See Notes to Financial Statements

CITY OF COLDWATER

PROPRIETARY FUNDS STATEMENT OF CASH FLOWS - Continued FOR THE YEAR ENDED JUNE 30, 2024

	Electric Fund	Water Fund	Waste Water Fund	Nonmajor Telecommunications Fund	Nonmajor Rubbish Fund	Nonmajor GIS Fund	Totals
BALANCE SHEET CLASSIFICATION OF CASH AND CASH EQUIVALENTS							
Cash and investments	\$14,074,307	\$2,715,269	\$8,206,273	\$418,254	\$271,963	\$354,854	\$26,040,920
Restricted cash and investments	-	67,050	1,320,827	-	-	-	1,387,877
Less amounts classified as investments	-	(67,050)	(1,320,827)	-	-	-	(1,387,877)
Total cash and cash equivalents	<u>\$14,074,307</u>	<u>\$2,715,269</u>	<u>\$8,206,273</u>	<u>\$418,254</u>	<u>\$271,963</u>	<u>\$354,854</u>	<u>\$26,040,920</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES							
Operating income (loss)	\$3,201,876	\$816,566	\$1,796,802	\$14,442	\$(4,126)	\$(122,486)	\$5,703,074
Adjustments to reconcile operating income to net cash from operating activities:							
Miscellaneous income	98,690	16,020	14,812	14,291	-	-	143,813
Depreciation	2,245,482	825,101	1,364,371	272,331	20,000	-	4,727,285
Amortization	(23,264)	(2,282)	(16,738)	-	-	-	(42,284)
Changes in assets and liabilities:							
Receivables	(217,979)	67,634	62,191	(16,758)	(9,814)	-	(114,726)
Inventories	-	23,173	-	-	-	-	23,173
Prepays and other assets	(1,693)	3,568	(2,740)	105	-	28	(732)
Deferred outflows	166,083	74,945	74,945	25,620	-	-	341,593
Due from (to) other funds	-	-	-	-	-	-	-
Accounts payable	(818,457)	(30,667)	(13,363)	(10,045)	(7,309)	(337)	(880,178)
Accrued expenditures	183,250	1,943	(11,559)	(93)	260	(127)	173,674
Net pension liability	(496,374)	(223,990)	(223,990)	(76,570)	-	-	(1,020,924)
Compensated absences	6,604	13,644	6,063	7,586	353	(2,997)	31,253
Net cash provided by operating activities	<u>\$4,344,218</u>	<u>\$1,585,655</u>	<u>\$3,050,794</u>	<u>\$230,909</u>	<u>\$(636)</u>	<u>\$(125,919)</u>	<u>\$9,085,021</u>

See Notes to Financial Statements

EXHIBIT – 12



COLDWATER
MICHIGAN • 1861

ANNUAL BUDGET

FY 2025-2026

One Grand St. | Coldwater, MI 49036 | 517.279.9501 | Coldwater.org



**COLDWATER BOARD OF PUBLIC UTILITIES
ELECTRIC**

	Actual FY 23-24	Original Budget FY 24-25	Approved Budget FY 25-26
ELECTRIC			
Revenues:			
Residential Sales	\$ 5,987,128	\$ 6,077,000	\$ 6,231,000
Commercial Sales	5,400,065	5,471,000	5,526,000
Industrial Sales	13,294,346	13,478,000	13,175,000
Industrial Sales - Time of Use	18,982,930	19,173,000	19,623,000
Gas Power Plant Sales	20,313	200,000	64,000
Power Supply Cost Adjustment	2,945,130	8,429,358	7,361,000
Other Sales	391,536	415,344	452,000
Penalties on Customer Accounts	45,483	45,000	63,000
Contracted Service Income	662,482	300,000	300,000
Energy Optimization Revenue	401,631	-	-
Fiber Access Fee	232,416	232,416	232,000
	<hr/>	<hr/>	<hr/>
Total Operating Revenues	48,363,459	53,821,118	53,027,000
Expenses:			
Purchased Power	33,895,568	38,617,107	37,891,106
Power Plant	20,878	22,000	23,500
Natural Gas Plant	733,790	615,970	627,646
Distribution	2,043,719	2,552,129	2,491,251
Substation	197,288	145,225	266,479
Metering/Lighting	1,015,832	1,069,306	1,014,806
Customer Service	259,406	375,136	316,847
Finance, Billing, and Collections	194,875	197,862	250,444
Administrative and General	1,842,627	1,836,022	1,868,801
Payments in Lieu of Taxes	2,712,120	3,035,267	3,034,188
Depreciation	2,245,481	2,430,000	2,490,000
	<hr/>	<hr/>	<hr/>
Total Operating Expenses	45,161,583	50,896,024	50,275,068
Operating Income	3,201,876	2,925,094	2,751,932
Nonoperating Revenue (Expense)			
Investment Income	1,053,744	420,000	450,000
Interest Expense	(625,269)	(594,057)	(566,389)
Miscellaneous	98,690	107,000	105,000
Aid in Construction	143,120	-	-
Gain on Disposal of Assets	8,636	-	-
	<hr/>	<hr/>	<hr/>
Total Nonoperating Revenue (Expense)	678,921	(67,057)	(11,389)
Income Before Transfers	3,880,797	2,858,037	2,740,543



COLDWATER BOARD OF PUBLIC UTILITIES
ELECTRIC

	<u>Actual</u> <u>FY 23-24</u>	<u>Original</u> <u>Budget</u> <u>FY 24-25</u>	<u>Approved</u> <u>Budget</u> <u>FY 25-26</u>
Transfers			
Transfers from (to) Other Funds	<u>(50,000)</u>	<u>(50,000)</u>	<u>(60,000)</u>
Total Transfers	<u>(50,000)</u>	<u>(50,000)</u>	<u>(60,000)</u>
Net Income	<u>\$ 3,830,797</u>	<u>\$ 2,808,037</u>	<u>\$ 2,680,543</u>
BOND COVERAGE			
Net Income	\$ 3,830,797	\$ 2,808,037	\$ 2,680,543
Add back Depreciation	2,245,481	2,430,000	2,490,000
Add back Payments in Lieu of Taxes	2,712,120	3,035,267	3,034,188
Add back Interest Expense	<u>625,269</u>	<u>594,057</u>	<u>566,389</u>
Net Revenue	9,413,666	8,867,361	8,771,120
Annual Debt Payments	1,511,962	1,507,057	1,506,389
Coverage Ratio (1.1 Required)	6.23	5.88	5.82

EXHIBIT – 13



Questioned

As of: March 29, 2026 7:35 PM Z

Edenfield v. Commissioner

United States Tax Court

October 10, 1952, Promulgated

Docket Nos. 23491, 28554

Reporter

19 T.C. 13 *; 1952 U.S. Tax Ct. LEXIS 75 **

Ray Edenfield, Petitioner, v. Commissioner of Internal Revenue, Respondent

Disposition: **[**1]** *Decisions will be entered under Rule 50.*

Case Summary

Procedural Posture

Respondent Commissioner of Internal Revenue (Commissioner) issued a notice of deficiency to petitioner shareholder. The Commissioner determined that amounts that a corporation paid during 1944 and 1945 on mortgage indebtedness were taxable to the shareholder as constructive dividends. The shareholder filed a petition with the court and asserted the statute of limitations as an affirmative defense. The court conducted a trial.

Overview

The shareholder and two associates decided to invest in a hotel by buying stock in a corporation that owned the hotel. In order to obtain \$ 185,000 offered by the shareholder and his associates, the administrators of the estate that owned the hotel arranged for the corporation to give them a second mortgage for the stock owned by other outstanding shareholders. The corporation issued the second mortgage and made payments on it. The administrators then retired the balance of the outstanding stock. The Commissioner argued that the corporation made a constructive distribution to the shareholder based on the mortgage payments. The parties agreed that the statute of limitations for one year had expired unless it was open by virtue [I.R.C. § 275 \(1939\)](#). The court held that the payment of the mortgage by the corporation was not essentially equivalent to a dividend because the shareholder never signed the notes or assumed liability on them. As a result of other adjustments to the return, the court found that the statute of limitations was open because more than 25 percent of the shareholder's gross income was not reported on his return.

Outcome

The court held in favor of the shareholder on the constructive dividend issue. The court held in favor of the Commissioner on the statute of limitations issue. The court entered the decision under the applicable tax rule.

LexisNexis® Headnotes

Business & Corporate Law > Corporations > Corporate Finance > General Overview

Business & Corporate Law > ... > Corporate Finance > Dividends & Reacquisition of Shares > General Overview

Tax Law > Federal Taxpayer Groups > C Corporations > General Overview

Tax Law > Federal Taxpayer Groups > C Corporations > Dividends & Dividends Paid Deduction

Tax Law > ... > C Corporations > Shareholder Taxation > General Overview

Tax Law > Federal Taxpayer Groups > C Corporations > Stock Redemptions

[HN1 I.R.C. § 115 \(1939\)](#) provides: Distributions by Corporations. (a) Definition of Dividend. -- The term "dividend" when used in this chapter means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made. (g) Redemption of Stock. -- (1) In General. -- If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or

cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

Governments > Legislation > Statute of Limitations > General Overview

Tax Law > Federal Tax Administration & Procedures > General Overview

Tax Law > ... > Tax Credits & Liabilities > Assessments of Tax > General Overview

Tax Law > ... > Tax Credits & Liabilities > Collection of Tax > General Overview

Tax Law > State & Local Taxes > Administration & Procedure > General Overview

Tax Law > State & Local Taxes > Administration & Procedure > Assessments

Tax Law > State & Local Taxes > Administration & Procedure > Collection of Taxes

[HN2 I.R.C. § 275 \(1939\)](#) provides: Period of Limitation Upon Assessment and Collection. Except as provided in § 276 --(c) Omission from Gross Income. -- If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within five years after the return was filed.

Tax Law > Federal Income Tax Computation > General Overview

Tax Law > Federal Income Tax Computation > Business Expenses > Entertainment & Trade Expenses

Tax Law > Federal Income Tax Computation > Tax Accounting > Inventory & Uniform Capitalization Rules

[HN3](#) The Internal Revenue Code authorizes no deduction for cost of goods sold or cost of operation but such costs must be deducted in arriving at gross income.

Syllabus

1. In June 1943, petitioner and his associates acquired all the outstanding shares of stock of The Read House Company, petitioner acquiring one-half the corporate stock. During the taxable years 1944 and 1945, the corporation made to its former stockholders substantial payments of principal and interest on

its second mortgage which arose out of the cancellation of the shares of corporate stock not purchased by petitioner and his associates. Respondent determined that the payments to the extent of \$ 37,808.85 in 1944 and \$ 41,481.98 in 1945, were income to petitioner based on the theory that the payments made by the corporation were in effect a part of the purchase price to be paid for the corporation's stock by petitioner and the other acquiring stockholders. *Held*, these payments are not taxable to petitioner as dividends under the provisions of [section 115 \(a\)](#) and [\(g\) of the Internal Revenue Code](#). No part of the indebtedness which the corporation owed on its second mortgage was petitioner's indebtedness or was incurred in his behalf. Consequently, the payments made were not made in his behalf or for his account.

2. *Held*, that **[**2]** petitioner omitted from his 1944 return more than 25 per centum of his gross income for that year. Consequently, the 5-year statute of limitations provided in [section 275 \(c\)](#) of the Code is applicable and the statute of limitations does not bar the deficiency determined for 1944.

Counsel: *William Waller, Esq., and Andrew Ewing, Esq.*, for the petitioner.

Homer F. Benson, Esq., for the respondent.

Judges: Black, *Judge*.

Opinion by: BLACK

Opinion

[*14] The respondent has determined deficiencies in petitioner's income tax as follows:

 [Go to table1](#)

The proceedings have been consolidated.

Certain adjustments **[**3]** as made by the respondent to the net income as reported by petitioner on his returns are not contested. Two issues are raised by the pleadings. The first issue relates to both taxable years. Were the payments made during 1944 and 1945 by The Read House Company to the holders of its second mortgage indebtedness taxable to the petitioner as essentially the equivalent of a dividend? Petitioner contends that respondent erred in determining in respect to the year 1944 that:

(a) It is held that payments were made by the corporation. The

Read House Company, on the principal and interest, in the respective amounts of \$ 89,176.07 and \$ 21,792.50, of outstanding obligations incurred for the benefit of you and your associates; that, of the total payment of \$ 110,968.57, the amount of \$ 35,350.87 is nontaxable; and, that the balance of \$ 75,617.70 represents dividends taxable in full, 50% of which is taxable to you.

Petitioner contends that respondent erred in determining in respect to the year 1945 that:

(a) Payment on principal and of interest made by Read House Company, Chattanooga, Tennessee, all of the outstanding capital stock of which is owned by you and your associates, on **[**4]** an obligation incurred for the benefit of you and your associates, is held to be income taxable to you as follows: **[*15]**

 [Go to table2](#)

The second issue relates only to the year 1944. The deficiency determined against petitioner is barred by the statute of limitations unless the exception provided by [section 275 \(c\)](#) is applicable. The question involved is whether the exception exists as provided by the statute.

FINDINGS OF FACT.

Some of the facts have been stipulated and are found as stipulated.

Petitioner Ray Edenfield during 1943 and the taxable years under consideration was engaged in the electrical contracting business in Nashville, Tennessee. He was also interested in several other businesses. Petitioner filed his individual Federal income tax returns with the collector of internal revenue at Nashville. Petitioner's income tax returns were prepared on a cash basis.

Some time in the latter part of March or April 1943, A. D. Noe, Jr., who at that time was a resident and hotel operator of Jackson, Tennessee, contacted the petitioner relative **[**5]** to interesting him in joining in the purchase of The Read House. The Read House, one of the leading hotels in Chattanooga, Tennessee, was owned and operated by The Read House Company, a corporation organized under the laws of the State of Tennessee.

The capital stock of The Read House Company consisted of 1,755 shares of Class A stock and 5,354 shares of Class B stock, or a total of 7,109 shares. All the shares of stock were owned by the estate of Samuel R. Read, which estate was being administered by the American Trust & Banking Company of Chattanooga, together with J. D. L. McPheeters and Edmond

Smartt. The administrators desired to sell the stock in The Read House Company. Sufficient cash was desired in order to pay estate taxes due by the estate. The administrators made several efforts to sell the stock but they were unsuccessful in finding any prospective buyer. Subsequently, in the spring of 1943, the petitioner, Noe, and Tom Florida, the latter a mortgage and business banker in Osceola, Arkansas, entered into negotiations for the purchase of The Read House property or the stock of The Read House Company. The petitioner was interested in purchasing a one-half interest **[**6]** in the property provided his liability therefor did not exceed \$ 100,000. The reason for limiting his liability to that amount was that a liability in excess of that amount might interfere with his making bond for performance of contracts sometimes necessary in his electrical contracting business.

[*16] In order to reach a definite agreement regarding the purchase of the property, petitioner, Noe, and Florida met representatives of the Read estate on several occasions to discuss provisions of the proposed transaction. As a result of extensive negotiations, a written offer to sell the entire capital stock of 7,109 shares of The Read House Company dated May 28, 1943, was submitted to the prospective purchasers, who refused to accept it. Petitioner objected to the provision which required that all corporate profits should be applied to the payment of the second mortgage and also to certain other features. After more negotiations, a second written offer dated June 10, 1943, for the sale of the stock of The Read House Company was submitted by the prospective purchasers. On June 17, 1943, the administrators and heirs of the Read estate accepted the offer. Under this contract petitioner **[**7]** and his associates offered to purchase "all of said shares of stock of the said The Read House Company, or the number of shares remaining after the retirement contemplated herein if said retirement is completed prior to the consummation of this agreement, for the sum of \$ 185,000.00 cash net to the Administrators." It was further provided in the contract that a second mortgage deed of trust should be executed by The Read House Company covering all real estate and tangible personalty of the company in the amount of \$ 581,990 net to the administrators in purchase and retirement of the shares of stock not purchased by petitioner and his associates. The contract further provided that petitioner and his associates were to pledge their stock to secure the second mortgage indebtedness created, or to be created, by The Read House Company. Also contained in the contract were provisions limiting the salaries and dividends to be paid by the company.

On June 22, 1943, the board of directors of the company held a special meeting at which a resolution was adopted authorizing an amendment to the corporate charter to decrease the par value of its capital stock from \$ 100 to \$ 25 per share, and

[8]** authorizing the issuance of corporate bonds not in excess of \$ 700,000 to be secured by a second mortgage trust deed on the corporate assets for the purpose of purchasing its corporate stock. At a special meeting of the stockholders held immediately after the directors meeting, the stockholders ratified and approved the recommendations made by the directors.

At an adjourned meeting of the board of directors held on June 29, 1943, resignations of all directors which had previously been submitted, with the exception of E. H. Lawman, were accepted and their successors, namely, E. H. Lawman, petitioner, and his associates were elected directors and officers of the corporation. The chairman announced that the reduction in the par value of the stock had been accomplished. At the meeting, E. H. Lawman, on behalf of the administrators of the Read estate, made the following offer:

[*17] Chattanooga, Tennessee

June 29, 1943

To The Board of Directors of

The Read House Company:

We, the undersigned, Administrators with the Will Annexed of the Estate of Samuel R. Read, do hereby offer to exchange for retirement 5354 shares of Class "B" stock, and 465 shares of Class "A" stock of The Read **[**9]** House Company, for \$ 581,990.00 of The Read House Company's notes, said notes to be secured by a Second Mortgage on the real estate, equipment, fixtures, furnishings, etc. in accordance with the terms and conditions as set forth in the attached unexecuted Deed of Trust.

American Trust & Banking Company

By E. H. Lawman, Vice President

Edmond Smartt

J. D. L. McPheeters

Administrators with the Will Annexed of the Estate of Samuel R. Read.

Acceptance of the offer was made by the following resolution:

RESOLVED That the foregoing offer be accepted and that a copy of said Deed of Trust and a copy of one of the 37 notes described therein be spread of record in an appendix, as part of the minutes of this meeting, and that said exchange for retirement be made from the capital surplus of this corporation;

* * *

On June 29, 1943, The Read House Company executed the deed of trust and 37 notes bearing interest at 4 1/2 per cent and in the total amount of \$ 581,990. These were delivered to the administrators as consideration for the purchase of the 5,819 shares of company stock held by the administrators. As additional security for their performance of the contract, petitioner and his associates **[**10]** pledged with the administrators of the Read estate the 1,290 shares of stock of The Read House Company owned by them. As of this time these 1,290 shares of stock represented all the outstanding shares of stock of the company. These shares of stock were held as follows:

 [Go to table3](#)

Petitioner paid \$ 100,000 for his 645 shares of stock. The purchase price paid by petitioner and his associates for the 1,290 shares of stock was \$ 185,000.

The reduction in par value of the company stock from \$ 100 to \$ 25 was for the purpose of creating a capital surplus. The surrender of stock as reflected by the books of the company converted capital and capital surplus into a mortgage payable in the amount of \$ 581,990 and did not affect earned surplus of the company. The contract of sale between the administrators and petitioner, Noe, and Florida did expressly provide that 25 per cent of the corporate profit should be reserved and applied to payment of the second mortgage debt. During **[*18]** the taxable years The Read House Company made payments on the second mortgage indebtedness to the administrators **[**11]** of the Read estate as follows:

 [Go to table4](#)

In 1944, The Read House Company had accumulated earnings and profits available for distribution in the amount of \$ 75,617.70. The payments made by the company during 1944 on the principal and interest exceeded this amount, but since only \$ 75,617.70 represented earnings and profits, the Commissioner determined that one-half of this amount was taxable income to petitioner (who held one-half the stock of the company) as being essentially equivalent to the distribution of dividends on the stock of the company. During 1945, the net income of the company exceeded the \$ 83,163.95 paid on principal and interest on the indebtedness. The Commissioner determined that one-half thereof, or \$ 41,581.98, was taxable during 1945 to the petitioner as being essentially equivalent to a distribution of a dividend by the company.

In auditing The Read House Company's tax return for the year 1944, the revenue agent disallowed the interest payment made by the corporation to the administrators of the Read estate on

the second mortgage notes in the **[**12]** amount of \$ 21,792.60 on the theory that such payment was not interest but dividends paid to the corporation's then three stockholders, one of whom was petitioner. The petitioner has been allowed in the deficiency notice an additional deduction of \$ 10,896.25 for interest paid, which deduction was not claimed by petitioner on his tax return.

In the deficiency notice for the year 1945, the Commissioner added to petitioner's net income \$ 41,581.98 as a distribution from The Read House Company being essentially the equivalent of a dividend. Among other adjustments to petitioner's net income for 1945 respondent allowed an additional deduction of \$ 17,580.30 for interest paid on the indebtedness.

Petitioner contends that on his 1944 income tax return he reported gross income of \$ 758,004.18 from his sole proprietorship, Edenfield Electric Co., while respondent contends that petitioner reported from the business a gross income of \$ 18,127.46. In addition to the gross income from the Edenfield Electric Co. petitioner reported on his 1944 tax return gross income of \$ 18,070.25. Thus it is contended by respondent that the total amount of gross income which petitioner **[*19]** reported **[**13]** on his return for 1944 was \$ 36,197.71. The following schedule was attached to and incorporated in petitioner's income tax return for the year 1944:

 [Go to table5](#)

On his individual income tax return (Form 1040) filed for the year 1944, petitioner reported a gross income in the amount of \$ 36,197.71, of which \$ 18,127.46 was reported as earned from Edenfield Electric Co. Petitioner omitted from his return of 1944, \$ 13,560.60 "profits on jobs." The Commissioner has added this amount to the net income reported by petitioner on his return and in his petition, petitioner does not assign this action of respondent as error.

OPINION.

The principal issue in these proceedings is whether **[**14]** certain amounts paid during the years 1944 and 1945 by The Read House Company, a Tennessee corporation, on a second mortgage indebtedness payable to the American Trust & Banking Company, Edmond Smartt, and J. D. L. McPheeters, administrators with the will annexed of the estate of Samuel R. Read, deceased, were taxable to petitioner as being essentially the equivalent of dividends constructively received by him. The second issue is whether petitioner omitted on his tax return for the year 1944, 25 per cent of his gross income so as to bring into effect the 5-year period of limitation provided by [section 275 \(c\)](#) of the Code.

[*20] *First Issue.*

Relying on the authority of [section 115](#) of the Code, the applicable portions being set forth in the margin, ¹ **[**15]** respondent determined that petitioner received income in the form of dividends from The Read House Company ² to the extent of \$ 37,808.85 during 1944 and \$ 41,581.98 during 1945.

At the outset it should be remembered that we do not have before us as a petitioner The Read House Company, a Tennessee corporation, and do not have to determine whether the interest it paid in each of the years 1944 and 1945 to the Read estate, the holder of the second mortgage indebtedness, was deductible as interest by the corporation. We pass no judgment as to that because it is not an issue before us.

The question which we have to determine is whether the second mortgage indebtedness upon which the payments were made was the indebtedness of petitioner and his two associates, Noe and Florida. If it were, then, of course, when The Read House Company made the payments on the indebtedness they would be payments made on petitioner's indebtedness and the tax consequences would be as the Commissioner has determined. It requires no citation of authorities that such would be taxable income to petitioner if the payments were made to discharge his indebtedness. We think, however, that **[**16]** it is entirely clear that the indebtedness was not the indebtedness of petitioner and his two associates and never was their indebtedness. The creditor was the Read estate and the debtor was the corporation, and petitioner and his two associates were merely the stockholders of the corporation which owed the debt. Under such state of facts it requires no citation of authorities to establish that payments on the debt did not result in dividends to petitioner. We are entirely convinced by the evidence before us, through stipulation and through testimony, and by the entire record that the payments in question were not essentially a dividend taxable to petitioner. In the instant case, the petitioner did **[*21]** not at any time purchase or own the stock which was retired. The stock was never transferred to him and he never

1 HN1 SEC. 115. DISTRIBUTIONS BY CORPORATIONS. (a) Definition of Dividend. -- The term "dividend" when used in this chapter *** means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made. * * * * * (g) Redemption of Stock. -- (1) In General. -- If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

2 The Read House Company is hereinafter sometimes referred to as the company, and at other times as the corporation.

assumed any personal liability for the mortgage. Neither petitioner nor his two associates signed the notes which were secured by the second mortgage. It is true they put up their 1,290 shares of stock in the corporation as additional security for the second mortgage but that was merely giving the corporation of which they were then the sole stockholders the benefit **[**17]** of the use of their collateral. The mortgage indebtedness was in no sense their indebtedness. It was the corporation's indebtedness. The corporation purchased the stock directly from the Read estate. The evidence indicates that petitioner and his associates were interested in buying all the outstanding shares of corporate stock and that they intended to invest not more than \$ 200,000. In order to obtain the \$ 185,000 offered in cash (no other purchasers had been willing to pay as much) the administrators of the Read estate and their attorneys worked out the arrangement whereby second mortgage notes amounting to \$ 581,990 were accepted from the corporation in exchange for the shares of stock not sold to petitioner and his associates and these shares were immediately retired. Petitioner and Tom Florida both testified that they did not participate in planning this arrangement, and, in fact, all they did was to accept the plan as it was offered to them.

As to the first issue we hold for the petitioner.

Second Issue.

This issue, as we have already stated, involves the statute of limitations. Respondent concedes that the statute of limitations has run as to the deficiency determined **[**18]** for the year 1944 unless petitioner omitted from his return for that year 25 per centum of his gross income. Respondent alleges that petitioner did so omit 25 per centum of his gross income for that year and, therefore, the 5-year statute of limitations applies. The applicable statute is printed in the margin.³ The respondent, in alleging that the statute of limitations had not run as to the year 1944, makes the following affirmative allegations in his answer:

5. The petitioner in his individual income tax return for the calendar year 1944, filed with the Collector of Internal Revenue for the District of Tennessee, reported total gross income in the sum of \$ 36,197.71, and a net loss in the sum of \$ 122.84.

[*22] 6. Petitioner's correct total gross income for the taxable year 1944 is in the sum of \$ 87,577.25.

³ HN2 SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION. Except as provided in section 276 -- **** (c) Omission from Gross Income. -- If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.


7. The sum of \$ 51,369.54, omitted from gross income and properly includible therein, is in excess of 25 per cent of the amount of gross income reported in the said return.

8. Under the provisions of [Section 275 \(c\) of the Internal Revenue Code](#), the tax for the year 1944 may be assessed, or a proceeding in Court for the collection of such tax may be begun without assessment **[**19]** at any time within five years after the return was filed.

As we have noted in our Findings of Fact, respondent has computed that petitioner reported gross income on his return for 1944 of \$ 36,197.71. This \$ 36,197.71 was composed of \$ 18,127.46 gross income from petitioner's business of Edenfield Electric Co. and \$ 18,070.25 from other sources. We have found as a fact that petitioner reported as gross income for 1944, \$ 36,197.71.

Petitioner claims \$ 758,004.18 gross income was reported from his business of Edenfield Electric Co. Of course, **[**20]** if he is correct as to that, then clearly [section 275 \(c\)](#) does not have any application. But it seems to us that petitioner confuses gross receipts with gross income and obviously the two are not the same. The expenses in question constitute a part of the cost of operations of the Edenfield Electric Co. and, as such, these expenses are to be deducted from gross receipts in arriving at gross income. [HN3](#) The Internal Revenue Code authorizes no deduction for cost of goods sold or cost of operation but such costs must be deducted in arriving at gross income. Cf. [Lela Sullenger, 11 T. C. 1076](#); [Joe W. Scales, 18 T. C. 1263](#). When this fact is kept in mind, we fail to see where the Commissioner is in error when he alleges that the total gross income reported by petitioner on his return for 1944 was \$ 36,197.71; one-fourth of this amount is \$ 9,049.43.

The Commissioner in his determination of the deficiency has determined that the petitioner omitted from his return the following items of income:

 [Go to table6](#)

We have **[**21]** held against the Commissioner as to item (a), \$ 37,808.85, in our decision of Issue 1. Therefore, petitioner omitted no such amount from his gross income. Petitioner assigned no error as to item (b), \$ 13,560.69. Therefore, that adjustment stands as the Commissioner has made it. It follows that petitioner has omitted from his gross income for 1944, \$ 13,560.69. This is in excess of 25 per centum of the gross income reported on his return for 1944 and the 5-year statute of limitations provided by [section 275 \(c\)](#) is applicable. Assessment of **[*23]** the deficiency determined by respondent for the year 1944 is not barred by the statute of limitations.

On this second issue the Commissioner is sustained.

Decisions will be entered under Rule 50.

Table1 ([Return to related document text](#))

Year	Docket No.	Amount of deficiency
1944	28554	\$ 14,934.98
1945	23491	20,116.08

Table1 ([Return to related document text](#))

Table2 ([Return to related document text](#))

Payment on -- principal	\$ 65,583.65
interest	17,580.30
Total payment	\$ 83,163.95
645/1290ths taxable to you	\$ 41,581.98

Table2 ([Return to related document text](#))

Table3 ([Return to related document text](#))

Name of stockholder	Number of shares
Tom Florida	322 1/2
A. D. Noe, Jr	322 1/2
Ray Edenfield	645

Table3 ([Return to related document text](#))

Table4 ([Return to related document text](#))

Year	Principal	Interest	Total
1944	\$ 89,176.07	\$ 21,792.50	\$ 110,968.57
1945	65,583.65	17,580.30	83,163.95

Table4 ([Return to related document text](#))

Table5 ([Return to related document text](#))

Edenfield Electric Co.	
Year -- 1944	
Gross Receipts	\$ 793,029.73
Less:	
Labor	\$ 714,812.79
Material	35,025.55
Other cost	25,063.93
	774,902.27
Gross Profit	\$ 18,127.46
Less Operating Expenses:	

Edenfield Electric Co.

Year -- 1944

Interest and discount	\$ 971.64	
General expenses	11,635.58	
Taxes	1,567.12	
Insurance	423.35	
Trucks & auto expense	2,898.68	
Misc. expense	1,885.30	
Donations	1,207.50	
Dues and license	696.77	
Depreciation	3,075.14	24,361.08
Net Loss		6,233.62

Table5 ([Return to related document text](#))

Table6 ([Return to related document text](#))

(a) Additional income	\$ 37,808.85
(b) Pro rata profit on jobs	13,560.69
Total gross income omitted	\$ 51,369.54

Table6 ([Return to related document text](#))

End of Document

EXHIBIT – 14



Warning

As of: March 29, 2026 7:45 PM Z

Scales v. Commissioner

United States Tax Court

September 30, 1952, Promulgated

Docket Nos. 23672, 34297

Reporter

18 T.C. 1263 *; 1952 U.S. Tax Ct. LEXIS 86 **

Joe W. Scales and Corinne Scales, Husband and Wife,
Petitioners, v. Commissioner of Internal Revenue, Respondent

Disposition: **[**1]** *Decisions will be entered under Rule 50.*

Case Summary

Procedural Posture

Petitioner taxpayers sought review of a notice of deficiency of respondent Commissioner of the Internal Revenue Service, which determined deficiencies and penalties in the taxpayers' federal income taxes.

Overview

The court held that the capital gain from the taxpayers' sale of a dairy farm and cattle could not be reported on the installment method because it was too late for the taxpayers to claim the benefits of [I.R.C. § 44](#). The court sustained the commissioner's finding of the taxpayers' long term capital gain. The court determined that the taxpayers omitted more than 25 percent of gross income from their tax return. Therefore, the court found that the five year statute of limitations of [I.R.C. § 275\(c\)](#) was applicable and that the commissioner was not barred by the statute of limitations. The case dealt with the legal interpretation of a series of transactions and several documents pertaining to the sale of a dairy farm. The taxpayers reported all the cash received from the sale on their return, albeit in a confusing manner and a mistaken conception of their legal rights. The court concluded that confusion and legal mistake did not constitute negligence and that the deficiency was not due to negligence; therefore, the court found that the commissioner erred in asserting a negligence penalty under I.R.C. § 293(a).

Outcome

The court entered its decision, finding that the taxpayers could not report the capital gain from the sale on the installment basis and that the commissioner erred in assessing a negligence penalty.

LexisNexis® Headnotes

Tax Law > Federal Income Tax Computation > Business Expenses > General Overview

Tax Law > Federal Income Tax Computation > Credits > General Overview

Tax Law > ... > Sales & Exchanges > Installment Sales > General Overview

HN1 [I.R.C. § 44](#) provides that in the case of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding \$ 1,000, or of a sale or other disposition of real property, if in either case the initial payments do not exceed 30 per centum of the selling price (or, in case the sale or other disposition was in a taxable year beginning prior to January 1, 1934, the percentage of the selling price prescribed in the law applicable to such year), the income may, under regulations prescribed by the Commissioner of the Internal Revenue Service with the approval of the Secretary of the Treasury, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

Tax Law > Federal Income Tax Computation > Business Expenses > General Overview

Tax Law > Federal Income Tax Computation > Credits > General Overview

Tax Law > ... > Sales & Exchanges > Installment Sales > General Overview

Tax Law > ... > Sales & Exchanges > Installment
Sales > Installment Method

HN2 Taxpayers are required to make an affirmative election in a timely filed income tax return in order to elect to report a sale of property on the installment method under [I.R.C. § 44\(b\)](#). Once an election has been made to report a sale as a completed transaction, in a subsequent year the taxpayer could not recompute his tax liability by changing to the installment method. Where a taxpayer fails to file timely tax returns, he cannot use the installment method.

Tax Law > Federal Income Tax Computation > Business
Expenses > General Overview

Tax Law > Federal Income Tax Computation > Credits > General
Overview

Tax Law > Federal Income Tax Computation > Sales &
Exchanges > General Overview

Tax Law > ... > Sales & Exchanges > Basis Rules > General
Overview

Tax Law > ... > Sales & Exchanges > Installment Sales > General
Overview

HN3 Where a taxpayer sells property and receives a promissory note for the full purchase price of the property and no election is made on his return to report the gain resulting from the sale on the installment basis as provided in [I.R.C. § 44](#), the taxpayer may not later claim the benefit of the installment basis of reporting income.

Business & Corporate Compliance > Labor &
Employment > Affirmative Action > Program Compliance

Labor & Employment Law > Affirmative Action > Program
Compliance

Tax Law > Federal Income Tax Computation > Business
Expenses > General Overview

Tax Law > Federal Income Tax Computation > Credits > General
Overview

Tax Law > ... > Sales & Exchanges > Installment Sales > General
Overview

HN4 When benefits are sought by taxpayers, meticulous compliance with all the named conditions of the statute is required, and in the case of [I.R.C. § 44](#), timely and affirmative action is required on the part of those seeking the advantages of reporting upon the installment basis.

Governments > Legislation > Statute of Limitations > Pleadings &
Proof

Governments > Legislation > Statute of Limitations > Time
Limitations

Tax Law > Federal Tax Administration & Procedures > General
Overview

Tax Law > Federal Tax Administration &
Procedures > Administration > General Overview

Tax Law > ... > Audits & Investigations > Burdens of
Proof > Burden of Government

HN5 [I.R.C. § 275\(c\)](#) provides that if the taxpayer omits from gross income an amount properly includable therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment at any time within five years after the return was filed. The Commissioner of the Internal Revenue Service has the burden of proving that the five year limitations period applies.

Tax Law > Federal Income Tax Computation > Gross Income

Tax Law > State & Local Taxes > Income Taxes > General
Overview

HN6 Gross income is gross sales less cost of goods sold.

Syllabus

1. Petitioner transferred a dairy farm, real and personal property, in 1943 executing a bill of sale, deed and lease. *Held*, that the 1943 transfer constituted a sale, not a lease.

2. *Held, further*, petitioner did not make an election in a timely filed income tax return to report the capital gain on the installment method under [section 44\(b\), I. R. C.](#), and the entire capital gain is taxable in 1943.

3. *Held, further*, that petitioner realized a capital gain on the sale of 98.72 acres of land, which property was inherited from a relative who died on June 20, 1913.

4. Petitioner omitted from gross income for 1943 an amount in excess of 25 per cent of the amount of gross income stated on the return. *Held*, therefore, that the deficiencies are not barred since [section 275\(c\), I. R. C.](#), providing for a 5-year statute of limitations is applicable.

5. *Held, further*, in 1947 petitioner, a cash basis taxpayer, realized no taxable income when he received a note in connection with a refinancing including sums owed for feed bills and interest of prior years.

6. *Held, further*, that the deficiencies were not due to negligence and **[**2]** respondent erred in determining negligence penalties.

Counsel: *Cecil Sims, Esq., W. W. Berry, Esq., and James W. Allen, C. P. A.*, for the petitioners.

Homer F. Benson, Esq., for the respondent.

Judges: Black, *Judge*.

Opinion by: BLACK

Opinion

[*1264] Respondent determined deficiencies and penalties in the income taxes of petitioners as follows:

 [Go to table1](#)

In the pleadings the parties have raised the following issues for the calendar year 1943:

1. The respondent determined **[**3]** that petitioners realized gains in connection with the sale of a dairy farm of \$ 37,394 for the land to be taxed as a long term capital gain and \$ 41,558.46 for the cattle and personal property to be taxed as ordinary income. Petitioners contend that the gain should be computed in its entirety as a capital gain on the installment basis in accordance with [section 44, I. R. C.](#), as follows: \$ 1,025.32 for the land and \$ 1,229.76 for the cattle. In the alternative, petitioners contend there was no sale in 1943 but the sums in question were received pursuant to a 5-year lease.

2. The respondent determined that \$ 2,000 paid to petitioner under the 1943 sale contract was for the sale of dairy equipment and taxable as ordinary income in the year 1943. Petitioner contended that the sale of cattle was for \$ 43,558.46 and taxable as a capital gain, and the dairy equipment was transferred for no value. In his brief, respondent specifically concedes this issue. Petitioner contends that of this \$ 43,558.46 capital gain, \$ 3,318.46 is short term and \$ 40,240 long term, and respondent concedes this issue specifically. The cost basis for the personal property is conceded to be zero, as the costs **[**4]** were written off as expenses.

3. The respondent determined that petitioners realized a long term capital gain of \$ 1,622 upon the exchange of 98.72 acres of land for 67 acres of land. Petitioners contend there was no taxable gain of the transaction.

4. The respondent determined that a 5 per cent negligence penalty applies to the total tax liability, including the deficiency, under section 293(a), I. R. C. Petitioners assign error to the penalty.

5. Petitioners contend that the respondent was barred by the period of limitation from asserting deficiencies and penalties under **[*1265]** [section 275\(c\), I. R. C.](#), since petitioners did not omit 25 per cent of their gross income from their 1943 return.

The following issues were raised in the pleadings for the year 1947:

1. In the event the Court determines that the sale of the dairy farm did not take place in 1943, respondent determines in the alternative that the sale took place in 1947, and petitioners realized long term capital gains in 1947 of \$ 30,651.22 for the land and ordinary income of \$ 36,161.26 for the cattle and personal property. Petitioners contend that the dairy farm, real and personal property, was sold in 1943 and refinanced **[**5]** in 1947. Petitioners contend that the sale of cattle and personal property resulted principally in a long term capital gain, not ordinary income, and respondent concedes this contention specifically in his brief. Petitioners in the alternative contend that the sale in 1947 was an installment sale of capital assets in accordance with [section 44, I. R. C.](#), the payment to petitioners being \$ 84.30 in 1947.

2. In determining that the basis for the long term capital gain in 1947 was \$ 30,651.22 for the sale of land, respondent determined that the cost basis was \$ 21,781.24. Petitioners contend the basis was \$ 22,605.

3. Respondent determined that petitioners realized a long term capital gain of \$ 1,740.26 from the sale of farm equipment. Petitioners contend that the sale took place in 1943 and was merely refinanced in 1947. In his brief respondent specifically agreed to petitioners' contention that the farm equipment was transferred for no value and the amount applied by respondent to the farm equipment should be added to the sale of cattle. Therefore, this issue is no longer before the Court and the Issue 1 above should be adjusted accordingly.

4. The respondent determined that **[**6]** petitioners received interest income in the amount of \$ 4,825.63, to which petitioner assigned error.

5. The respondent determined that petitioners realized income

of \$ 3,500 for a feed bill. Petitioners contend that a preexisting indebtedness existed for this feed bill and said indebtedness was merely refinanced without resulting in taxable income.

6. Respondent determined that a negligence penalty of 5 per cent is applicable pursuant to section 293(a), I. R. C., to which petitioners assigned error.

FINDINGS OF FACT.

The petitioners Joe W. Scales and Corinne Scales, husband and wife, are residents of Wales, Giles County, Tennessee. In 1943 and 1947 they filed joint Federal income tax returns on the cash basis with the collector of internal revenue for the district of Tennessee.

[*1266] In the year 1943, petitioners resided at Eagleville, Rutherford County, Tennessee, on a farm owned by Corinne Scales. In 1943, Joe W. Scales, sometimes herein referred to as petitioner, operated a dairy on his wife's farm at Eagleville, Tennessee. In addition, Joe W. Scales owned and operated another dairy farm in Giles County, Tennessee.

Joe W. Scales had been selling his entire output of milk **[**7]** from the Giles County farm to the White Way Pure Milk Company at Decatur, Alabama. This milk company was operated by Emmette L. Barran, sometimes herein referred to as Barran, and C. E. Winton, sometimes herein referred to as Winton. On July 6, 1943, petitioner agreed to sell the Giles County farm and improvements thereon, together with certain personal property located on the farm, to Barran and Winton. Barran and Winton agreed to execute a note for \$ 60,000 in payment of the real estate and to execute a note in an amount to be determined by inventory of the personal property included in the bill of sale. The petitioner, Barran, and Winton further agreed to execute a lease to the real and personal property and an escrow agreement and to deposit the warranty deed, bill of sale, and the two notes with the escrow agent. An escrow agreement dated July 6, 1943, was executed between the parties and the Third National Bank in Nashville as escrow agent. Upon the execution of the deed, bill of sale, two notes, and lease agreement, these documents were delivered to the escrow agent. In accordance with the agreement of July 6, 1943, a warranty deed conveyed the Giles County farm to Barran **[**8]** and Winton for the consideration of a \$ 60,000 note. The deed included the following language:

* * * in the principal amount of \$ 60,000.00, bearing interest at the rate of 5% per annum on the unpaid balance of said note, payable monthly, the principal of which is payable in equal monthly installments of \$ 333.33, which note is payable to Joe W. Scales and is secured by a vendor's lien herein and hereby retained on the property hereinafter described and conveyed. *

* *

Also, in accordance with the provisions of the July 6, 1943, agreement, Joe W. Scales executed a bill of sale on July 31, 1943, conveying to Barran and Winton the following described personal property located on the Giles County farm:

 [Go to table2](#)

[*1267] Inventory with no charges

1 McCormick Milker Unit with 4 milkers

1 Surge Milker Unit with 14 milkers

1 Cooling Board

1 5-H. P. Hammer Mill with Motor

1 5-H. P. Boiler,

1 Feed Mixing Mill,

3 Refrigerator Boxes (2 Wilson -- 1 Westinghouse) (for cans of milk)

1 Norge Compressor

(The consideration includes \$ 5,000.00 loaned to said **[**9]** Barran and Winton)

Barran and Winton at the same time executed their second promisory note payable to the order of Joe W. Scales in the amount of \$ 48,558.46, with interest on the unpaid balance at the rate of 5 per cent per annum, payable monthly at the rate of \$ 269.88 a month.

Also, in accordance with the original agreement of July 6, 1943, Joe W. Scales and Barran and Winton executed an "agreement" in the form of a lease dated July 6, 1943, which recited that it was effective or entered into as of the first day of July 1943, and which provided that Joe W. Scales leased the Giles County farm to Barran and Winton for the term of 5 years, beginning July 1, 1943, and ending June 30, 1948. This agreement included, among others, the following provisions:

The Lessees guarantee that the receipts from said farm to be payable to Lessor will not be any less than \$ 7,238.52 each year, and agree and bind themselves to pay to Lessor the sum of \$ 603.21 on the first day of each and every month during the life of this lease (the payment for July, 1943, as adjusted, having been paid and receipt of same is acknowledged at the time of delivery of this instrument). It is agreed that at least **[**10]** the said sum of \$ 603.21 must be paid the first day of each month,

so that, including the payment made or due June 1, 1944, the Lessor will receive the sum of \$ 7,238.52, as rent for the first year and it is agreed that any amounts due each month may be paid in advance as receipts come in from said farm, and all such amounts paid in advance shall be credited on the minimum which is due in succeeding months. * * *

(4) Upon the end or termination of this lease, if the same be terminated prior to June 30, 1948, or terminated on that date without delivery of deed and bill of sale mentioned in Section 7 of this lease, as hereinafter provided, it is agreed that the farm and improvements shall be returned to Lessor in substantially the condition they now are, reasonable wear and tear excepted, and that an inventory of the personal property will be taken at the time, which shall show the kind, quantity and value of the personal property, and if such personal property plus the amount that would be credited on the note for the personal property if this contract were performed exceeds in value the personal property now delivered to Lessees, it is agreed that Lessees may remove such part of the **[**11]** personal property as they may select, which equals in value the excess of the inventory then taken plus such payments over the inventory now taken of the personal property turned over and delivered. In the event the inventory plus such payments shows the value of the personal property to be less than the personal property now turned over, Lessees agree to pay Lessors the difference in cash. In the event Lessees are at the time of settlement indebted to Lessor, the Lessor shall credit on such **[*1268]** indebtedness the amount of the excess of the then inventory of personal property plus such payments over the present inventory of personal property, if there be such, and Lessor shall be entitled to retain all personal property.

* * * *

It is agreed and understood, subject to the terms of an escrow agreement, that in the event Lessees carry out and perform this trade, that at the end or termination thereof the amount paid and received by Lessor as rent (excluding all other amounts paid as taxes, insurance, maintenance, etc.,) shall be credited on said two notes by the escrow agent, credited six-elevenths (6/11) on the note given for the real property and five-elevenths (5/11) on the **[**12]** note given for personal property, and thereupon the escrow agent is to deliver the deed and bill of sale to Lessees herein named, and deliver the two notes so credited to Lessor herein named. It is further agreed that said two notes are payable on or before, and that any amounts may be paid thereon on the first day of any month, and if at any time Lessees elect to pay one-third of the amount due on said notes in advance of the termination of this lease to said Lessor, they have the privilege of so doing, and thereupon the said notes shall be credited as aforesaid and delivered to Lessor, and the deed and bill of sale

delivered to Lessees, and this lease agreement shall end and terminate without further responsibility of one party to the other hereunder, it being understood and agreed that Lessees will become the owner of the real and personal property and will accept same in the condition it is at the time of such delivery.

In the event of the forfeiture of this lease for any reason, as hereinabove provided, the said notes are to be returned to Lessees and the said deed and bill of sale to Lessor, and Lessor shall retain all rents paid under this agreement to the date of termination.

[13]** The total consideration recited in the deed and bill of sale, including the loan of \$ 5,000, amounted to \$ 108,558.46. The aforesaid two notes executed by Barran and Winton for this amount provided for the payment of same in equal monthly installments over a 15-year period, the monthly installments amounting to \$ 603.21, or \$ 7,238.52 per annum. The rental provided for in the lease agreement that was to be credited on said notes was the sum of \$ 7,238.52 per annum and was payable in monthly installments of \$ 603.21 each. Thus, the monthly payments due under the lease agreement were equal in amount to the payments due on said notes.

When Joe W. Scales made the transaction with Barran and Winton in July 1943, there was no discussion regarding the fixing of a reasonable annual rental for the leasing of the property, and it was not the intent or purpose of the parties to lease the property. A sale was really contemplated. But the lease agreement was executed because the lawyers who prepared the papers explained to Joe W. Scales that the lease gave him authority to remove the purchasers with less difficulty in the case of a default than if he had delivered only a deed direct to the **[**14]** purchasers.

Upon the execution of the various documents in July 1943, the Giles County farm and dairy herd and other property described in the bill of sale were delivered to Barran and Winton, who took possession of same and began making the monthly payments called for **[*1269]** in the documents. They made the monthly payments throughout the remainder of 1943 and continued so doing until about 1945, when they began defaulting on the payments. At that time petitioner became concerned and visited the Giles County farm. He learned that Barran and Winton had sold the herd of cattle but had not replaced same. Petitioner made no attempt to reposses the farm but entered into negotiations with Barran and Winton for the purpose of collecting the balance of the purchase price for the farm and the personal property.

These negotiations culminated in a new agreement between Joe W. Scales and Barran and Winton dated April 23, 1946, which,

in substance, authorized Barran and Winton to sell the Giles County farm, either at private sale for an amount to be approved by Joe W. Scales or at public auction, and that the proceeds of the sale would first be used to pay Joe W. Scales for the balance ****15** owing him on the two promissory notes executed by Barran and Winton in 1943. In the event of a sale of the farm, petitioner had no right to receive from the proceeds of the sale any sums in excess of the unpaid balance due him under the original documents executed in 1943. This agreement dated April 23, 1946, further provided that on July 30, 1946, whether or not the Giles County farm or any part thereof had been sold, Barran and Winton would execute new notes to Joe W. Scales for the "full balance due to" Joe W. Scales under the documents executed in 1943. These notes were to be secured by a mortgage on the Giles County farm and, in addition, on the milk plant of Barran and Winton located in Decatur, Alabama. Upon the execution of the new notes and mortgages, Joe W. Scales would have the Third National Bank in Nashville deliver to Barran and Winton the deed, bill of sale, and two notes placed in escrow at that bank in 1943.

In accordance with the agreement dated April 23, 1946, Barran and Winton attempted to sell the Giles County farm at auction but were unsuccessful. On August 1, 1946, Joe W. Scales and Barran and Winton executed an agreement terminating the escrow arrangement ****16** with the Third National Bank in Nashville. All the documents were delivered to an attorney in Pulaski, Tennessee, to be held by him until final papers were executed giving Joe W. Scales a mortgage on the Giles County farm and property of Barran and Winton in Decatur, Alabama, as provided in the second agreement dated April 23, 1946. Before the final papers were executed, additional negotiations resulted in Joe W. Scales' making a new loan in the amount of \$ 85,000 to Barran and Winton for financing improvements to their milk plant which was to increase the efficiency of their operation and enable them to repay the balance thereby owed to Joe W. Scales for the Giles County farm, livestock and equipment, and loans.

The unpaid principal and accrued interest due for the Giles County farm and livestock and equipment as of July 30, 1946, amounted to ***1270** \$ 98,832.47. To this amount was added additional sums owing to Joe W. Scales by Barran and Winton, making their total indebtedness to Joe W. Scales \$ 103,084.30. In May 1947, Barran and Winton paid Joe W. Scales \$ 84.30 and gave him their promissory note for the balance of \$ 103,000. Another note was executed by Barran and Winton ****17** to Scales in the principal amount of \$ 85,000 representing the loan for the improvements to the milk plant in Decatur, Alabama. At the same time a deed was executed dated May 27, 1947, to convey the Giles County farm to Barran and Winton as tenants in common and to reconvey the farm to Scales as trustee for the

purpose of securing the payment of the two promissory notes. At the same time Barran and Winton also executed a mortgage on their milk plant at Decatur, Alabama.

From July 1, 1943, to the present time, Barran and Winton have been in complete possession of the Giles County farm.

Petitioner received from Barran and Winton the sum of \$ 5,250.03 in 1943 as payments of principal and interest due on the deferred purchase price for the Giles County farm and livestock and equipment. Of this sum, \$ 3,016.05 represented principal and \$ 2,233.98 represented interest. The entire sum of \$ 5,250.03 was reported by petitioner and his wife in their joint income tax return for 1943, together with \$ 600 of rent from other property which is not in issue, as "Rent of Farm Lands \$ 5,850.03." Petitioners did not report on their 1943 return any part of the purchase price of the Giles County farm ****18** and livestock and equipment that was not actually received by them in 1943, nor the fact of sale. In their joint income tax returns filed for the years 1943 and 1947, petitioner and his wife did not elect to report gain from the sale to Barran and Winton of either the real estate or the personal property of the dairy farm on the installment basis nor indicate in any way that there was this sale to Barran and Winton. Since the sale took place in 1943, the entire capital gain realized is taxable in 1943. A check for \$ 84.30 dated May 21, 1947, drawn by the White Way Pure Milk Company and payable to Joe W. Scales was reported as interest by petitioners in their joint income tax return for that year. This \$ 84.30 was properly reported as interest and was not payment on principal.

The adjusted cost basis of the farm and improvements as of July 6, 1943, was \$ 22,605, and as of May 27, 1947, the adjusted cost basis was \$ 21,781.24. The real property had been owned by the petitioners for a period of more than 12 months prior to the date of sale. The cost basis for the personal property was agreed to be zero, and of the total sales price of \$ 43,558.46, \$ 3,318.46 was for property held ****19** less than six months and \$ 40,240 was long term gain.

In 1947, Scales received a note from Barran and Winton for \$ 103,000, which note included interest computed to July 30, 1946, on certain obligations to Scales, the principal one of which was their indebtedness ***1271** to him for the unpaid balance of the purchase price of the Giles County farm, livestock and equipment. Petitioners reported their income for the year 1947 on the cash receipts and disbursements basis, and did not receive any payment of principal or interest on the \$ 103,000 note in the year 1947. Included in the promissory note for \$ 103,000 received by Scales from Barran and Winton in 1947 was the amount of \$ 3,500 representing feed sales in prior years and a 1944 note for that purpose. The \$ 103,000 note also included

accrued interest from prior years of \$ 4,815.37. The major portion of the note was the indebtedness due for the sale of the dairy farm and the additional security of the mortgage on the milk plant was substitute collateral for the livestock improperly disposed of. Petitioners reported their income for the year 1947 on the cash basis and received no income on account of the interest or feed **[**20]** sales aforesaid by the receipt of the \$ 103,000 note in the year 1947.

Corinne Scales inherited from her grandfather, who died on June 20, 1913, a tract of land in Rutherford County, Tennessee, consisting of 98.72 acres. On November 6, 1943, Corinne Scales conveyed this tract of land to Marvin Scales for another tract of land consisting of about 67 acres and in addition the sum of \$ 1,622 in cash. A short while thereafter, Corinne Scales sold the 67-acre tract for \$ 8,250, making the total amount received by her for her original tract of 98.72 acres amount to \$ 9,872, or \$ 100 per acre. As of June 20, 1913, the date Corinne Scales acquired the land, there were white oak timber and valuable red cedar rails on the property but as of November 6, 1943, the date on which petitioner sold the property, the timber and cedar rails had been sold. The fair market value of the 98.72 acres of land as of June 20, 1913, the date of the death of John C. Haley, was \$ 8,250, and the sale of the land in 1943 resulted in a long term capital gain of \$ 1,622.

Petitioner has omitted the following amounts from his gross income for 1943:

 [Go to table3](#)

[21]** **[*1272]** Petitioners contend the gross income reported on their 1943 return is \$ 170,231.74, while respondent determined it to be \$ 83,260.94. Petitioner reports feed sales of \$ 79,229.07, of feed which was purchased and not raised. Petitioner did not deduct from his computation to ascertain gross income any amounts representing cost of feed sold. Cost of feed sold must have amounted to at least \$ 50,000.

The major deficiencies for 1943 resulted from a confusing series of transactions and complicated documents. Having considered all the facts, we conclude that the deficiency for 1943 was not due to negligence. For the same reason, we find no negligence in the taxable year 1947.

OPINION.

The pleadings have raised several issues with regard to the sale of a dairy farm and dairy cattle for the taxable years 1943 and 1947. Some of these issues are alternative issues depending upon whether the sale took place in 1943 or 1947. We shall first determine that question in order to dispose of the issues that are moot and to present the actual issues before us.

On July 6, 1943, petitioners executed a deed and bill of sale to Barran and Winton to sell a farm, dairy herd, and other personal **[**22]** property and received two promissory notes in the amounts of \$ 60,000 for the land and \$ 48,558.46 for the personal property plus a \$ 5,000 loan. There is no contention by petitioner that these notes were not worth their face value. Petitioner was to be paid in installments, and a lease for 5 years was also executed for the farm, admittedly to facilitate foreclosure in the event Barran and Winton did not maintain their installment payments. All the documents were placed in escrow. The so called lease provided that Barran and Winton would receive credits on their two notes for all amounts paid as rent and if terminated earlier the lessees were to receive personal property equivalent in value for rents paid. In the event of forfeiture by Barran and Winton, the rents would also be forfeited.

Barran and Winton took immediate possession of the property in 1943. The payments were not made in accordance with the agreement and Barran and Winton had sold the herd of cattle. A new agreement dated April 23, 1946, provided that Barran and Winton would sell the dairy farm, and would pay the proceeds to petitioner, but petitioner was not to receive any sums in excess of the balances due **[**23]** under the two 1943 notes. That agreement further provided that Barran and Winton execute new notes for the full balance due petitioner, together with a mortgage on the dairy farm and also a milk plant owned by Barran and Winton. The attempted sale was unsuccessful and the new notes and mortgages were executed in May, 1947.

[*1273] The parties intended that the sale of the dairy farm took place in July 1943, and the so called lease was in reality a security device. *Alexander W. Smith, Jr., Executor*, 20 B. T. A. 27; *Truman Bowen*, 12 T. C. 446. Apparently both petitioner's and respondent's briefs prefer the position that the sale took place in 1943. We agree that it did take place in that year and consequently the incidence of the tax falls within that year.

The following issues now remain to be decided: (1) Can the capital gain from this sale now be reported on the installment method, or was the entire gain taxable in 1943? (2) Was there any capital gain on the exchange of 98.72 acres of land in 1943? (3) Did petitioner omit 25 per cent of the amount reported as gross income bringing into effect the 5-year statute **[**24]** of limitations? (4) Should a 5 per cent negligence penalty be applied to 1943? (5) When the new notes were issued in 1947, did petitioner realize any taxable income from interest or feed sales, and is a negligence penalty applicable? By holding the dairy farm sale took place in 1943, the issues raised on the supposition that the sale took place in 1947 become moot.

Issue 1.

The major issue in this proceeding relates to the method of reporting the capital gain from the sale of the dairy farm and cattle thereon for a total consideration of \$ 103,558.46. In 1943 Barran and Winton paid \$ 5,250.03 in cash and promissory notes were executed covering the balance. Respondent contends that the capital gain should be reported in full in 1943, while petitioner contends that it may be reported on the installment basis under [section 44\(b\), I. R. C.](#) The applicable statute is quoted in the margin.¹

[**25] On their 1943 income tax returns the petitioner and his wife did not report in any way the sale of the dairy farm, either the real or personal property, nor make any election of reporting this sale on the installment basis. But the 1943 return reported the cash payments of \$ 5,250.03 made by Barran and Winton as well as another item of \$ 600 for rent as follows: "Rent of Farm Lands \$ 5,850.03." The respondent [*1274] contends that a taxpayer, desiring to report income from a sale of real property and a casual sale of personal property, must make an affirmative election in the return filed for the year of the sale.

Judicial decisions have generally required [HN2](#) taxpayers to make an affirmative election in a timely filed income tax return in order to elect to report a sale of property on the installment method under [section 44\(b\), I. R. C.](#) Once an election has been made to report a sale as a completed transaction, in a subsequent year the taxpayer could not recompute his tax liability by changing to the installment method. [Pacific Nat'l. Co. v. Welch, 304 U.S. 191.](#) Where a taxpayer fails to file timely tax returns, he cannot use the installment method. [**26] [Cedar Valley Distillery, Inc., 16 T. C. 870, 882; Sarah Briarly, 29 B. T. A. 256, 258-259.](#)

[HN3](#) Where a taxpayer sells property and receives a promissory note for the full purchase price of the property and no election is made on his return to report the gain resulting from the sale on the installment basis as provided in [section 44](#) of the Code, the taxpayer may not later claim the benefit of the installment basis of reporting income. [W. T. Thrift, Sr., 15 T. C. 366.](#) In the *Thrift* case, we said:

1 HN1 SEC. 44. INSTALLMENT BASIS. (b) Sales of Realty and Casual Sales of Personalty. -- In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding \$ 1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 30 per centum of the selling price (or, in case the sale or other disposition was in a taxable year beginning prior to January 1, 1934, the percentage of the selling price prescribed in the law applicable to such year), the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

* * * Having accepted a demand promissory note from the son for the full purchase price of all 24 lots at the time of the conveyance, the fair market value of the note was includible in the petitioners' gross income for 1946 unless they made an election and qualified under the installment provisions of [section 44](#). As no election to report the gain on the installment basis was made, and the petitioners have not shown that the fair market value of the note was less than its face value, we are of the opinion that the respondent correctly determined that the gain realized from the sale of all 24 lots [**27] was properly includible in petitioners' income for 1946.

Nor may the petitioners now claim that they are entitled to the benefits of [section 44](#). The opinion of this Court in [Sarah Briarly, 29 B. T. A. 256](#), is expressive of the established rule, wherein it states that [HN4](#) when benefits are sought by taxpayers, meticulous compliance with all the named conditions of the statute is required, and that in the case of [section 44](#), timely and affirmative action is required on the part of those seeking the advantages of reporting upon the installment basis. We feel that it is now too late for the petitioners to claim the benefits of [section 44](#). [Citing authorities].

It seems to us that our decision in [W. T. Thrift, Sr., supra](#), is in point here.

In the instant case the sale in question was reported in the timely filed income tax return for 1943 as follows: "Rent of Farm Lands \$ 5,850.03," with no further explanation or information. From this return, the Commissioner was not apprised of any sale whatsoever nor of an election to use the installment method. As indicated in the return, petitioner apparently received professional assistance [**28] in its preparation.

[*1275] Petitioner relies principally on [United States v. Eversman, 133 F. 2d 261.](#) The Court there held that though no special ritual had to be followed to report on the installment basis, the circuit court emphasized the fact that a complete disclosure of all relevant facts was made on that return. In the instant case we have no such complete disclosure. We hold that the petitioner cannot now claim the right to report the capital gain from the sale of the dairy farm and cattle on the installment basis.

Issue 2.

In 1943, petitioner's wife Corinne Scales exchanged 98.72 acres of real estate for 67 acres of real estate and the sum of \$ 1,622 in cash. Corinne Scales sold the 67 acres of real estate within a short time after she acquired it for \$ 8,250. Thus, the total

consideration she received for the 98.72 acres of real estate in 1943 was \$ 9,872, or \$ 100 per acre. The issue here depends upon Corinne Scales' basis for determining gain with respect to the 98.72 acre tract. Respondent determined the basis was \$ 8,250, while petitioner contends the basis was \$ 9,872.

Corinne Scales inherited the 98.72 acre tract under **[**29]** the will of her grandfather, John C. Haley, who died on June 20, 1913. He left the property to Corinne Scales' mother for life and the remainder to her heirs -- only Corinne Scales. The basis for determining gain depends on the value of this property on June 20, 1913. Petitioner testified that in his opinion the fair market value of the land was \$ 80 per acre and the timber and rails \$ 40 per acre on June 20, 1913. At the time of the exchange in 1943, there was no longer any timber or cedar rails on the land. They had been sold and removed from the land. The fair market value of the land on June 20, 1913, was not more than \$ 8,250. The basis of \$ 8,250 determined by respondent is sustained and petitioner realized a long term capital gain of \$ 1,622 in 1943.

Issue 3.

The third issue is whether respondent is barred by limitations from asserting deficiencies and penalties for the year 1943 or whether [section 275\(c\), I. R. C.](#), is applicable. **HN5** [Section 275\(c\) of the Internal Revenue Code](#) provides as follows:

* * * If the taxpayer omits from gross income an amount properly includable therein which is in excess of 25 per centum of the amount of gross income stated in the return, **[**30]** the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment at any time within 5 years after the return was filed.

The respondent has the burden of proving that the 5-year limitations period applies, [C. A. Reis, 1 T. C. 9](#).

[*1276] We have determined from the evidence that the following amounts have been omitted from petitioner's gross income for 1943:

 [Go to table4](#)

[31]** Petitioner contends that the gross income reported on their 1943 return is \$ 170,231.74, while respondent determined \$ 83,260.94. Even under petitioner's computation, more than 25 per cent of \$ 170,231.74 (\$ 42,557.94) has been omitted and [section 275\(c\)](#) is applicable.

Moreover, even if it would be determined that our findings on any of the smaller issues were not correct, the omission only of

the capital gain from the sale of the dairy farm constitutes at least 25 per cent of the gross income reported on the 1943 return. The most important difference between the methods of computation by petitioner and respondent concerns the sale of feed. Petitioner reported gross income of feed sales of \$ 79,229.07, which is the total price without deducting any amount for cost of feed sold. Petitioner listed as an expense deduction on his return "Feed \$ 107,600.05." Respondent determined that cost of feed sold is \$ 79,229.07, having shown that the feed was purchased and not raised.

In figuring business income involving the sale of goods, it is axiomatic that **HN6** gross income is gross sales less cost of goods sold. [Lela Sullenger, 11 T. C. 1076](#), Regulations 111, **[**32]** section 29.22 (a)-5. The feed sold must have cost something. We have found that the feed sold must have cost at least \$ 50,000. The following computation shows petitioner's gross income for 1943 after an adjustment is made for cost of feed sold:

 [Go to table5](#)

We have determined heretofore that petitioner omitted \$ 43,192.37 gross income from his return for 1943 and have given figures to substantiate this total. Therefore, the 5-year statute of limitations of [section 275\(c\)](#) is applicable and we hold that respondent is not barred by limitations for the year 1943.

[*1277] Issue 4.

Respondent asserted a 5 per cent negligence penalty for the year 1943 under section 293(a), I. R. C. The major issue in this case deals with the legal interpretation of a series of transactions and several documents pertaining to the sale of a dairy farm. Petitioner reported all the cash received from the sale in 1943 on his return, albeit in a confusing manner and a mistaken conception of his legal rights. Confusion and legal mistake **[**33]** under the circumstances here shown do not constitute negligence. No citation of authorities seems necessary for that proposition. The other adjustments are relatively small and minor. Having considered all the facts, we hold that the deficiency for 1943 was not due to negligence and respondent erred in asserting a negligence penalty.

Issue 5.

There are several issues still remaining for the year 1947: Did petitioner receive income of \$ 4,815.37 from interest and \$ 3,500 from a feed bill by the receipt of a note for \$ 103,000, and was the 1947 deficiency due to negligence giving rise to a 5 per cent penalty under section 293(a), I. R. C. Though these issues have not been rendered moot by our holdings so far and have

not been conceded by respondent, respondent has not argued these questions in his brief.

In 1947, Barran and Winton gave a note of \$ 103,000 to petitioner to consolidate all their obligations into one evidence of indebtedness and to extend the maturity date. The new note included accrued interest from prior years and a 1944 note for feed sales. The security of the note was the security originally given for the sale price of the dairy farm. The additional security **[**34]** of a mortgage on a milk plant was substitution collateral for the livestock which had been sold. Petitioner was on the cash basis. There was no determination that the consolidated note given petitioner for the original debts for interest and feed sales was the equivalent of cash or was given or accepted as payment. [Mellinger v. United States \(Ct. Cl.\), 21 F. Supp. 964](#). We hold, therefore, that petitioner did not receive income in 1947 in the amounts of \$ 3,500 for the feed bill and \$ 4,815.37 for interest. The facts show that they remain yet to be paid .

For the year 1947 there has been no showing of any additional income other than that already agreed to by petitioner. Having considered all the facts we hold there is no basis for the assertion of a negligence penalty for 1947 under section 293(a), I. R. C.

Decisions will be entered under Rule 50.

Table1 ([Return to related document text](#))

Docket No.	Year ended	Deficiency	Penalty
23672	Dec. 31, 1943	\$ 35,710.10	\$ 1,966.00
34297	Dec. 31, 1947	33,145.53	1,860.41

Table1 ([Return to related document text](#))

Table2 ([Return to related document text](#))

6	Heifers
2	Big Horse Mules,
2	Young mules 1 horse and 1 mare
1	Horse 2 Age mules
2	Gray mules
	Meal (feed)
428	Cows,
12	Calves

Table2 ([Return to related document text](#))

Table3 ([Return to related document text](#))

One-half of long-term gain from sale of land		\$ 18,697.00
One-half of long-term gain from sale of personal property:		
Total sale price personal property		\$ 43,558.46
Less: Amount reported	\$ 3,016.05	
Short-term gain	3,318.46	6,334.51
Long-term gain of sale of land omitted from gross income		37,223.95
One-half of long-term gain omitted		18,611.97
Short-term gain from sale of personal property		3,318.46
One-half of long-term gain from sale of 98.72 acre tract		811.00
Other items omitted and conceded by petitioner		1,753.94
Total omissions from gross income		\$ 43,192.37

Table3 ([Return to related document text](#))

Table4 ([Return to related document text](#))

One-half of long-term gain from sale of land	\$ 18,697.00
One-half of long-term gain from sale of personal property	² 18,611.97
Short-term gain from sale of personal property	3,318.46
One-half of long-term gain from exchange of 98.72 acre tract	811.00
Other items omitted and conceded by petitioner	1,753.94

² Total sale price personal property \$ 43,558.46 Less: Amount reported \$ 3,016.05 Short term gain 3,318.46 6,334.51 Long term gain of sale of land omitted from gross income 37,223.95 One-half of long term gain omitted 18,611.97

Total omissions from gross income

\$ 43,192.37

Table4 ([Return to related document text](#))

Table5 ([Return to related document text](#))

Petitioner's computation	\$ 170,231.74
Less allowance for cost of feed sold	50,000.00
Total income allegedly reported	120,231.74
25 per cent of total	30,057.94

Table5 ([Return to related document text](#))

End of Document

EXHIBIT – 15



In re Gossett

United States Bankruptcy Court for the Southern District of Ohio, Western Division

June 30, 1988, Decided ; June 30, 1988, Entered

Case No. 1-87-04326, Chapter 12

Reporter

86 B.R. 941 *; 1988 Bankr. LEXIS 967 **

In re Charles L. GOSSETT and Linda P. Gossett, Debtors

Case Summary

Procedural Posture

Creditor filed objections to debtors' plan at the confirmation hearing of a Chapter 12 bankruptcy case.

Overview

In a plan confirmation hearing under Chapter 12 bankruptcy proceedings, creditor filed objections to debtors' plan claiming debtors' level of non-farm income did not make them eligible for Chapter 12 relief. Creditor sought to require the debtors to extend their plan in order to increase the dividend paid to unsecured creditors. The court overruled the objections and confirmed the plan. The court decided that determining gross farm income did not contemplate a reduction of gross receipts from farming by all farm expenses shown on debtors' tax return. For purposes of [11 U.S.C.S. §§ 101\(17\) \(A\)](#) and [109\(f\)](#), the debtors were family farmers and could be debtors under Chapter 12 since their farm income exceeded 50 percent of their total income. Nothing in the code prohibited a debtor from voluntarily extending a plan beyond three years. There was neither a showing of cause nor any allegation of bad faith, and the debtors had not proposed an extension. As long as the plan met the requirements of [11 U.S.C.S. § 1225](#) and absent a voluntary extension or some showing of cause, the debtors could not be forced to submit their disposable income to the plan for a period longer than three years.

Outcome

Creditor's objections to debtors' Chapter 12 plan were overruled and the amended plan was confirmed.

LexisNexis® Headnotes

Business & Corporate Compliance > Bankruptcy > Debtor Benefits & Duties > Eligibility
Bankruptcy Law > Debtor Benefits & Duties > Eligibility

Bankruptcy Law > Farming & Fishing Debtors > Eligibility

[HN1](#) Debtor Benefits & Duties, Eligibility

See [11 U.S.C.S. § 109\(f\)](#).

Bankruptcy Law > Claims > Types of Claims > Definitions

Tax Law > State & Local Taxes > Income Taxes > General Overview

Bankruptcy Law > Farming & Fishing Debtors > Eligibility

Bankruptcy Law > Farming & Fishing Debtors > Plans

[HN2](#) Types of Claims, Definitions

[11 U.S.C.S. § 101\(17\)\(A\)](#) defines "family farmer" in relevant part as an individual or individual and spouse engaged in a farming operation who "receive from such farming operation more than 50% of [their] gross income for the taxable year preceding" the year they file their bankruptcy petition.

Bankruptcy Law > Claims > Types of Claims > Unsecured Nonpriority Claims

Governments > Courts > Authority to Adjudicate

[HN3](#) Types of Claims, Unsecured Nonpriority Claims

The court does not have power to look beyond face of a debtor's income tax return.

Bankruptcy Law > Taxation > Postpetition Liability & Reporting

Governments > Courts > Authority to Adjudicate

Bankruptcy Law > Claims > Types of Claims > Unsecured Nonpriority Claims

[HN4](#) Taxation, Postpetition Liability & Reporting

The court must follow the rule of technical adherence to definition sections of the code; the court has neither power nor inclination to delve beyond face of debtors' tax returns.

Bankruptcy Law > Individuals With Regular Income > Eligibility > Debtors in Business

Civil Procedure > ... > Pretrial Judgments > Nonsuits > Voluntary Nonsuits

Bankruptcy Law > Farming & Fishing Debtors > Plans

[HN5](#) Eligibility, Debtors in Business

A strict tax code approach should be modified or abandoned in those cases in which a tax code solution would be absurdly irreconcilable with the Chapter 12 statutory provisions and legislative history.

Tax Law > ... > Compensation & Welfare Benefits > Tips, Wages & Other Compensation > General Overview

Tax Law > Federal Income Tax Computation > Gross Income

[HN6](#) Compensation & Welfare Benefits, Tips, Wages & Other Compensation

Gross income, according to [26 U.S.C.S. § 61](#), is "all income from whatever source, except for those items specifically excluded by the Code." [26 U.S.C. § 61](#). Listed within this definition are 15 types of income. One so listed is "gross income from business."

Tax Law > ... > Effects of Bankruptcy > Discharge of Indebtedness > Section 108 Relief

[HN7](#) Discharge of Indebtedness, Section 108 Relief

At least two recent bankruptcy cases have found "gross income from business" to mean gross profits and not gross receipts. Gross profits are the total receipts minus the cost of goods sold.

Tax Law > Federal Income Tax Computation > Business Expenses > Entertainment & Trade Expenses

Tax Law > ... > Effects of Bankruptcy > Discharge of Indebtedness > Section 108 Relief

Tax Law > State & Local Taxes > Income Taxes > General Overview

[HN8](#) Business Expenses, Entertainment & Trade Expenses

Gross income for businesses engaged in manufacturing, merchandising or mining is determined by deducting the cost of goods sold from the total sales.

Bankruptcy Law > Farming & Fishing Debtors > Plans

Tax Law > State & Local Taxes > Income Taxes > General Overview

Tax Law > Federal Income Tax Computation > Tax Accounting > General Overview

Tax Law > ... > Tax Accounting > Cash Basis Method > General Overview

Tax Law > ... > Tax Accounting > Cash Basis Method > Taxable Year of Inclusion

[HN9](#) Farming & Fishing Debtors, Plans

A farmer on the cash basis must include in gross income all cash, or the value of merchandise or other property received from the sale of livestock and produce which he has raised, profits from the sale of livestock or other items which have been bought by him, and gross income received from all other sources. Profit from the sale of livestock or other items bought by a farmer is computed by deducting the cost from the sales price.

Bankruptcy Law > ... > Plan Confirmation > Nonconsensual Confirmations > Cramdowns

Business & Corporate Compliance > ... > Plans > Plan Confirmation > Cramdowns

Bankruptcy Law > Farming & Fishing Debtors > Plans

Bankruptcy Law > ... > Plans > Plan Contents > General Overview

HN10 Nonconsensual Confirmations, Cramdowns

See [11 U.S.C.S. § 1222\(c\)](#).

Bankruptcy Law > Individuals With Regular Income > Plans > General Overview

Bankruptcy Law > Conversion & Dismissal > Lack of Good Faith

HN11 Individuals With Regular Income, Plans

Nothing in the code prohibits a debtor from voluntarily extending a plan beyond three years, and a desire by the debtor to pay a higher dividend to creditors may be justifiable cause for extension. If the debtor could be required by the trustee, a creditor, or other party-in-interest, to extend his or her plan beyond three years, such a requirement would be a form of involuntary servitude in the eyes of the court.

Bankruptcy Law > ... > Plan Confirmation > Nonconsensual Confirmations > Cramdowns
Business & Corporate Compliance > ... > Plans > Plan Confirmation > Cramdowns

Bankruptcy Law > Farming & Fishing Debtors > Plans

Bankruptcy Law > Individuals With Regular Income > Plans > Plan Contents

HN12 Nonconsensual Confirmations, Cramdowns

The purpose of [11 U.S.C.S. §1322\(c\)](#) is to protect debtors from involuntary participation in Chapter 13. Confirmation issues relating to creditor dissatisfaction with the amount of the dividend on unsecured claims or doubts about the plan's feasibility involve determinations which are better made under other code provisions. As long as the plan meets the requirements of [11 U.S.C.S. § 1225](#) and absent a voluntary extension or some showing of cause, a debtor cannot be forced

to submit their disposable income to the plan for a period longer than three years.

Counsel: Richard L. Goettke, Esq., Blanchester, Ohio, Case Attorney for Debtors.

J. Michael Debbeler, Esq., Cincinnati, Ohio, Attorney for Liberty Savings Bank, F.S.B..

Judges: Burton Perlman, U. S. Bankruptcy Judge.

Opinion by: PERLMAN

Opinion

[*941] ORDER RE CONFIRMATION OF CHAPTER 12 PLAN

BURTON PERLMAN, U. S. BANKRUPTCY JUDGE

At Cincinnati, in said District, on the 30th day of June, 1988.

This Chapter 12 case has proceeded to the point of the filing of a plan which was set for hearing on confirmation. A creditor, Liberty Savings Bank, F.S.B. ("LSB"), filed objections to the plan at the confirmation hearing. While in its initial filing LSB set out a number of grounds for objection, only two remained at the time of the hearing. These were (1) the issue of eligibility for Chapter 12 given the debtors' level of non-farm income and (2) whether **[**2]** a creditor could require the debtors to extend their plan to five years.

From the schedules and the submissions of counsel, we find the following facts. The debtors, Charles and Linda Gossett, own approximately 140 acres and lease an additional 430 acres of farmland near Lynchburg, Ohio. They raise hogs and grow corn and soybeans on this land. They have engaged in farming since 1971. Debtors also own and operate Gossett's Farm Supply, a grocery and feed store in Hillsboro, Ohio. This business was begun in 1982.

The debtors' 1986 income tax return, Schedule F (Farm Income and Expenses) shows gross farm income of \$ 71,621.00, with a net profit of \$ 10,172.00.

In addition to their farm income, in 1986 debtors had income of \$ 3,800.00 in wages, salaries and tips. (Mr. Gossett began working part-time at Airborne Express five months prior to the bankruptcy filing and he also works part-time at the Gossett Farm Supply store; Mrs. Gossett is a full-time employee at the store.) They also listed \$ 652.00 in interest income, \$ 1,569.00 in business income from their farm supply store, \$ 9,192.00 from

pensions, and \$ 1,753.00 from a loss carry-forward.

1. Eligibility for Chapter 12.

According to **[**3]** to [11 U.S.C. § 109\(f\)](#), [HN1](#) "only a family farmer with regular income may be a debtor under Chapter 12 of this title." [HN2 Section 101\(17\) \(A\)](#) defines family farmer in relevant part as an individual or individual and spouse engaged in a farming operation who "receive from such farming operation more than 50% of [their] gross income for the taxable year preceding" the year they file their bankruptcy petition.

[*942] "Gross income" is not defined in the Bankruptcy Code, and the determination of farm versus non-farm income is not as clear-cut as one might hope. The Seventh Circuit Court of Appeals, believing Congress intended a mechanical, easily applicable test for determining who is a farmer, has stated:

The way to make [Section 101\(17\)](#) work best is to make it work simply. That is most easily done by deeming the statute to incorporate the definition of gross income in federal income tax law. Then everyone will know where he stands. Given the arbitrary nature of the statutory definition of farmer, no higher value than certainty can be served by the interpretation of the words gross income; and the interpretation that best serves that value is the one that equates gross income in **[**4]** the Bankruptcy Code to gross income in the tax code.

[In re Wagner](#), 808 F.2d 542, 549 (7th Cir. 1986).

Some courts have followed *Wagner* in rejecting the "mud on the boots" approach to determining who is a farmer under the Bankruptcy Code. See, [In re Bergmann](#), 78 B.R. 911 (Bankr. S.D. Ill. 1987) [HN3](#) (court does not have power to look beyond face of debtors' income tax return); [In re Nelson](#), 73 B.R. 363 (Bankr. D. Kan. 1987) [HN4](#) (court must follow rule of technical adherence to definition sections of the Code; court has neither power nor inclination to delve beyond face of debtors' tax returns.)

Other courts have adopted a less rigid posture. [HN5](#) "[A] strict tax code approach should be modified or abandoned in those cases in which a tax code solution would be absurdly irreconcilable with the Chapter 12 statutory provisions and legislative history." [In re Faber](#), 78 B.R. 934, 935 (Bankr. S.D. Iowa 1987). See also, [In re Welch](#), 74 B.R. 401 (Bankr. S.D. Ohio 1987).

In the case before us, LSB argues that for purpose of determining debtors' Chapter 12 eligibility, the gross sales from their farm supply store, with no deduction taken for cost of goods sold, should **[**5]** be used in figuring their non-farming

gross income from this source. But, says LSB, if cost of goods is to be deducted from the total sales to arrive at a "gross income" figure for the farm supply store, then the same approach should be followed for calculating farm income, i.e., the costs of operation should be deducted. By following the same method for calculating both farm and non-farm gross income, LSB argues, the non-farm income would clearly represent more than 50% of debtors' 1986 income and they would thus be ineligible for Chapter 12 relief.

Debtors, to the contrary, argue that "gross income" from the farm supply store is gross sales minus cost of sales, or \$ 14,977.00. When added to the pension, interest and non-farm wages listed on the return, total non-farm income then is \$ 28,621.00. They then argue that gross farm income listed as \$ 71,621.00 should not be reduced by expenses. When that position is taken, debtors' farm income clearly exceeds 50% of their total income.

We accept the debtors' position on the issue of eligibility. We are justified in doing so under either the *Wagner* or *Faber* approach.

[HN6](#) Gross income, according to [§ 61 of the Internal Revenue Code](#), **[**6]** is "all income from whatever source, except for those items specifically excluded by the Code." [26 U.S.C. § 61](#). Listed within this definition are 15 types of income. One so listed is "gross income from business". This phrase is not further defined, but [HN7](#) at least two recent bankruptcy cases have found "gross income from business" to mean gross *profits* and not gross receipts. Gross profits are the total receipts minus the cost of goods sold. [In re Pratt](#), 78 B.R. 277, 280 (Bankr. D. Mont. 1987). Citing Treasury Regulation § 1.6-3(a), the court in *Faber, supra*, held that [HN8](#) gross income for businesses engaged in manufacturing, merchandising or mining is determined by deducting the cost of goods sold from the total sales. Under this definition, the debtors' "gross income" from the farm supply store, which is a merchandising business, would be \$ 14,977.00 (\$ 63,500.00 gross sales, minus \$ 48,523.00 for cost of goods sold).

[*943] Adding this figure to the other non-farm sources of income, we find the debtors' total non-farm gross income for 1986 was as follows:

 [Go to table1](#)

[7]** To determine gross farm income, we look again to the case of *Faber, supra*. Citing the tax standards for "gross income" set forth in the U. S. Master Tax Guide, CCH 1986, the court in *Pratt at p. 280* found that:

HN9 A farmer on the cash basis must include in gross income all cash, or the value of merchandise or other property *received* from the sale of livestock and produce which he has raised, profits from the sale of livestock or other items which have been bought by him, and gross income received from all other sources.

Profit from the sale of livestock or other items bought by a farmer is computed by deducting the cost from the sales price.

This definition does not contemplate a reduction of gross receipts from farming by all farm expenses shown on debtors' tax return as urged by LSB. It would only be proper to deduct the cost of resold livestock, a fact pattern which does not apply here. Using the *Faber* guideline then, as taken from their 1986 Schedule F (Farm Income and Expenses), debtors' farm income would be \$ 71,621.00. (Sale of livestock, produce, grains, etc., \$ 60,162.00; profit from livestock bought for resale, \$ 1,783.00; cash, \$ 8,625.00; machine ****8** work, \$ 840.00; other income, \$ 211.00.)

Thus, by looking no further than the income tax returns of the debtors, we find a total farm gross income of \$ 71,621.00, compared to non-farm income of \$ 28,621.00. If it were necessary to look beyond the returns, the record as presented shows a family whose main endeavor for the past 17 years has been farming. The debtors are neither farming as a large corporate operation, nor as a tax shelter, two situations that Congress specifically did not want to protect when it enacted the Chapter 12 provisions. *See*, 132 Cong. Rec. 515076 (Daily Ed. Oct. 3, 1986). It is clear that for purposes of [11 U.S.C. §§ 101\(17\) \(A\)](#) and [109\(f\)](#), the debtors are family farmers and may be debtors under Chapter 12.

2. Compel Extension Beyond Three Years.

The second issue presented is whether LSB can compel the debtors to extend their plan beyond three years in order to increase the dividend paid to unsecured creditors. The bank's argument is essentially one of equity. It argues that the proposed payment of only 8.7% to unsecured creditors is unfair in light of the debtors' potential ability to discharge a significant portion of their debt.

LSB cites no case ****9** authority for its position and we have found none. The statute in question, [11 U.S.C. § 1222\(c\)](#), provides that:

. . . **HN10** the plan may not provide for payments over a period that is longer than three years unless the court *for cause* approves a longer period, but the court may not approve a period that is longer than five years. (Emphasis

supplied.)

"Cause" under [§ 1222\(c\)](#) is not defined by the Code. The language of [§ 1222\(c\)](#) is, however, identical to that of [§ 1322\(c\)](#), and there is abundant, though not unanimous, case law interpreting "cause" in a Chapter 13 context. *See, e.g., In re Festa*, 65 B.R. 85 (Bankr. S.D. Ohio 1986); *In re Fries*, 68 B.R. 676 (Bankr. E.D. Pa. 1986); *In re Greer*, 60 B.R. 547 (Bankr. C.D. Cal. 1986); *In re Powell*, 15 B.R. 465 (Bankr. N.D. Ga. 1981); *In re Stein*, 18 B.R. 768 (Bankr. S.D. Ohio 1982).

In the recent, jointly-decided cases of *In re Pierce*, No. 2-87-03253, *In re Owens*, No. 2-87-03330, and *In re Mabry*, No. 2-87-03415 [82 B.R. 874 \(Bankr. S.D. Ohio 1987\)](#) (Cole, J.), collectively "*Pierce*", all three debtors voluntarily proposed Chapter 13 plans in excess of 36 months in order to ****944** ****10** pay higher dividends to unsecured creditors. The debtors apparently felt personal obligations to make higher percentage payments than those possible under three-year plans, and were also concerned that lower percentage plans might violate the good-faith requirement of [§ 1325 \(a\) \(3\)](#).

The court found that the definition of cause was left by Congress "to judicial discretion, to be decided on a case by case basis", citing *In re Poff*, [7 B.R. 15, 17 \(Bankr. S.D. Ohio\)](#). Such cause could be the curing of a default, the payment of priority or allowed secured claims, the preservation of a subsequent discharge under [§ 727 \(a\) \(9\)](#) by payment of a 100% dividend, or a sincere and honest effort to repay all creditors.

The court thus determined that **HN11** nothing in the Code prohibits a debtor from *voluntarily* extending a plan beyond three years, and a desire by the debtor to pay a higher dividend to creditors may be justifiable cause for extension. It specifically held, however, that:

. . . if the debtor could be required by the trustee, a creditor, or other party-in-interest, to extend his or her plan beyond three years, such a requirement would be a form of involuntary servitude ****11** in the eyes of this Court.

Pierce slip op. at 882.

We believe the same logic set forth by the *Pierce* court and the court in *In re Fries*, *supra*, applies in a Chapter 12 context:

HN12 The purpose of that [section \[1322\(c\)\]](#) is to protect debtors from involuntary participation in Chapter 13. Confirmation issues relating to creditor dissatisfaction with the amount of the dividend on unsecured claims or doubts about the plan's feasibility involve determinations which

are better made under other Code provisions.

Fries at 680.

As long as the plan meets the requirements of [§ 1225](#) and absent a voluntary extension or some showing of cause, the debtors cannot be forced to submit their disposable income to the plan for a period longer than three years. Here, there has been no showing of cause nor any allegation of bad faith and the debtors have not proposed an extension.

Accordingly, for the reasons stated above, the objections of Liberty Savings Bank, F.S.B., to the Chapter 12 plan of Charles and Linda Gossett are hereby overruled and the plan, amended **[**12]** to conform with the changes made orally at the April 11, 1988 hearing, is confirmed.

So

Ordered.

Table1 ([Return to related document text](#))

Wages, salaries, etc.	\$ 3,800.00
Interest	652.00
Business income from	
farm supply	14,977.00
Pensions	9,192.00
	\$ 28,621.00

Table1 ([Return to related document text](#))

End of Document

EXHIBIT – 16

In re Faber

United States Bankruptcy Court for the Southern District of Iowa

October 20, 1987, Filed

No. 87-509-C, Chapter 12

Reporter

78 B.R. 934 *; 1987 Bankr. LEXIS 1658 **; 16 Bankr. Ct. Dec. 651

In the Matter of Vaughn B. FABER, Patricia L. Faber, Engaged
in Farming, Debtors

Case Summary

Procedural Posture

Creditor bank filed a motion to dismiss debtors' bankruptcy case, alleging that debtors were not "family farmers" within the meaning of [11 U.S.C.S. § 101\(17\)\(A\)](#) and, therefore, were ineligible to seek protection under Chapter 12 of the Bankruptcy Code.

Overview

Debtors asserted that, in computing gross income from their trucking operations, they were entitled to deduct the "costs of operations" from gross receipts. Such a deduction would result in their satisfying the income test required to qualify them as a "family farmer" under [11 U.S.C.S. § 101\(17\)\(A\)](#). Creditor bank asserted that no such deduction was allowable, because the trucking operation was a "service" rather than a "manufacturing" operation and, therefore, the gross receipts figure also represented gross income. As such, debtors did not meet the "50 percent" test of [11 U.S.C.S. § 101\(17\)\(A\)](#). The court ruled that debtors were not primarily engaged in manufacturing a product but instead were providing a service. Debtors were thus ineligible for bankruptcy protection under Chapter 12.

Outcome

The court dismissed debtors' bankruptcy claim, stating that debtors' "costs of operations" were not deductible from gross receipts in computing the gross income of their trucking operation, and debtors' income was therefore inadequate to qualify them as family farmers under Chapter 12.

LexisNexis® Headnotes

Bankruptcy Law > Farming & Fishing Debtors > Eligibility

HN1 [11 U.S.C.S. § 101\(17\)\(A\)](#) limits the definition of family farmers to include only those debtors who received more than 50 percent of their gross income in the preceding taxable year from farming operations.

Bankruptcy Law > Farming & Fishing Debtors > General Overview

Bankruptcy Law > Farming & Fishing Debtors > Eligibility

Civil Procedure > ... > Pretrial Judgments > Nonsuits > Voluntary Nonsuits

HN2 Gross income is not defined in the Bankruptcy Code. Thus, this court must look elsewhere to determine what Congress intended the phrase to encompass. It is arguable that "gross income" for the purpose of determining Chapter 12 eligibility should be given the same meaning that term has under federal income tax law. Yet, a strict tax code approach should be modified or abandoned in those cases in which a tax code solution would be absurdly irreconcilable with the Chapter 12 statutory provisions and legislative history. This is not such a case. Rather, the tax code analysis is compatible with Chapter 12's primary purpose--to assist family farmers to continue farming.

Bankruptcy Law > Farming & Fishing Debtors > Eligibility

Tax Law > Federal Income Tax Computation > General Overview

Tax Law > Federal Income Tax Computation > Gross Income

HN3 Pursuant to [I.R.C. § 61](#), gross income includes "gross income derived from business". The statutory section does not specifically define "gross income derived from business." However, [Treas. Reg. § 1.61-3\(a\)](#) provides that in a

manufacturing, merchandising, or mining business, "gross income" means the total sales less the cost of goods sold. Gross income is determined without subtraction of selling expenses, losses or other items not ordinarily used in computing costs of goods sold. Where a business is engaged primarily in the providing of a service, rather than mining, manufacturing, or merchandising, the business gross receipts constitute gross income.

Bankruptcy Law > Farming & Fishing Debtors > Eligibility
 Tax Law > Federal Income Tax Computation > General Overview
 Tax Law > Federal Income Tax Computation > Taxable Income
 Tax Law > ... > Income Taxes > Individuals, Estates & Trusts > Deductions

HN4 With regard to a trucking operation, debtors are not primarily engaged in manufacturing a product but instead are providing a service.

Bankruptcy Law > Farming & Fishing Debtors > Eligibility
 Tax Law > Federal Income Tax Computation > General Overview
 Tax Law > Federal Income Tax Computation > Amortization, Depletion & Depreciation > General Overview
 Tax Law > ... > Amortization, Depletion & Depreciation > Amortization, Cost Recovery & Depreciation > General Overview
 Tax Law > Federal Income Tax Computation > Business Expenses > Entertainment & Trade Expenses
 Tax Law > Federal Income Tax Computation > Gross Income
 Tax Law > ... > Individuals > Adjustments to Income > General Overview
 Tax Law > ... > Individuals > Adjustments to Income > Adjusted Gross Income
 Tax Law > ... > Individuals > Business Deductions > General Overview
 Tax Law > ... > Individuals > Business Deductions > Travel Expenses
 Tax Law > ... > Individuals > Divorce & Separation Payments > General Overview

HN5 I.R.C. § 62 defines adjusted gross income as gross income minus those trade and business deductions allowed under Chapter 1 of the Internal Revenue Code. Included among the deductions in Chapter 1 are deductions for salaries and traveling expenses and deductions for depreciation expenses. I.R.C. §§

162, 167. Thus, since those items are deducted from gross income in determining adjusted gross income, it is logical and necessary that they be included in gross income.

Bankruptcy Law > Farming & Fishing Debtors > Eligibility

HN6 Where debtors' "costs of operations" are not deductible from gross receipts in computing the gross income of a trucking operation, and where less than 50% of the debtors' total gross income is derived from a farming operation, debtors do not qualify as family farmers pursuant to [11 U.S.C.S. § 101\(17\)\(A\)](#).

Counsel: Deborah S. Krauth, Attorney for Debtors.

Elizabeth A. Nelson, for Chapter 12 Trustee.

Linda R. Reade, Assistant U.S. Attorney, for Representing U.S.A.

David L. Davitt, for Representing the Bank.

Judges: **[**1]** Lee M. Jackwig, U.S. Bankruptcy Judge.

Opinion by: JACKWIG

Opinion

[*934] ORDER ON CREDITOR'S MOTION TO DISMISS DEBTORS' CHAPTER 12 BANKRUPTCY

LEE M. JACKWIG, U.S. BANKRUPTCY JUDGE.

A motion to dismiss debtors' Chapter 12 bankruptcy, filed by the First National Bank of Kirksville, Missouri, was set for hearing on July 21, 1987. At that time, attorneys for the parties indicated that the issues involved had been narrowed to an issue at law only and that the taking of evidence was not necessary. The parties have stipulated to the facts relevant to the issue and have filed briefs on the issue. Debtors are represented by Deborah S. Krauth and the Bank is represented by David L. Davitt. The court considers the matter fully submitted.

FACTUAL BACKGROUND

The debtors filed for protection under Chapter 12 of the Bankruptcy Code on February 27, 1987. First National Bank filed a motion to dismiss the bankruptcy case on July 16, 1987, alleging that the debtors are not "family farmers" within the meaning of [11 U.S.C. § 101\(17\)\(A\)](#) **[**2]** and therefore are ineligible to seek protection under Chapter 12 of the Bankruptcy Code. [11 U.S.C. \[*935\]](#) § 101(17)(A) **HN1** limits the

definition of family farmers to include only those debtors who received more than 50 percent of their *gross income* in the preceding taxable year from farming operations.

Debtors were engaged in two businesses--farming and trucking--during the 1986 tax year. The debtors' *gross income* from farming for that year was \$ 22,550.36. His share of *gross receipts* from the trucking operation for the year was \$ 72,713.93. The debtor had "costs of operation" expenses for the trucking operation of \$ 56,273.31 for the year. These costs included: \$ 4,035.59 for repairs; \$ 3,815.68 for taxes and license; \$ 22,921.21 for fuel; \$ 607.35 for tolls; \$ 867.53 for fuel permits; \$ 480.00 for unloading charges; \$ 354.21 for washing; \$ 160.08 for weighing; \$ 86.33 for advertising charges; \$ 159.17 for shipping charges; \$ 1,821.09 for tires; \$ 133.50 for fuel bonds; \$ 143.92 for claims; \$ 16,679.52 for equipment depreciation; and \$ 4,008.33 for contract labor. Subtraction of these costs of operation from gross receipts leaves an amount of \$ 16,440.62.

DISCUSSION

Debtors assert **[**3]** that in computing gross income from the trucking operations they are entitled to deduct the above listed "costs of operations" from *gross receipts*. Such a deduction would result in their satisfying the income test and otherwise qualifying as a "family farmer". The Bank asserts that no such deduction is allowable because the trucking operation was a "service" rather than a "manufacturing" operation, and therefore, the gross receipts figure also represents gross income. If the Bank is correct, the debtors do not meet the 50% test of [11 U.S.C. § 101\(17\)\(A\)](#).

HN2 Gross income is not defined in the Bankruptcy Code. Thus, this court must look elsewhere to determine what Congress intended the phrase to encompass. In this case, both parties have looked to the Internal Revenue Code for the answer. It is arguable that "gross income" for the purpose of determining Chapter 12 eligibility should be given the same meaning that term has under federal income tax law. See *Matter of Wagner*, 808 F.2d 542 (7th Cir. 1986). Yet, a strict tax code approach should be modified or abandoned in those cases in which a tax code solution would be absurdly irreconcilable with the Chapter 12 statutory provisions **[**4]** and legislative history. This is not such a case. Rather, the tax code analysis is compatible under the present set of facts with Chapter 12's primary purpose--to assist family farmers to continue farming.

HN3 Pursuant to [section 61 of the Internal Revenue Code](#), gross income includes "gross income derived from business". The statutory section does not specifically define "gross income derived from business." 28 U.S.C. § 61. However, [Treasury Regulation § 1.61-3\(a\)](#) provides that "in a manufacturing,

merchandising, or mining business, 'gross income' means the total sales less the cost of goods sold Gross income is determined without subtraction of selling expenses, losses or other items not ordinarily used in computing costs of goods sold" On the other hand, "where a business is engaged primarily in the providing of a service, rather than mining, manufacturing, or merchandising, the business gross receipts will constitute gross income." *Guy F. Atkinson Co. of California and Subsidiaries v. Commissioner of Internal Revenue*, 82 T.C. 275, 298 (1984), *aff'd on other grounds* 814 F.2d 1388 (9th Cir. 1987).

Debtors argue that if the court does adopt the distinction **[**5]** between service businesses and merchandising, mining and manufacturing businesses, their trucking operation should be categorized as a mining, manufacturing or merchandising business because trucking "is very capital intensive." Debtors cite no authority and this court can find none for the proposition that the amount of capital involved is a determinative factor.

The most relevant case addressing the distinction appears to be *Hahn v. Commissioner of Internal Revenue*, 30 T.C. 195 (1958) *aff'd* 271 F.2d 739 (5th Cir. 1959), wherein the tax court held that a person who operated a blacksmith and welding shop was primarily engaged in the providing **[*936]** of service rather than in manufacturing. [30 T.C. at 198](#). The court held that:

Hahn was not engaged in the manufacturing business. The record as a whole makes it clear that what John Hahn was selling, for the most part at least, was not a material product to which direct costs could be allocated as in the case of a manufacturing business, but rather that he was selling services, consisting of his ability, know-how, and experience as a blacksmith and welder

[Id. at 198](#).

This court finds that the debtors are in a similar position **[**6]** with regard to the trucking operation. **HN4** They are not primarily engaged in manufacturing a product but instead are providing a service. Debtors reliance on *Lela Sullenger*, 11 T.C. 1076 (1948) is misplaced. That case deals with the constitutionality of taxing various items. No one disputes that debtors are entitled to deduct the "costs of operations" from gross income in computing taxable income. Indeed, the provisions of the tax code defining how taxable income is computed provide additional evidence that the debtors' "costs of operations" are not deductible from gross receipts in computing gross income.

For example, [26 U.S.C. § 62](#) **HN5** defines *adjusted gross income* as *gross income* minus those trade and business deductions allowed

under Chapter 1 of the Internal Revenue Code. Included among the deductions in Chapter 1 are deductions for salaries and traveling expenses and deductions for depreciation expenses. 26 U.S.C. §§ 162, [167](#). Thus, since those items are deducted from gross income in determining adjusted gross income, it is logical and necessary that they be included in gross income.

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, it is hereby found **[**7]** that [HN6](#) debtors' "costs of operations" are not deductible from gross receipts in computing the gross income of the trucking operation. Accordingly, it is also found that less than 50% of the debtors' total gross income in 1986 was derived from the farming operation, meaning that debtors do not qualify as family farmers pursuant to [11 U.S.C. § 101\(17\)\(A\)](#).

THEREFORE, the debtors' Chapter 12 bankruptcy is hereby dismissed.

Signed and filed this 20th day of October, 1987.

End of Document

EXHIBIT – 17

In re Pratt

United States Bankruptcy Court for the District of Montana

June 24, 1987, Filed

No. 87-20198

Reporter

78 B.R. 277 *; 1987 Bankr. LEXIS 979 **

In re John Duane PRATT, Quoteal Barnes Pratt, Debtors

family farm operation.

Case Summary

Procedural Posture

The creditor contested the eligibility of the debtors as family farmers under [11 U.S.C.S. § 101\(17\)](#) and filed a motion to dismiss the debtors' Chapter 12 bankruptcy case.

Overview

The debtors filed for bankruptcy as family farmers under Chapter 12 of the bankruptcy code. The court granted the creditor's motion to dismiss the case, holding that the debtors did not meet the eligibility requirements under [11 U.S.C.S. § 101\(17\)](#) because they did not receive more than 50 percent of their gross income in the taxable year preceding their bankruptcy filing from farming operations. In making this determination, the court determined that the definition of "gross income" under the Internal Revenue Code was applicable to the eligibility test for a family farmer.

Outcome

The court granted the motion to dismiss the Chapter 12 bankruptcy case.

LexisNexis® Headnotes

Bankruptcy Law > Farming & Fishing Debtors > Eligibility

Bankruptcy Law > Farming & Fishing Debtors > Plans

HN1 Under [11 U.S.C.S. § 101\(17\)](#) of the 1986 Family Farmer Bankruptcy Act of 1986, [11 U.S.C.S. § 1201 et seq.](#), the income test for eligibility requires the debtors to show gross income for the taxable year in question in excess of 50 percent from their

Bankruptcy Law > Farming & Fishing Debtors > Eligibility

Tax Law > ... > Income Taxes > Individuals, Estates & Trusts > General Overview

HN2 "Family farmer" means individual or individual and spouse engaged in a farming operation whose aggregate debts do not exceed \$ 1,500,000 and not less than 80 percent of whose aggregate non-contingent, liquidated debts, excluding a debt for the principal residence of such individual or such individual principal residence of such individual or such individual and spouse unless such debt arises out of a farming operation, on the date the case is filed, arise out of a farming operation owned or operated by such individual or such individual and spouse, and such individual or such individual and spouse received from such farming operation more than 50 percent of such individual's or such individual and spouse's gross income for the taxable year preceding the taxable year in which the case concerning such individual or such individual and spouse was filed.

Bankruptcy Law > Farming & Fishing Debtors > Eligibility

Tax Law > State & Local Taxes > Income Taxes > General Overview

HN3 Determining eligibility for family farmer relief under the gross income test requires a careful review of the debtors' tax and financial records for the prior tax year.

Bankruptcy Law > Farming & Fishing Debtors > Eligibility

HN4 Application of the Internal Revenue Code definition of gross income is an eligibility test for a family farmer.

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > Alimony, Child Support & Maintenance

Family Law > Marital Termination & Spousal Support > Spousal Support > General Overview

Tax Law > Federal Income Tax Computation > Compensation & Welfare Benefits > General Overview

Tax Law > ... > Compensation & Welfare Benefits > Fringe Benefits > General Overview

Tax Law > ... > Compensation & Welfare Benefits > Tips, Wages & Other Compensation > General Overview

Tax Law > ... > Compensation & Welfare Benefits > Tips, Wages & Other Compensation > Compensation for Services

Tax Law > Federal Income Tax Computation > Effects of Bankruptcy > Discharge of Indebtedness

Tax Law > Federal Income Tax Computation > Gross Income

Tax Law > Federal Income Tax Computation > Unearned Income > Royalties

HN5 For federal income tax purposes, "gross income" means all income from whatever source, except for those items specifically excluded by the Internal Revenue Code. [I.R.C. § 61](#). Fifteen of the more common types of "gross income" are enumerated by [§ 61](#). They are: (1) Compensation for services, including fees, commissions, fringe benefits, and similar items; (2) gross income from business; (3) gain from dealings in property; (4) interest; (5) rents; (6) royalties; (7) dividends; (8) alimony and separate maintenance payments; (9) annuities; (10) income from life insurance and endowment contracts; (11) pensions; (12) income from discharge of debt; (13) partner's share of partnership income; (14) income "in respect of a decedent"; and (15) income from an interest in an estate or trust.

Tax Law > ... > Compensation & Welfare Benefits > Tips, Wages & Other Compensation > General Overview

Tax Law > Federal Income Tax Computation > Gross Income

Tax Law > State & Local Taxes > Income Taxes > General Overview

HN6 The definition of gross income in [I.R.C. § 61](#) includes gross income derived from business. As to a business, however, gross income is usually the same as gross profit, not gross receipts. Gross profit is the total receipts from sales minus the cost of the goods sold.

Business & Corporate Law > General Partnerships > Management

Duties & Liabilities > General Overview

Business & Corporate Law > ... > Management Duties & Liabilities > Rights of Partners > Management & Voting

Tax Law > ... > Compensation & Welfare Benefits > Tips, Wages & Other Compensation > General Overview

HN7 Essentially, income from farming is treated in the same way as income from any other business. Every individual, partnership or corporation which cultivates, operates, or manages a farm for gain or profit, either as owner or tenant, is designated as a farmer. A person who cultivates or operates a farm for recreation or pleasure, the result of which is a continual loss from year to year, is not regarded as a farmer.

Business & Corporate Compliance > Contracts > Sales of Goods > General Overview

Contracts Law > Types of Commercial Transactions > Sales of Goods > General Overview

Tax Law > ... > Compensation & Welfare Benefits > Tips, Wages & Other Compensation > General Overview

Tax Law > Federal Income Tax Computation > Tax Accounting > General Overview

Tax Law > ... > Tax Accounting > Cash Basis Method > General Overview

Tax Law > ... > Tax Accounting > Cash Basis Method > Taxable Year of Inclusion

Tax Law > State & Local Taxes > Income Taxes > General Overview

HN8 A farmer on the cash basis must include in gross income all cash, or the value of merchandise or other property received from the sale of livestock and produce which he has raised, profits from the sale of livestock or other items which have been bought by him, and gross income received from all other sources. A cash-basis farmer may defer recognition of gain from the sale of a crop delivered in one year until the following year if he enters into a valid contract with the purchaser or the purchaser's agent that prohibits payment until the following year, but not if the payment is deferred merely at the seller's request.

Tax Law > ... > Compensation & Welfare Benefits > Tips, Wages & Other Compensation > General Overview

Tax Law > Federal Income Tax Computation > Amortization, Depletion & Depreciation > General Overview

Tax Law > ... > Amortization, Depletion &

Depreciation > Amortization, Cost Recovery &
Depreciation > General Overview

HN9 Profit from the sale of livestock or other items bought by a farmer is computed by deducting the cost from the sales price. In case animals are sold which originally were bought as draft or work animals, or for breeding or dairy purposes and not for resale, the profit is the difference between the sale price and the depreciated basis of the animal sold.

Tax Law > ... > Tax Accounting > Retirement Plans > Tax Sheltered Annuities

Tax Law > Federal Income Tax Computation > Tax Accounting > General Overview

Tax Law > ... > Tax Accounting > Cash Basis Method > General Overview

HN10 A cash-basis farmer who receives insurance proceeds as a result of destruction or damage to crops may elect to include the proceeds in income in the year after the year of damage or destruction if he can show that the income from the crops would normally have been reported in such following year. This includes payments received under the Agricultural Act of 1949 as a result of the destruction of or damage to crops caused by drought, flood, or other natural disaster, or the inability to plant crops because of such a natural disaster. [I.R.C. § 451\(d\)](#).

Tax Law > Federal Income Tax Computation > Tax Accounting > General Overview

Tax Law > ... > Tax Accounting > Cash Basis Method > General Overview

Tax Law > ... > Tax Accounting > Cash Basis Method > Taxable Year of Inclusion

HN11 A cash-basis farmer who is forced to sell livestock, other than foundation herd livestock, due to drought conditions in an area designated as eligible for assistance by the federal government may elect to be taxed on the forced sale income, gain that normally would not have been realized in the year of the forced sale, in the following year if he can show that the income from the sale of livestock would normally have been reported in such following year. [I.R.C. § 451\(e\)](#).

Tax Law > ... > Compensation & Welfare Benefits > Tips, Wages & Other Compensation > General Overview

Tax Law > ... > Tax Accounting > Accrual Method > General

Overview

HN12 Gross profit of a farmer on the accrual basis is found by adding to the inventory value of livestock and products at the end of the year the amount received from the sale of livestock and products, and any other receipts such as for the hire of machinery, and subtracting from this total the sum of the inventory value of livestock and products at the beginning of the year and the cost of such items bought during the year.

Tax Law > ... > Tax Accounting > Accrual Method > General Overview

HN13 Livestock raised or bought for sale must be inventoried. Livestock bought for draft, breeding or dairy purposes and not for sale may be inventoried or, instead, be treated as capital assets subject to depreciation, if the method used is consistently followed from year to year. If inventoried livestock is sold, its cost must not be taken as an additional deduction in the return of income, since the inventory will reflect such cost.

Tax Law > ... > Compensation & Welfare Benefits > Tips, Wages & Other Compensation > General Overview

Tax Law > Federal Taxpayer Groups > C Corporations > General Overview

Tax Law > State & Local Taxes > Income Taxes > General Overview

Tax Law > State & Local Taxes > Sales Taxes > General Overview

HN14 Amounts received as loans from the Commodity Credit Corporation may, at the election of the taxpayer, be considered as income and included in gross income for the taxable year in which received. [Treas. Reg. § 1.77-2](#).

Counsel: Attorney for Debtors: McKinley Anderson.

Attorney for Creditor: Kenneth R. Neill.

Judges: **[**1]** John L. Peterson, United States Bankruptcy Judge.

Opinion by: PETERSON

Opinion

[*277] ORDER

JOHN L. PETERSON, United States Bankruptcy Judge

At Butte in said District this 24th day of June, 1987.

The creditor Nollmeyer Farms, Inc. has contested the eligibility of the Debtors as family farmers under [11 U.S.C. § 101\(17\)](#). The issue involves the application of the gross income test, which requires that an individual family farmer and his spouse receive more than 50% of their gross income from farming operations.

The facts are undisputed. The Debtors filed this Chapter 12 case on April 6, 1987. [HN1](#) Under [§ 101\(17\)](#) of the 1986 Family Farmer Bankruptcy Act of 1986, P.L. 99-554, [11 U.S.C. § 1201 et seq.](#), the income test for eligibility requires the Debtors to show gross income for the taxable year 1986 in excess of 50% from their family farm operation. ¹ In 1986, the Debtors received income [\[*278\]](#) from the following sources according to Debtors' Schedules and testimony, to-wit:

 [Go to table1](#)

[\[**2\]](#)

[\[**3\]](#) According to the legislative history of P.L. 99-554 (H.R. 5316), the income limitations were added to the legislation to prevent high income, low non-farm debt tax shelter investors from qualifying for relief under Chapter 12. The statement in the Senate from Senator McConnell was as follows:

"The language that I propose to add to Senator Grassley's bill would establish more reasonable guidelines to insure that the use of chapter 12 bankruptcy is restricted for family farms and corporations, not for corporations involved in farming just for the tax shelter that farming has provided in the past. There would be a requirement added to the definition of 'family farmer' that requires that, for the purposes of this definition, that a farmer must receive at least 50% of his gross income from farming. In addition, a corporation who seeks to file under chapter 12 must have

¹(17) [HN2](#) "family farmer" means --

(A) individual or individual and spouse engaged in a farming operation whose aggregate debts do not exceed \$ 1,500,000 and not less than 80 percent of whose aggregate non-contingent, liquidated debts (excluding a debt for the principal residence of such individual or such individual principal residence of such individual or such individual and spouse unless such debt arises out of a farming operation), on the date the case is filed, arise out of a farming operation owned or operated by such individual or such individual and spouse, and such individual or such individual and spouse received from such farming operation more than 50 percent of such individual's or such individual and spouse's gross income for the taxable year preceding the taxable year in which the case concerning such individual or such individual and spouse was filed.

50 percent of its stock or equity owned by a person who is actually farming." 132 Cong. Rec. S.5614 (daily ed. May 8, 1986).

[HN3](#) Determining eligibility under the gross income test requires a careful review of the Debtors' tax and financial records for the prior tax year. However, the term gross income is not defined in the [\[**4\]](#) Code. There is, nevertheless, case authority which interprets the term gross income as it is used in [§ 101\(19\)](#) in defining farmers. [§ 101\(19\)](#) also uses the term gross income, and relates the test to the preceding tax year from the date the case was commenced. The case of [Matter of Wagner, 808 F.2d 542 \(7th Cir. 1986\)](#), holds the term gross income in the definition of farmer under [§ 101\(19\)](#) [formerly [§ 101\(17\)](#)] is intended to refer to gross income as defined in [Section 61 of the Internal Revenue Code of 1954](#), as amended. *Wagner* states:

"Prior to the 1978 overhaul of the bankruptcy law the definition of 'farmer' had undergone a painful statutory evolution each stage of which had generated considerable litigation. See Oler, *The Farmer and the Bankruptcy Laws*, 40 Dickinson L.Rev. 122 (1936). In the last stage, the statute, still worded unclearly, had been interpreted to mean 'an individual personally engaged in farming,' provided that 'the principal part of his income' was derived from farming. See 11 U.S.C. § 1(17) (1976 ed.); [In re Beery, 680 F.2d 705, 713 \(10th Cir. 1982\)](#). The substitution of an income test for the earlier tests of whether the individual was 'chiefly' [\[**5\]](#) or 'primarily' engaged in farming -- tests hopelessly vague in practice, as shown by such cases as [Powers v. Silberman, 3 F.2d 802 \(3d Cir. 1925\)](#), and [In re Macklem, 22 F.2d 426 \(D. Md. 1927\)](#) -- was a step toward greater precision; but the statute defined neither 'principal part' nor 'income,' and in particular it failed to indicate whether gross or net income was intended. See [In re Beery, supra, 680 F.2d at 713-17](#). Against this [\[*279\]](#) background Congress in the 1978 Code made a fresh start by defining 'farmer' as one who 'received more than 80 percent of [his] gross income during' his immediately preceding 'taxable year from a farming operation owned or operated' by him. [11 U.S.C. § 101\(17\)](#). ([Section 101\(18\)](#) defines 'farming operation' to include 'farming, tillage of the soil, dairy farming,' etc.) No legislative history bears on the question whether 'gross income' in the new statute should be given the same meaning that it has in federal income tax law.

...

From the statutory references to 'taxable year' and 'gross income,' both themselves technical terms, though of tax law rather than bankruptcy law, it is possible to infer that

Congress intended to use these terms in [section **\[**6\]** 101\(17\)](#) in their tax sense. Certainly 'taxable year' is so used; Wagner does not dispute that. Whether 'gross income' was intended to be used in its tax sense is less certain. Maybe, as Wagner argues, Congress used 'taxable year' merely to spare the farmer the bother of having to keep an additional set of books in order to be sure not to lose his bankruptcy exemption.

...

[5, 6] Yet, on balance, the interpretation that will best carry out Congress's purposes in the Bankruptcy Code is that gross income for purposes of the farmer's exemption has the same meaning as in the Internal Revenue Code. The language and background of [section 101\(17\)](#) show that Congress wanted a mechanical, which is to say an easily applicable, test for 'farmer' rather than a test that would reflect the economic realities of agriculture.

...

But for either creditor or debtor to decide what the debtor's gross income is in some sense of 'gross income' that is significant for the policy of the bankruptcy law would be an altogether more uncertain undertaking, at least until the courts had evolved a jurisprudence of gross income for this purpose. The threshold determination of eligibility for the exemption should not be **[**7]** subject to such uncertainty. Debtors and creditors ought to be able to know from the start whether the debtor is exempt from bankruptcy; they would not know till much later if we embarked on the protracted undertaking of constructing, in common law manner, case by case, a new jurisprudence of gross income. All this assumes moreover that 'income' itself is a straightforward concept; it is no more straightforward than 'gross' income is. Compare [Howell v. United States, 775 F.2d 887 \(7th Cir. 1985\)](#).

Moreover, no matter how brilliantly the courts aligned the concept of gross income in the Bankruptcy Code, with the best thinking of economists and accountants on the difference between income and capital, the statutory definition of farmer would still be arbitrary. The brilliance would be wasted, but bankruptcy litigation would be formented, and both debtors and creditors would be made worse off, since creditors when extending credit to a farmer wouldn't know what their remedies were in the event of default and farmers wouldn't know whether they were exempt from bankruptcy. [The way to make section 101\(17\) work best is to make it work simply. That is most easily done by deeming the **\[**8\]** statute to incorporate](#)

[the definition of gross income in federal income tax law.](#) Then everyone will know where he stands. Given the arbitrary nature of the statutory definition of farmer, no higher value than certainty can be served by the interpretation of the words gross income; and the interpretation that best serves that value is the one that equates gross income in the Bankruptcy Code to gross income in the tax code. Needless to say, we express no view on whether the same equation should be made in interpreting other statutes that use the words 'gross income' without express reference to the Internal Revenue Code. See 2 U.S.C. Sec. 707(1); 5 U.S.C.App. **[*280]** Sec. 209(1); [42 U.S.C. Sec. 300n\(3\)\(c\)](#)." [Id. 544-548](#).

[The rationale of the Wagner case is likewise applicable to Section 101\(17\) of the 1986 Act, and HN4 thus requires an application of the IRS Code definition of gross income as an eligibility test for a family farmer.](#)

U.S. Master Tax Guide, CCH 1986, references the appropriate tax standards on gross income:

"701. Gross Income Defined. [HN5](#) For Federal income tax purposes, 'gross income' means all income from whatever source, except for those items specifically excluded by **[**9]** the Code (Code [Sec. 61](#)).

Fifteen of the more common types of 'gross income' are enumerated by Code [Sec. 61](#). They are: (1) Compensation for services, including fees, commissions, fringe benefits, and similar items; (2) Gross income from business; (3) Gain from dealings in property; (4) Interest; (5) Rents; (6) Royalties; (7) Dividends; (8) Alimony and separate maintenance payments; (9) Annuities; (10) Income from life insurance and endowment contracts; (11) Pensions; (12) Income from discharge of debt; (13) Partner's share of partnership income; (14) Income 'in respect of a decedent'; and (15) Income from an interest in an estate or trust.

...

766. Business Profit. [HN6](#) The definition of gross income in Code [Sec. 61](#) includes 'gross income derived from business.' As to a business, however, gross income is usually the same as gross *profit*, not gross *receipts*. Gross profit is the total receipts from sales minus the cost of the goods sold.

...

771. Farming Is A Business. [HN7](#) Essentially, income from farming is treated in the same way as income from any other business. Every individual, partnership or

corporation which cultivates, operates, or manages a farm for gain or profit, either as owner **[**10]** or tenant, is designated as a farmer. A person who cultivates or operates a farm for recreation or pleasure, the result of which is a continual loss from year to year, is not regarded as a farmer. See p. 1059.

Cash Basis. A farmer on the cash basis does not use inventories. In addition to filing Form 1040, he must file a Schedule F (Form 1040), 'Farm Income and Expenses.' The general rules for all cash-basis taxpayers also apply to a farmer on the cash basis. See p. 611. A farmer must also file Schedule SE (Form 1040) for computing earnings from self-employment. See p. 190.

HN8 A farmer on the cash basis must include in gross income all cash, or the value of merchandise or other property *received* from the sale of livestock and produce which he has raised, profits from the sale of livestock or other items which have been bought by him, and gross income received from all other sources. A cash-basis farmer may defer recognition of gain from the sale of a crop delivered in one year until the following year if he enters into a valid contract with the purchaser or the purchaser's agent that prohibits payment until the following year, but not if the payment is deferred merely at the seller's **[**11]** request.

HN9 Profit from the sale of livestock or other items bought by a farmer is computed by deducting the cost from the sales price. In case animals are sold which originally were bought as draft or work animals, or for breeding or dairy purposes and not for resale, the profit is the difference between the sale price and the depreciated basis of the animal sold.

HN10 A cash-basis farmer who receives insurance proceeds as a result of destruction or damage to crops may elect to include the proceeds in income in the year after the year of damage or destruction if he can show that the income from the crops would normally have been reported in such following year. This includes payments received under the Agricultural Act of 1949 as a result of the destruction of or damage to crops caused by drought, flood, or other natural disaster, or the inability to plant crops because of such a natural disaster. (Code [Sec. 451\(d\)](#)).

HN11 **[*281]** A cash-basis farmer who is forced to sell livestock (other than foundation herd livestock), due to drought conditions in an area designated as eligible for assistance by the Federal Government may elect to be

taxed on the forced sale income (gain that normally would not **[**12]** have been realized in the year of the forced sale) in the following year if he can show that the income from the sale of livestock would normally have been reported in such following year (Code [Sec. 451\(e\)](#)).

Accrual Basis. A farmer on the accrual basis must use inventories taken at the start and the end of his taxable year. Such a farmer must also use Schedule F (Form 1040) and Schedule SE (Form 1040) for the special self-employment tax computations for farmers.

HN12 Gross profit of a farmer on the accrual basis is found by adding to the inventory value of livestock and products at the end of the year the amount received from the sale of livestock and products (and any other receipts such as for the hire of machinery) and subtracting from this total the sum of the inventory value of livestock and products at the beginning of the year and the cost of such items bought during the year.

HN13 Livestock raised or bought for sale must be inventoried. See p. 654. Livestock bought for draft, breeding or dairy purposes and not for sale may be inventoried or, instead, be treated as capital assets subject to depreciation, if the method used is consistently followed from year to year. If inventoried **[**13]** livestock is sold, its cost must not be taken as an additional deduction in the return of income, since the inventory will reflect such cost.

Aside from ordinary methods, two other inventory methods are available to the farmer. He may use either the 'farm-price' method, or the 'unit livestock price' method; as to which see p. 654.

For income from the sale of farm property other than inventory, see Chapter IX. As to 'tax shelter' farming operations, see pp. 365-367.

A farmer is subject to the same rules as any other individual regarding the use of Form 1040 (p. 118), exemptions (p. 151), and the zero bracket amount (p. 126). For expenses of a farmer, see 1059.

...

773. Commodity Credit Corporation Loan. **HN14** Amounts received as loans from the Commodity Credit Corporation may, at the election of the taxpayer, be considered as income and included in gross income for the taxable year in which received. (Reg. [§ 1.77-2](#))."

Applying the above tax tests to the facts of this case brings the

Court to the conclusion that Pratts do not qualify under the 50% income test rule. Pratt's sale of cattle in 1986 brought gross income of \$ 20,029.00, the difference between the sales price and the cost of goods *****14** sold. The contracting income is treated in the same manner. Since the total gross income from farming operations was 44% of Debtors total gross income (\$ 21,529 divided by \$ 48,581), the Debtors do not qualify as family farmers under Chapter 12 of the Code.

IT IS ORDERED the motion of Nollmeyer Farms, Inc. to dismiss this case is granted.

Table1 ([Return to related document text](#))

Farm Income:

Cattle sales - \$ 59,832.00 less	
cost of cattle \$ 39,803.00 - net	\$ 20,029.00
Farm labor	1,500.00
Total	\$ 21,529.00

Non-Farm Income:

Quoteal Pratt salary	14,052.69
Rental Income	6,000.00
Contracting Income from dwell -	
ing unit - \$ 76,335.69 less	
expenses \$ 69,335.69 - net	7,000.00
Total Non-Farm Income	\$ 27,052.69
Total Gross Income	\$ 48,581.00

Table1 ([Return to related document text](#))

End of Document

STATE OF MICHIGAN
BRANCH COUNTY CIRCUIT COURT

JASON MATE, individually and as
representative of a class of
similarly-situated persons and entities,

Plaintiff,

Case No. 2025-12507-CZ

Hon. Kirk A. Kashian
Acting Circuit Court Judge

v.

CITY OF COLDWATER, MICHIGAN
a municipal corporation, by and through THE
COLDWATER BOARD OF PUBLIC UTILITIES

Defendant.

Gregory D. Hanley (P51204)
Jamie K. Warrow (P61521)
Edward F. Kickham Jr. (P70332)
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**INDEX OF EXHIBITS SUBMITTED IN SUPPORT OF
PLAINTIFF'S MOTION FOR SUMMARY DISPOSITION AS TO HIS CHARTER
VIOLATION CLAIM IN COUNT I OF THE CLASS ACTION COMPLAINT**

VOLUME II – EXHIBITS 18-28

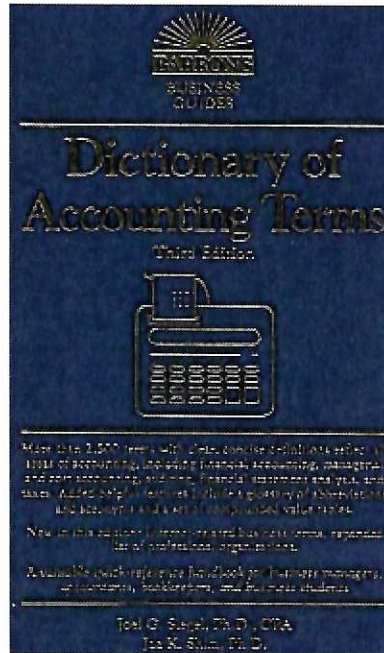
<u>EXHIBIT</u>	<u>DESCRIPTION</u>
18.	Shim and Siegel, <i>Dictionary of Accounting Terms</i> (5th Ed. 2010) (Excerpts)
19.	<i>States Welding Inc. v. BC Steel Inc.</i> 261 P.3d 513
20.	<i>Tingey v. Haisch</i> 159 Wn.2d 652

EXHIBIT

DESCRIPTION

21. *AAA Northeast v. Port Auth. of N.Y. N.J.* 221 F. Supp. 3d 374
22. *Caldwell v. City of San Francisco* 2021 U.S. Dist. LEXIS 72358
23. Investopedia Website “What Is Gross Income” found at <https://www.investopedia.com/terms/g/grossincome.asp>
24. *Isakina v. ReAlpha Tech. Corp.* 2023 U.S. Dist. LEXIS 198497
25. *Padilla v. Cmty. Health Sys.* 2022 U.S. Dist. LEXIS 147151
26. *Luma v. Dib Funding Inc.* 2022 U.S. Dist. LEXIS 10528
27. *Mich. Ass'n of Home Builders v. City of Troy* 2024 Mich. App. LEXIS 8354
28. *In re Wagner* 808 F.2d 542

EXHIBIT 18



title:
author:
publisher:
isbn10 | asin:
print isbn13:
ebook isbn13:
language:
subject
publication date:
lcc:
ddc:
subject:

Corner Points		CM
A	B	
		$\$25A + \$40B$
(a) 30	0	$\$25(30) + \$40(0) = \$750$
(b) 20	15	$\$25(20) + \$40(15) = \$1100$
(c) 0	25	$\$25(0) + \$40(25) = \$1000$
(d) 0	0	$\$25(0) + \$40(0) = \$0$

The corner 20A, 15B produces the most profitable solution.

GRAPHIC SOFTWARE

program for depicting accounting information in graphic form, including charts, diagrams, and signs. This enhances understanding of financial statement accounts, trends, and relationships.

GREENMAIL PAYMENT

payoff given to a potential acquirer by a company targeted for a takeover. In most cases, the targeted company buys back its shares at a significantly higher price. In reciprocation for selling the shares back, the suitor agrees to end the attempted takeover.

GROSS INCOME

amount of money earned (which is collected or will be collected) from the sale of goods minus the cost of the goods sold; also called GROSS PROFIT or *gross margin*. For example, if sales total \$4000 and the cost of goods sold is \$1200, the gross income is \$2800 (\$4000 - \$1200). Gross profit less operating expenses equals net income.

GROSS MARGIN

see GROSS PROFIT.

GROSS MARGIN PRICING

cost-based pricing approach in which the price is computed using a markup percentage based on a product's total production costs.

GROSS MARGIN RATIO

percentage of each sales dollar remaining after a firm has paid for its goods; also called *gross profit margin*. It is calculated by dividing gross income (profits) by net sales. For example, assume that net sales are \$80,000 and gross profit is \$30,000. The gross margin ratio is 0.38 (\$30,000/\$80,000).

GROSS DOMESTIC PRODUCT (GDP)

current market value in dollars of all final goods and services produced in the economy in a given period. GDP is normally stated in annual terms, though data are compiled and released quarterly. It consists of personal consumption expenditures, gross private domestic investment, government spending, and net exports (exports minus imports).

EXHIBIT 19



United States Welding, Inc. v. B&C Steel, Inc.

Court of Appeals of Colorado, Division Three

July 7, 2011, Decided

Court of Appeals No. 10CA0879

Reporter

261 P.3d 513 *; 2011 Colo. App. LEXIS 1119 **

United States Welding, Inc., a Colorado corporation, Plaintiff-Appellant, v. B&C Steel, Inc., a Colorado corporation; Metro Steel Fabricating, Inc., d/b/a Metro Steel Inc., a Colorado corporation; and Buckeye Welding Supply Company, Inc., a Colorado corporation, Defendants-Appellees.

Prior History: **[**1]** City and County of Denver District Court No. 09CV3342. Honorable Anthony F. Vollack, Judge.

Disposition: JUDGMENT AFFIRMED IN PART, REVERSED IN PART, AND CASE REMANDED WITH DIRECTIONS.

Case Summary

Overview

With respect to damages for the purchasers' failure to purchase oxygen and carbon dioxide, the seller was engaged in retail sales. Thus, the evidence of the purchase price paid by the seller was sufficient evidence of gross profit to survive a motion to dismiss. Further, gross profits on the sale of oxygen and carbon dioxide could be awarded as net profits. However, there was insufficient evidence of lost gross profits with respect to the lost sales of acetylene to survive a motion to dismiss at the close of the seller's evidence.

Outcome

Judgment affirmed in part and reversed in part, and case remanded.

LexisNexis® Headnotes

Civil Procedure > Appeals > Standards of Review > De Novo Review

Evidence > Weight & Sufficiency

HN1 Standards of Review, De Novo Review

An appellate court reviews the sufficiency of the evidence under a de novo standard.

Civil Procedure > Appeals > Standards of Review > General Overview

Civil Procedure > Dismissal > General Overview

HN2 Appeals, Standards of Review

On an appeal from a judgment granting a motion to dismiss at the end of a plaintiff's case, an appellate court must consider all relevant facts in the light most favorable to the plaintiff.

Civil Procedure > Remedies > Damages > General Overview

Contracts Law > ... > Measurement of Damages > Foreseeable Damages > Lost Profits

HN3 Remedies, Damages

Under Colorado law, damages for lost profits means the loss of net, not gross, profits.

Civil Procedure > Remedies > Damages > General Overview

Contracts Law > ... > Measurement of Damages > Foreseeable Damages > Lost Profits

HN4 Remedies, Damages

When operating expenses (overhead) are fixed, gross profits may be awarded as representing net profits.

Civil Procedure > Remedies > Damages > General
Overview

[HN5 Remedies, Damages](#)

"Gross profit" has been legally defined as total sales revenue less the cost of the goods sold with no adjustment being made for additional expenses and taxes.

Civil Procedure > Remedies > Damages > General
Overview

Contracts Law > ... > Measurement of
Damages > Foreseeable Damages > Lost Profits

[HN6 Remedies, Damages](#)

The synonymous terms "net profit" and "net income" are accounting terms defined as revenue less all expenses. The difference between an enterprise's revenues and its cost of sales, operating expenses, and taxes during a particular income period. The synonymous terms "cost of sales" and "cost of goods sold" have been defined as follows: the price of buying or making an item that is sold; also called cost of goods sold. The difference between sales and cost of sales is gross profit. For a retail business, the cost of sale is the purchase price of the item. For a manufactured good, the cost of sale include direct material, direct labor, and factory overhead associated with producing it. The terms also mean the collection of the costs attributable to items sold during an accounting period, which the enterprise previously purchased for resale or manufactured. Those costs includes direct materials and labor, other direct costs, and an allocable portion of indirect costs such as factory overhead. Those costs do not include office, selling, accounting, or advertising expenses. Direct material is all the material that becomes an integral part of the finished product. Direct labor is work directly involved in making the product. Factory overhead is the total of all costs of manufacturing except direct materials and direct labor.

Civil Procedure > Appeals > Standards of Review > Abuse
of Discretion

Evidence > Admissibility > Procedural Matters > Rulings
on Evidence

Civil Procedure > Appeals > Standards of

Review > Clearly Erroneous Review

[HN7 Standards of Review, Abuse of Discretion](#)

A trial court's evidentiary ruling may be reversed upon a showing of abuse of discretion or clear error. An abuse of discretion occurs when the trial court's decision is manifestly arbitrary, unreasonable, or unfair, or when the trial court applies incorrect legal standards.

Evidence > Types of Evidence > Documentary
Evidence > Summaries

[HN8 Documentary Evidence, Summaries](#)

See [Colo. R. Evid. 1006](#).

Evidence > Types of Evidence > Documentary
Evidence > Summaries

[HN9 Documentary Evidence, Summaries](#)

For admission, a proponent of the summary evidence must (1) identify the documents underlying the summary and show them to be voluminous; (2) establish that the underlying documents are otherwise admissible evidence; (3) provide the other party with a copy of the summary in advance of its use; and (4) provide an opposing party with a reasonable time and place for examination of the available documents underlying such summary.

Evidence > Types of Evidence > Documentary
Evidence > Summaries

[HN10 Documentary Evidence, Summaries](#)

Pursuant to [Colo. R. Evid. 1006](#), an offering party must lay a sufficient foundation for, or the parties must stipulate to, the admissibility of the underlying material.

Counsel: Arkey & Reha, LLC, John F. Reha, Sara Y. Hunt, Littleton, Colorado, for Plaintiff-Appellant.

Bucholtz & Bull, P.C., James C. Bull, Littleton, Colorado, for Defendants-Appellees.

Judges: Opinion by JUDGE ROY. Furman and Lichtenstein, JJ., concur.

Opinion by: ROY

Opinion

[*514] In this breach of contract case, plaintiff, United States Welding, Inc. (seller), appeals from a judgment in favor of defendants, B&C Steel, Inc. and Metro Steel Fabricating, Inc. (purchasers), and Buckeye Welding Supply Company, Inc. (competitor). We affirm in part, reverse in part, and remand.

Seller is a supplier of gases used in welding. It has seventeen outlets or facilities in six states, the most notable for our purposes being a store in Denver and an acetylene manufacturing facility in Salt Lake City, Utah.

In 2001, seller and purchasers entered into a requirements contract for the purchase and sale of carbon dioxide, oxygen, and acetylene. On appeal, the parties do not dispute either the nature of the contract or its breach by purchasers. Instead, the dispute centers on seller's **[**2]** calculation of gross profits from the sale of carbon dioxide, oxygen, and acetylene.

At trial, purchasers and competitor objected to the evidence of seller's calculation of damages because it lacked an adequate foundation and was based on a summary of documents not in evidence under [CRE 1006](#). The trial court sustained the objection, and at the conclusion of seller's case, granted purchasers' motion to dismiss.

I. Lost Profits

Seller first contends that the trial court erred in dismissing its claims at the close of its evidence on the ground that it had not presented sufficient evidence of its lost profits. We agree in part and disagree in part.

A. Standard of Review

HN1 We review the sufficiency of the evidence under a de novo standard. [E-470 Public Highway Authority v. 455 Co.](#), 3 P.3d 18, 22 (Colo. 2000). **HN2** On an appeal from a judgment granting a motion to dismiss at the end of a plaintiff's case, we must consider all relevant facts in the light most favorable to the plaintiff. [Goodfellow v. Kattnig](#), 533 P.2d 58, 59 (Colo. App. 1975) (not published pursuant to [C.A.R. 35\(f\)](#)).

B. Net Profit - Gross Profit

HN3 Under Colorado law, damages for lost profits means the loss of net, not gross, profits. [Lee v. Durango Music](#), 144 Colo. 270, 355 P.2d 1083 (1960); **[**3]** [Graphic Directions, Inc. v. Bush](#), 862 P.2d 1020, 1024 (Colo. App. 1993).

HN4 When operating expenses (overhead) are fixed, however, gross profits may be awarded as representing net profits. [Combined Communications Corp. v. Bedford Motors, Inc.](#), 702 P.2d 281, 282 (Colo. App. 1985); [P & M Vending Co. v. Half Shell of Boston, Inc.](#), 41 Colo. App. 78, 80-81, 579 P.2d 93, 96 (1978); see also [Carriage Bags, Ltd. v. Aerolinas](#) **[*515]** [Argentinas](#), 521 F. Supp. 1363, 1367 (D. Colo. 1981) (applying Colorado law).

In *P & M Vending*, the division observed:

At trial, plaintiff established that it is a relatively large company with about fifty employees and approximately two thousand [cigarette] vending machine locations in the Denver area, some of which are in the immediate vicinity of the defendants' restaurant; that plaintiff's operating and overhead expenses are fixed costs that would not diminish as a result of the loss of one location such as the defendants'; and that there would be no difference or only a minimal difference between plaintiff's revenues from the vending machine and the plaintiff's net profits. Plaintiff further established that it had more vending machines than locations, and that profits were **[**4]** dependent on the number of locations rather than the number of machines. This evidence formed the basis of the findings and award entered by the trial court.

Where operating expenses are fixed, gross profits may be awarded as representing net profits. [Distillers Distributing Corp. v. J.C. Millet \[t\] Co.](#), 310 F.2d 162 (9th Cir. 1962). Hence, under the circumstances presented here, the trial court was correct in concluding that the liquidated damages contemplated by the written agreement were not disproportionate to plaintiff's actual damages and that the liquidated damages provision was valid and enforceable.

[41 Colo. App. at 80-81, 579 P.2d at 95](#) (emphasis added).

Seller tried its case in reliance on [Carriage Bags](#), 521 F. Supp. at 1367. In *Carriage Bags*, the court, without reference to *P & M Vending*, stated that damages should place the injured party in the same position it would have enjoyed had the contract not been breached, and that if overhead remained unchanged, then lost gross profits would be the proper measure of damages. *Id.*

We conclude that seller's lost gross profits from the sale of carbon dioxide and oxygen as a retailer may be awarded as net profits under the holding in *P* **[**5]** *& M Vending*. However, with respect to acetylene, this case turns on whether there is sufficient evidence of gross profits.

C. Definitions

No Colorado authority defines and applies the terms "gross

profit" and "net profit." These terms are rooted in accounting, and undoubtedly accountants, economist, or other professionals frequently testify as expert witnesses on these issues.¹ However, no accountant testified here, and purchasers and competitor, as they did in the trial court, challenge the sufficiency of the evidence. Therefore, in order to resolve the matter before us and provide guidance to the practicing bar, we address and apply these terms.

In defining these terms, we rely on Jae K. Shim and Joel G. Siegel, *Dictionary of Accounting Terms* (5th ed. 2010) (*Dictionary*); a glossary in David R. Hervitz and Matthew J. Barrett, *Accounting for Lawyers* (4th ed. 2006) (*Textbook*); and *Black's Law Dictionary* (9th ed. 2009) (*Black's*).

HN5 "Gross profit" has been legally defined **[**6]** as "[t]otal sales revenue less the cost of the goods sold [with] no adjustment being made for additional expenses and taxes." *Black's* at 1329. The accounting definitions are similar. *Dictionary* at 222 ("sales minus cost of sales; also called *gross margin*"); *Textbook* at 1118 ("difference between net sales and cost of goods sold").

HN6 The synonymous terms "net profit" and "net income" are accounting terms defined as "revenue less all expenses." *Dictionary* at 312. The *Textbook* definition is: "[T]he difference between an enterprise's revenues and its cost of sales, operating expenses, and taxes during a particular income period." *Textbook* at 1122.

The synonymous terms "cost of sales" and "cost of goods sold" have been defined as follows:

[*516] [The] price of buying or making an item that is sold; also called *cost of goods sold*. The difference between sales and cost of sales is gross profit. *For a retail business, the cost of sale is the purchase price of the item. For a manufactured good, the cost of sale include [sic] direct material, direct labor, and factory overhead associated with producing it.*

Dictionary at 117 (emphasis added). The *Textbook* definition is similar:

[C]ollects the costs attributable **[**7]** to items sold during an accounting period, which the enterprise previously purchased for resale or manufactured. *These costs include direct materials and labor, other direct costs, and an allocable portion of indirect costs such as factory overhead. These costs do not include*

office, selling, accounting, or advertising expenses.

Textbook at 1112 (emphasis added).

Direct material is "all the material that becomes an integral part of the finished product." *Dictionary* at 146. Direct labor is "work directly involved in making the product." *Id.* Factory overhead is "the total of all costs of manufacturing except direct materials and direct labor." *Id.* at 183.

D. The Evidence

Seller's evidence of damages was admitted through the testimony of its contract administrator (administrator), an attorney. His approach to determining gross profits was to determine the average sales price of each product during the period in question, less the average cost of the product during the period in question, and multiply the remainder by the average number of unit sales to purchasers, plus income from cylinder rental.²

1. Oxygen and Carbon Dioxide

According to administrator, seller purchases oxygen and carbon dioxide in bulk and transfers the gases into cylinders. The gas is sold in cylinders rented by and delivered to its customers. The transfer of the gases involves placing the retail cylinder on a scale and connecting it to a bulk tank. The valves are opened and the gas is transferred into the retail cylinder until it contains the requisite weight of gas (fifty pounds in the case of oxygen).

2. Acetylene

Acetylene is the product of a chemical reaction between calcium carbide and water, which is then stored in retail cylinders containing acetone, which stabilizes the acetylene. Seller manufactures acetylene at its plant in Salt Lake City, Utah. According to administrator, the principal material cost in the manufacture of acetylene is the calcium carbide, and its cost was the only cost of production included in his calculation of cost of goods sold for acetylene. **[**9]** Administrator testified that seller manufactures approximately 6,500 retail cylinders of acetylene a month; purchasers collectively purchased an average of 11 cylinders a month, or .169% of seller's production; purchasers' requirements could be satisfied out of inventory maintained for walk-in customers; and production costs are unaffected by the loss of the sales to purchasers. On cross-

²An illustrative example of a gross profit calculation for a retail business is: Sales - Cost **[**8]** of Sales [beginning inventory + purchases - ending inventory] = Gross Profit. <http://www.allbusiness.com/glossaries/cost-goods-sold/4949230-1.html> (last visited June 6, 2011). This method essentially determines cost of sales based on averages.

¹In defining and applying accounting terms here, we recognize that accountants and others qualified as experts may define or apply them differently as the context or their professional standards and experience may require.

examination, administrator conceded that his cost figures for acetylene did not include the cost of water and acetone, the cost of the seven employees operating the plant, the costs of maintaining and certifying the acetylene tanks, the cost of maintaining the manufacturing facility, depreciation of the manufacturing facility, the cost of shipping the cylinders to and from the manufacturing facility, or the cost of insuring the manufacturing facility which engages in a hazardous activity.

The administrator testified that because the costs, other than for calcium carbide, are either de minimis or remain constant regardless of whether purchasers perform on the requirements contract, there is no need to separately account for them in determining gross profit.

[*517] E. Analysis and Conclusion

With respect to damages **[**10]** for purchasers' failure to purchase oxygen and carbon dioxide, it appears that seller is engaged in retail sales. That is, while it broke the bulk quantities of the gases down into retail cylinders, the operation was simple and inexpensive, similar to a retail store's unpacking merchandise from shipping boxes or containers. Therefore, in our view, the evidence of the purchase price paid by seller is sufficient evidence of gross profit to survive a motion to dismiss. Further, we agree with seller that, under the circumstances, gross profits on the sale of these gases could be awarded as net profits.

However, as to acetylene, seller did not, in our view, present sufficient evidence of gross profits to survive a motion to dismiss at the close of its evidence. Unlike the sale of the oxygen and carbon dioxide, seller is in the business of manufacturing and distributing acetylene. The evidence does not include all the direct material costs, direct labor costs, and factory overhead associated with the manufacture of acetylene. It is possible that these unsupported costs are relatively minor, but we cannot determine even that question on this record.

Therefore, there is insufficient evidence **[**11]** of lost gross profits with respect to the lost sales of acetylene to survive a motion to dismiss at the close of seller's evidence.

II. Admission of a Summary of Damages

Because any award of damages for oxygen and carbon dioxide on remand must be based on the summary of damages, we address seller's argument that the trial court abused its discretion in rejecting its exhibit summarizing the calculation of gross profits as to those gases.

HN7 A trial court's evidentiary ruling may be reversed upon a

showing of abuse of discretion or clear error. *Honey v. People*, 713 P.2d 1300, 1303 n.4 (Colo. 1986). An abuse of discretion occurs when the trial court's decision is manifestly arbitrary, unreasonable, or unfair, or when the trial court applies incorrect legal standards. *LaBrenz v. American Family Mut. Ins. Co.*, 181 P.3d 328, 333 (Colo. App. 2007).

HN8 CRE 1006 provides:

The contents of voluminous writings, recordings, or photographs which cannot conveniently be examined in court may be presented in the form of a chart, summary, or calculation. The originals or duplicates, shall be made available for examination or copying, or both, by other parties at reasonable time and place. The court may order **[**12]** that they be produced in court.

See *Airborne, Inc. v. Denver Air Center, Inc.*, 832 P.2d 1086, 1090 (Colo. App. 1992).

HN9 For admission, the proponent of the summary evidence must (1) identify the documents underlying the summary and show them to be voluminous; (2) establish that the underlying documents are otherwise admissible evidence; (3) provide the other party with a copy of the summary in advance of its use; and (4) provide "the opposing party with a reasonable time and place for examination of the available documents underlying such summary." *People v. McDonald*, 15 P.3d 788, 790 (Colo. App. 2000).

Here, at the close of seller's case, an exhibit summarizing the calculation of its damages was offered into evidence. Purchasers and competitor objected to its admission because it lacked an adequate foundation and because it was a summary of documents not in evidence under **CRE 1006**. The trial court rejected the exhibit because it represented the calculation of losses of gross, not net, profits.

A. Foundation

HN10 The offering party must lay a sufficient foundation for, or the parties must stipulate to, the admissibility of the underlying material. *Pyles-Knutzen v. Board of County Comm'rs*, 781 P.2d 164, 167 (Colo. App. 1989). **[**13]** The administrator testified that he had personal **[*518]** knowledge of the sales and other business records maintained by seller in the normal course of business. He testified that he calculated gross profit damages by taking a baseline of purchasers' average purchases for the year prior to the breach. He further testified that he had personal knowledge of the purchasing invoices from the seller's suppliers which were maintained in the normal course of business, that he personally reviewed all of the invoices, and that he included rents for the cylinders containing the gases billed to

purchasers based on reviewing gas invoices and determining monthly averages.

B. [CRE 1006](#)

Seller provided purchasers with a copy of the summary of damages approximately four months before the commencement of the trial but the supporting documents were first produced at trial. However, the supporting documents as to oxygen and carbon dioxide were admitted without objection.

In our view, there was substantial compliance with [CRE 1006](#), as there was sufficient evidence to support the admission of the damages summary as to oxygen and carbon dioxide before the summary was offered at trial. Thus, the trial court abused its **[**14]** discretion in rejecting the exhibit as to those gases.

The judgment is affirmed as to the dismissal of seller's claims for damages for lost profits from the sale of acetylene, reversed as to seller's claims for damages for lost profits from the lost sales of oxygen and carbon dioxide, and the case is remanded for further proceedings with respect to those gases consistent with the views expressed in this opinion.

JUDGE FURMAN and JUDGE LICHTENSTEIN concur.

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EXHIBIT 20

Tingey v. Haisch

Supreme Court of Washington

September 19, 2006, Argued; February 15, 2007, Filed

No. 77689-0

Reporter

159 Wn.2d 652 *; 152 P.3d 1020 **; 2007 Wash. LEXIS 130 ***

DAVID L. TINGEY, *Petitioner*, v. LLOYD HAISCH ET AL.,
Respondents.

Prior History: [***1] [Tingey v. Haisch, 129 Wn. App. 109, 117 P.3d 1189, 2005 Wash. App. LEXIS 2088 \(2005\)](#).

Case Summary

Procedural Posture

Petitioner attorney sued respondents, clients, in which he sought to recover legal fees incurred by the clients. The trial court denied the clients' motion to dismiss the action as time barred and granted partial summary judgment to the attorney on application of the six year statute of limitations. The Court of Appeals Division Three (Washington) reversed and held the action was time barred. The attorney appealed.

Overview

The attorney and the clients did not enter into a written fee agreement. The attorney regularly invoiced the clients for legal services on an hourly fee basis and the clients paid the invoices through June 1994. The attorney completed legal representation in December 1994. More than three years later, the attorney initiated a collection action against the clients, alleging they owed him in excess of \$20,000 for legal services rendered plus interest accrued. The court of appeals held that the term "account receivable" in Wash. Rev. Code § 4.16.040(2) was ambiguous, and as such, the six-year limitation for accounts receivable did not apply to the attorney's claim for attorney fees. The supreme court found that the plain meaning of "account receivable" as used in § 4.16.040(2) was an amount due a business on account from a customer who had bought merchandise or received services. This meaning encompassed a balance owed by a client to an attorney for legal services performed on behalf of the client on an hourly fee basis without a written fee agreement. Thus the six-year limitation for an action upon an account receivable incurred in the ordinary course of business applied.

Outcome

The court of appeals was reversed and the judgment of the trial court that the six year statute of limitations applied was reinstated.

LexisNexis® Headnotes

Governments > Legislation > Statute of
Limitations > Time Limitations

HN1 Statute of Limitations, Time Limitations

Wash. Rev. Code § 4.16.040(2) provides that an action upon an account receivable incurred in the ordinary course of business shall commence within six years.

Contracts Law > Defenses > Affirmative
Defenses > Statute of Limitations

Governments > Legislation > Statute of
Limitations > Time Limitations

HN2 Affirmative Defenses, Statute of Limitations

[Wash. Rev. Code § 4.16.080\(3\)](#) provides that except as provided in Wash. Rev. Code § 4.16.040(2), an action upon a contract or liability, express or implied, which is not in writing, and does not arise out of any written instrument shall commence within three years.

Civil Procedure > Appeals > Standards of Review > De
Novo Review

Civil Procedure > ... > Summary Judgment > Appellate

Review > Standards of Review

[HN3 Standards of Review, De Novo Review](#)

The Supreme Court of Washington reviews rulings on summary judgment de novo.

Civil Procedure > Appeals > Standards of Review > De Novo Review

Governments > Legislation > Interpretation

[HN4 Standards of Review, De Novo Review](#)

The Supreme Court of Washington reviews issues of statutory interpretation de novo.

Governments > Legislation > Interpretation

[HN5 Legislation, Interpretation](#)

A court's objective in construing a statute is to determine the legislature's intent. If the statute's meaning is plain on its face, then the court must give effect to that plain meaning as an expression of legislative intent. A statutory provision's plain meaning is to be discerned from the ordinary meaning of the language at issue, the context of the statute in which that provision is found, related provisions, and the statutory scheme as a whole. A provision that remains susceptible to more than one reasonable interpretation after such an inquiry is ambiguous and a court may then appropriately employ tools of statutory construction, including legislative history, to discern its meaning.

Contracts Law > Defenses > Affirmative Defenses > Statute of Limitations

Governments > Legislation > Statute of Limitations > Time Limitations

[HN6 Affirmative Defenses, Statute of Limitations](#)

Wash. Rev. Code § 4.16.040 provides that the following actions shall be commenced within six years: (1) an action upon a contract in writing, or liability express or implied arising out of a written agreement; (2) an action upon an account receivable incurred in the ordinary course of business; and (3) an action for the rents and profits or for the use and occupation of real estate.

Governments > Legislation > Statute of Limitations > Time Limitations

[HN7 Statute of Limitations, Time Limitations](#)

Wash. Rev. Code § 4.16.080(3) provides that except as provided in Wash. Rev. Code § 4.16.040(2), an action upon a contract or liability, express or implied, which is not in writing, and does not arise out of any written instrument shall be commenced within three years.

Governments > Legislation > Interpretation

[HN8 Legislation, Interpretation](#)

When a term has a well-accepted, ordinary meaning, a regular dictionary may be consulted to ascertain the term's definition. **When a technical term is used in its technical field, the term should be given its technical meaning by using a technical rather than a general purpose dictionary to resolve the term's definition.**

Contracts Law > Standards of Performance > General Overview

Contracts Law > Defenses > Affirmative Defenses > Statute of Limitations

[HN9 Contracts Law, Standards of Performance](#)

The plain meaning of "account receivable" in Wash. Rev. Code § 4.16.040(2) is an amount due a business on account from a customer who has bought merchandise or received services.

Governments > Legislation > Interpretation

[HN10 Legislation, Interpretation](#)

Where the legislature provides no statutory definition and a court gives a term its plain and ordinary meaning by reference to a dictionary, the court will avoid literal reading of a statute which would result in unlikely, absurd, or strained consequences. A reading that produces absurd results must be avoided because it will not be presumed that the legislature intended absurd results. The outcome of plain language analysis may be corroborated by validating the absence of an absurd

result. Where an absurd result is produced, further inquiry may be appropriate.

Governments > Legislation > Statute of Limitations > Time Limitations

[HN11](#) Statute of Limitations, Time Limitations

Oral contracts between two private parties are governed by the three-year limitation of [Wash. Rev. Code § 4.16.080\(3\)](#).

Contracts Law > Standards of Performance > General Overview

Contracts Law > Defenses > Affirmative Defenses > Statute of Limitations

[HN12](#) Contracts Law, Standards of Performance

The Supreme Court of Washington holds that the plain meaning of "account receivable" as used in Wash. Rev. Code § 4.16.040(2) is an amount due a business on account from a customer who has bought merchandise or received services. This meaning encompasses a balance owed by a client to an attorney for legal services performed on behalf of the client on an hourly fee basis without a written fee agreement.

Headnotes/Summary

Summary

MADSEN, J., concurs in the result only; CHAMBERS and C. JOHNSON, JJ., dissent by separate opinion.

Nature of Action: An attorney sought to recover unpaid attorney fees from a former client. The action was filed more than three years after the last day the attorney performed legal services for the client.

Superior Court: The Superior Court for Grant County, No. 99-2-01248-4, Evan E. Sperline, J., on September 22, 2003, ruled by partial summary judgment that the statutory time limitation applicable to the action was six years. Following a bench trial on the merits, Kenneth L. Jorgensen, J., on July 14, 2004, entered judgment in favor of the attorney.

Court of Appeals: The court *reversed* the judgment at [129 Wn. App. 109, 117 P.3d 1189 \(2005\)](#), holding that the transaction

between the attorney and the client did not involve an open account with ongoing debit and credit entries and a fluctuating balance left open until either party finds it convenient to settle and close, and that, therefore, the claim for attorney fees was not an account receivable subject to a six-year limitation period.

Supreme Court: Holding that the balance owed by the defendant to the plaintiff constituted an account receivable incurred in the ordinary course of business and that the action is subject to the six-year limitation period applicable to actions upon accounts receivable, the court *reverses* the decision of the Court of Appeals and *reinstates* the ruling on summary judgment that the six-year limitation period applies to the action.

Headnotes

[WA\[1\]](#) [1]

Judgment— > Summary Judgment— > Issues of Law— > Review— > Standard of Review.

A trial court's rulings on summary judgment are reviewed de novo.

[WA\[2\]](#) [2]

Statutes— > Construction— > Review— > Standard of Review.

Issues of statutory interpretation are reviewed de novo.

[WA\[3\]](#) [3]

Statutes— > Construction— > Legislative Intent— > Statutory Language— > Plain Meaning— > Context.

A court's objective in construing a statute is to determine the legislature's intent. If the statute's meaning is plain on its face, then the court must give effect to that plain meaning as an expression of legislative intent. A statutory provision's plain meaning is discerned from the ordinary meaning of the language at issue, the context of the statute in which the provision is found, related provisions, and the statutory scheme as a whole. A court may appropriately employ tools of statutory construction, such as legislative history, to discern the provision's meaning only if the provision is ambiguous. A statutory provision is ambiguous if, after a plain language analysis, it remains susceptible to more than one reasonable interpretation.

[WA\[4\]](#) [4]

Statutes— > Construction— > Meaning of Words— > Absence of Statutory Definition— > Resort to Dictionary.

When a statutory term that the statute does not define has a well-accepted, ordinary meaning, a regular dictionary may be consulted to ascertain the term's definition.

[WA\[5\]](#) [5]

Statutes— > Construction— > Meaning of Words— > Technical Language— > Resort to Technical Dictionary.

When a technical term in a statute is used in its technical field, the term should be given its technical meaning by using a technical rather than a general purpose dictionary to resolve the term's definition.

[WA\[6\]](#) [6]

Limitation of Actions— > Account Receivable— > What Constitutes— > Test.

For purposes of RCW 4.16.040(2), which provides that an action upon an account receivable incurred in the ordinary course of business is subject to a six-year limitation period, an “account receivable” is an amount due a business on account from a customer who has bought merchandise or received services.

[WA\[7\]](#) [7]

Limitation of Actions— > Account Receivable— > What Constitutes— > Past Due Attorney Fees for Legal Services Rendered.

The balance owed by a client to an attorney for legal services performed on behalf of the client on an hourly fee basis without a written fee agreement, but regularly invoiced in accordance with ordinary business practice, is an “account receivable” within the meaning of RCW 4.16.040(2), which provides that an action upon an account receivable incurred in the ordinary course of business is subject to a six-year limitation period.

[WA\[8\]](#) [8]

Limitation of Actions— > Attorney and Client— > Compensation— > Collection— > Limitation Period— > Oral

Agreement.

Absent a written fee agreement, a claim for past due attorney fees for legal services rendered on an hourly fee basis and regularly invoiced in accordance with ordinary business practice is subject to the six-year limitation period of RCW 4.16.040(2) for actions upon accounts receivable.

[WA\[9\]](#) [9]

Statutes— > Construction— > Meaning of Words— > Absence of Statutory Definition— > Avoiding Absurdity.

Where the legislature provides no statutory definition and a court gives a term its plain and ordinary meaning by reference to a dictionary, the court will avoid a literal reading of the statute which would result in unlikely, absurd, or strained consequences. A reading that produces absurd results must be avoided because it will not be presumed that the legislature intended absurd results.

[WA\[10\]](#) [10]

Statutes— > Construction— > Legislative Intent— > Statutory Language— > Plain Meaning— > Corroboration— > Absence of Absurd Result.

The outcome of a plain language analysis of a statutory provision may be corroborated by validating the absence of an absurd result. Where an absurd result is produced, further inquiry may be appropriate.

Attorney and Client— > Compensation— > Collection— > Limitation Period— > Oral Agreement.

Counsel: *David L. Tingey*, pro se.

Harold J. Moberg, for respondents.

Philip A. Talmadge on behalf of ACA International, amicus curiae.

Judges: Justice Mary E. Fairhurst. WE CONCUR: Chief Justice Gerry L. Alexander, Justice Susan Owens, Justice Barbara A. Madsen, result only, Justice Richard B. Sanders, Justice James M. Johnson, Justice Bobbe J. Bridge. Justice Tom Chambers. WE CONCUR: Justice Charles W. Johnson.

Opinion by: Mary E. Fairhurst

Opinion

En Banc

[*654]

¶1 **[**1021]** FAIRHURST, J. — Petitioner attorney David Tingey performed legal services for respondents Lloyd and Lucy Haisch (hereinafter Haisch) on an hourly fee basis without **[*655]** a written fee agreement. Tingey challenges a Court of Appeals decision holding that his action to collect those fees is not governed by the RCW 4.16.040(2) six-year limitation for “[a]n account receivable incurred in the ordinary course of business.”¹ **[***2]** Tingey argues that **[**1022]** the term “account receivable” has a plain meaning in Washington law and that the Court of Appeals, after improperly finding the term to be ambiguous, derived for the term an inappropriately narrow meaning that excluded his action. Haisch argues that the applicable statute of limitation for Tingey’s action is the [RCW 4.16.080\(3\)](#) three-year limitation for oral contracts.²

¶2 We hold that the plain meaning of “account receivable” as used in RCW 4.16.040(2) is an amount due a business on account from a customer who has bought merchandise or received services. This meaning encompasses a balance owed by a client to an attorney for legal services performed on behalf of the client on an hourly fee basis without a written fee agreement. Thus, the six-year limitation for “[a]n action upon an account receivable incurred in the ordinary course of business” applies to Tingey’s action to collect attorney fees from Haisch. RCW 4.16.040(2). We reverse the Court of Appeals and reinstate the trial court’s ruling on summary judgment that the six-year limitation applies.

I. FACTUAL AND PROCEDURAL HISTORY

¶3 Neither Tingey nor Haisch **[***3]** disputes the material facts of this case. In 1994, Tingey represented Haisch in a Grant County Superior Court lawsuit. They did not enter into a written fee agreement. Tingey regularly invoiced Haisch for legal services on an hourly fee basis, and Haisch paid the invoices through June 1994. Tingey completed legal representation of Haisch in December 1994.

¹ [HN1 RCW 4.16.040\(2\)](#) provides that “[a]n action upon an account receivable incurred in the ordinary course of business” shall commence within six years.

² [HN2 RCW 4.16.080\(3\)](#) provides that “[e]xcept as provided in [RCW 4.16.040\(2\)](#), an action upon a contract or liability, express or implied, which is not in writing, and does not arise out of any written instrument” shall commence within three years.

[*656]

¶4 More than three years later, Tingey initiated a collection action against Haisch, alleging Haisch owed him in excess of \$20,000 for legal services rendered plus interest accrued.³ The trial court denied Haisch’s motion to dismiss the action as time-barred by the three-year oral contract limitation of [RCW 4.16.080\(3\)](#). The trial court granted partial summary judgment to Tingey, ruling that the applicable statute of limitation for the action was six years. After Tingey prevailed on the merits in a bench trial, Haisch appealed the summary judgment ruling only.

¶5 **[***4]** The Court of Appeals, Division Three, reversed. [Tingey v. Haisch](#), 129 Wn. App. 109, 117 P.3d 1189 (2005). After finding the term “account receivable” to be ambiguous, the Court of Appeals held that “‘account receivable’ in RCW 4.16.040(2) refers to an ‘open account,’ that is ‘[a]n account that is left open for ongoing debit and credit entries by two parties and that has a fluctuating balance until either party finds it convenient to settle and close.’” [Tingey](#), 129 Wn. App. at 117, P 18 (quoting BLACK’S LAW DICTIONARY 20 (8th ed. 2004) (defining “open account,” a subdefinition within the definition of “account”). Based on this definition, the Court of Appeals held that the six-year limitation for accounts receivable did not apply to Tingey’s claim for attorney fees. *Id.* We granted Tingey’s petition for review. [Tingey v. Haisch](#), 156 Wn.2d 1035, 134 P.3d 1171 (2006).

II. ISSUE

¶6 Does the RCW 4.16.040(2) six-year limitation for an “action upon an account receivable incurred in the ordinary course of business” provide the limitation in an action to collect a balance owed by a **[***5]** client to an attorney for legal services performed on behalf of the client on an hourly fee basis without a written fee agreement?

[*657] III. ANALYSIS

[WA\[1,2\]](#) [1, 2]¶7 The trial court ruled on summary judgment that the RCW 4.16.040(2) six-year account receivable limitation governed Tingey’s action to recover attorney fees. [HN3](#) This court reviews rulings on summary judgment de novo. [Berrocal v. Fernandez](#), 155 Wn.2d 585, 590, P 5, **[**1023]** 121 P.3d 82 (2005). To resolve this matter, we must ascertain the meaning of “account receivable” as used in RCW 4.16.040(2). [HN4](#) We also

³ United Collection Services, Inc., initially filed suit against Haisch on Tingey’s behalf. Following mandatory arbitration, which resulted in an award to Haisch, United requested a trial de novo and Tingey was substituted as real party in interest.

review issues of statutory interpretation de novo. [Berrocal](#), 155 Wn.2d at 590, P.5.

A. Plain language analysis supplies the meaning of “account receivable” as used in RCW 4.16.040(2)

[WA\[3\]](#) [3]¶8 [HN5](#) A court's objective in construing a statute is to determine the legislature's intent. [State v. Jacobs](#), 154 Wn.2d 596, 600, P.7, 115 P.3d 281 (2005). “[I]f the statute's meaning is plain on its face, then the court must give effect to that plain meaning as an expression of legislative intent.” *Id.* (alteration in original) (quoting [Dep't of Ecology v. Campbell & Gwinn, LLC](#), 146 Wn.2d 1, 9-10, 43 P.3d 4 (2002)). [\[***6\]](#) A statutory provision's plain meaning is to be discerned from the ordinary meaning of the language at issue, the context of the statute in which that provision is found, related provisions, and the statutory scheme as a whole. *Id.* A provision that remains susceptible to more than one reasonable interpretation after such an inquiry is ambiguous, and a court may then appropriately employ tools of statutory construction, including legislative history, to discern its meaning. [Campbell & Gwinn](#), 146 Wn.2d at 12.

¶9 Prior to 1989, an action upon an oral contract was subject to the former [RCW 4.16.080\(3\)](#) (1937) three-year statute of limitations.⁴ This limitation encompassed a claim for attorney fees where there was no written fee agreement. [\[*658\]](#) [Hart v. Day](#), 17 Wn. App. 407, 413, 563 P.2d 227 (1977). In 1989, the legislature amended RCW 4.16.040, the six-year statute of limitations, adding as a new category “action[s] upon an account receivable incurred in the ordinary course of business.”⁵ LAWS OF 1989, ch. 38, § 1. The legislature simultaneously amended [RCW 4.16.080\(3\)](#), creating [\[***7\]](#) an exception to the three-year limitation on oral contracts for actions upon accounts receivable.⁶ [\[***8\]](#) LAWS OF 1989, ch. 38, § 2. In making these

⁴Former [RCW 4.16.080\(3\)](#) provided that “[a]n action upon a contract or liability, express or implied, which is not in writing, and does not arise out of any written instrument” shall be commenced within three years.

⁵[HN6](#) [RCW 4.16.040](#) provides: The following actions shall be commenced within six years: (1) An action upon a contract in writing, or liability express or implied arising out of a written agreement. (2) An action upon an account receivable incurred in the ordinary course of business. (3) An action for the rents and profits or for the use and occupation of real estate.

⁶As revised, [HN7](#) [RCW 4.16.080\(3\)](#) provides that “[e]xcept as provided in [RCW 4.16.040\(2\)](#), an action upon a contract or liability, express or implied, which is not in writing, and does not arise out of any written instrument” shall be commenced within three years. (Emphasis added.)

changes, the legislature did not define “account receivable.”⁷

[WA\[4.5\]](#) [4, 5]¶10 [HN8](#) When a term has a well-accepted, ordinary meaning, a regular dictionary may be consulted to ascertain the term's definition. [City of Spokane ex rel. Wastewater Mgmt. Dep't v. Dep't of Revenue](#), 145 Wn.2d 445, 454, 38 P.3d 1010 (2002). When a technical term is used in its technical field, the term should be given its technical meaning by using a “technical rather than a general purpose dictionary” to resolve the term's definition. *Id.*

[WA\[6-8\]](#) [6-8]¶11 The legislature modified “account receivable” with “incurred in the ordinary course of business.” RCW 4.16.040(2). This statutory [\[***9\]](#) context suggests that the legislature intended to use the term in a technical business sense. Used as a term of art in the accounting and finance [\[*659\]](#) sectors, “accounts receivable” means “amounts due [a business] on account from customers who have bought merchandise or received services.” JOEL G. SEIGEL & JAE K. SHIM, *DICTIONARY OF ACCOUNTING TERMS* 11 (3d ed. 2000). Consistent with the legislature's usage, the *Dictionary* [\[**1024\]](#) of *Accounting Terms'* technical definition of “accounts receivable” is likewise restricted to a business setting.

¶12 The term “account receivable” appears elsewhere in the Revised Code of Washington more than 10 times and is nowhere defined.⁸ The legislature makes it apparent through this pattern of use that it considers the term “account receivable” to have a plain meaning. Obtaining the definition of “account receivable” from a technical business dictionary is consistent with plain meaning analysis. The technical definition for “account receivable,” as “an amount due a business on account from a customer who has bought merchandise or received services,” is the appropriate definition to read into RCW 4.16.040(2). The attorney fees owed [\[***10\]](#) to Tingey, for which he regularly invoiced Haisch, satisfy this meaning of “account receivable.”

¶13 The dissent states that under our definition “all oral contracts for goods and services in the ordinary course of business have a six-year statute of limitation.” Dissent at 669. The dissent suggests, therefore, that our definition renders the term account receivable superfluous, contrary to established

⁷The dissent announces its preference for statutory definitions, dissent at 667, and “appeal[s] to the legislature to ... clearly define ‘account receivable’ for [RCW 4.16.040\(2\)](#).” Dissent at 674. Greater statutory clarity is always preferable. However, this court's duty does not stop at merely requesting remedial legislative action. We must discern what the legislature intended by the statutory language that it did enact.

⁸See, e.g., [RCW 7.60.100](#); [RCW 13.40.060](#); [RCW 28A.320.080](#); [RCW 41.50.160](#); [Title 60 RCW](#); [RCW 70.105D.020](#); [Title 82 RCW](#).

principles of statutory interpretation. *Id.* However, our definition of “account receivable” is considerably more narrow than the dissent represents. Our definition identifies the parties to the contract (a customer and a business) and the character of the transaction (a purchase by the customer). It requires the business to have completed performance [***11] (customer has bought or received the merchandise or services). It specifies the monetary nature of the remaining obligation (an amount due). Only oral [*660] contracts exhibiting all of these characteristics garner the account receivable six-year limitation.⁹

¶14 Both the Court of Appeals and the dissent deem the term “account receivable” to be ambiguous. *Tingey*, 129 Wn. App. at 114-15, P 11; dissent at 668. The Court of Appeals based its determination in part on the fact that “account receivable” appears in a variety of contexts, from which it concluded that the term “has different meanings depending upon the context.”¹⁰ *Tingey*, 129 Wn. App. at 114, P 10. However, while “account receivable” is used in a wide variety of settings, close examination reveals that our definition encompasses the meaning of the term [***12] in those contexts.¹¹ Moreover, the use of “account receivable” in a broad range of business-related contexts supports the term having a well-accepted technical meaning.

¶15 [***13] The Court of Appeals also identified that “whether or not a particular debt constitutes an account receivable may be a factual question.” *Id.* at 114, P 10. While accurate, this observation is not relevant to a plain language analysis of

⁹These characteristics likewise would determine whether the hypothetical transactions of the dissent's imaginary dairy farmer would constitute accounts receivable. Dissent at 667.

¹⁰The dissent agrees. Dissent at 668.

¹¹For instance, examining illustrations advanced by the Court of Appeals, in the “sale and valuation of businesses,” *Tingey*, 129 Wn. App. at 114, P 10, “account receivable” referred to the outstanding fees owed to a law firm for professional services rendered. *In re Marriage of Nichols*, 27 Cal. App. 4th 661, 33 Cal.Rptr.2d 13, 17-18 (1994). In “priority disputes between secured parties,” *Tingey*, 129 Wn. App. at 114, P 10, “account receivable” is defined as “any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper.” *Rocky Mountain Ass'n of Credit Mgmt. v. Hessler Mfg. Co.*, 37 Colo. App. 551, 553 P.2d 840, 843 (1976) (quoting *Colo. Rev. Stat. § 4-9-106* (1973)). Where an “account receivable” is the “balance owed on ... an unsettled account,” *Tingey*, 129 Wn. App. at 114, P 10, “account” is “generally defined as an unsettled claim or demand, by one person against another, which creates a debtor-creditor relationship between them.” 1 AM. JUR. 2D *Accounts & Accounting* § 1, at 620-21 (2005). These usages are not inconsistent with an account receivable being an amount due a business on account from a customer who has bought merchandise or received services.

“account receivable.” The meaning of “account receivable” as used in RCW 4.16.040 is a question of law. It must be resolved before applying the definition to a particular set of facts to determine whether a specific debt constitutes an “account receivable.”

[*661] [**1025]

¶16 Having found “account receivable” to be ambiguous, the Court of Appeals and the dissent resort to legislative history, from which they determine the intended meaning of “account receivable” to be an “open account.” *Tingey*, 129 Wn. App. at 117, P 18; dissent at 669-71. Although we do not find “account receivable” to be ambiguous, we examine the legislative history of RCW 4.16.040(2)¹² to demonstrate that it is inconsistent with the legislature's intending the term “account receivable” to mean “open account.”

¶17 [***14] The dissent derives from the legislative history that “the bill was passed with the intent of limiting the definition of account receivable to open accounts.” Dissent at 671. This assertion is inconsistent with revision of the bill's language from “balance due upon a mutual, open, and current account, the items of which are in writing,” S.B. 5213, 51st Leg., Reg. Sess. (Wash. 1989), to “[a]n action upon an account receivable incurred in the ordinary course of business.” SUBSTITUTE S.B. 5213, 51st Leg., Reg. Sess. (Wash. 1989). We agree with the dissent that by replacing “the items of which are in writing” with “in the ordinary course of business,” “the legislature intended to expand the scope ... to instances where a business' ordinary practices may not include writing down the terms of the account.” Dissent at 671 (quoting S.B. 5213, *supra*; SUBSTITUTE S.B. 5213, *supra*). But we find implausible the dissent's contention that substituting “account receivable” for “mutual, open, and current account” “do[es] not suggest ... inten[t] to expand the six-year statute of limitations beyond open accounts.” Dissent at 671 (quoting S.B. 5213, *supra*). Retaining the [***15] open account language would be consistent with intending to limit the statute's scope to open accounts. Replacing that language with “account receivable” indicates intent to expand the scope of the statute beyond open accounts.

[*662]

¶18 The dissent, relying on a floor debate excerpt, additionally states, “Senator Bill Smitherman explained the term ‘account receivable’ meant just an open account, and the bill passed

¹²RCW 4.16.040(2) was amended in the 1989 legislative session. LAWS OF 1989, ch. 38, § 1. For consistency, we adopt the dissent's practice of referring to this legislation, introduced as Senate Bill 5213 and later revised, as “the bill.” See S.B. 5213, 51st Leg., Reg. Sess. (Wash. 1989); SUBSTITUTE S.B. 5213, 51st Leg., Reg. Sess. (Wash. 1989).

following his explanation.”¹³ Dissent at 670. However, the full context of the exchange reveals that after Senator Bill Smitherman provided his definition of account receivable, Senator Philip A. Talmadge proceeded to make further remarks. *See* dissent at 670 n.17; *see also* SENATE JOURNAL, 51st Leg., Reg. Sess., at 509 (Wash. 1989). Subsequently, “[f]urther debate ensued.” SENATE JOURNAL, *supra*, at 509. That the bill was not put directly to a vote following Senator Smitherman's definition undermines the dissent's implication that the senate responded to Senator Smitherman's definition by passing the bill. One senator's eight words during floor debate form a thin thread upon which to hang a legislative history analysis.

¶19 [***16] The bill's revision supports the conclusion that the legislature intended the bill to broaden the circumstances under which business debt was subject to a six-year statute of limitations. Senator Talmadge expounded on how the “account receivable” language would affect oral contracts to which businesses were a party, and the bill nevertheless passed the senate later that day.¹⁴ [***17],¹⁵ The [**1026] legislature's intent is further evidenced by the evolution of the Senate [*663] Bill Report language.¹⁶ The legislative history

¹³ Senator Smitherman: “I believe it's just an open account, Senator.” SENATE JOURNAL, 51st Leg., Reg. Sess., at 509 (Wash. 1989).

¹⁴ Senator Talmadge remarked, in part: “[T]he problem is, if I enter into an oral contract with you, that's something that's a three year statute of limitations now and a three year statute of limitations under this bill. If I enter into an oral contract with you and you go back to your business and you say, ‘Well, I think I will carry that on my books,’ and you treat it as an account receivable, then it's something that would carry with it a six year statute of limitations.” SENATE JOURNAL, *supra*, at 509.

¹⁵ The dissent suggests that, upon hearing Senator Smitherman's definition, Senator Talmadge “offered a more expansive definition similar to the definition the majority adopts [and t]hat expansive definition lost.” Dissent at 672. Close reading of Senator Talmadge's remarks reveals that, rather than proposing a definition, he was warning the senate that the problem with the bill was its broader definition of account receivable. Despite Senator Talmadge's warning, as the dissent notes, no changes were made and the bill was passed. *Id.*

¹⁶ The Senate Bill Report that initially accompanied the bill when it failed to pass the senate on March 2, 1989, SENATE JOURNAL, *supra*, at 488, stated “that the statute of limitations should be extended to six years *for all actions based on an open and current account, which is in writing.*” S.B. REP. on S.B. 5213, *supra* (emphasis added). Upon reconsideration the following day, the bill passed, SENATE JOURNAL, *supra*, at 509, accompanied by a revised Senate Bill Report that “suggested that the statute of limitations should be extended to six years *for all actions based on an account receivable.*” S.B. REP. on Substitute S.B. 5213, *supra* (emphasis added). The House Bill Report indicated that “[t]he statute of limitations is set at six years for an account receivable incurred in the

supports the legislature's intending “account receivable” to have a broader meaning than open account.

¶20 [***18] HN9 The plain meaning of “account receivable” in RCW 4.16.040(2) is an amount due a business on account from a customer who has bought merchandise or received services. Tingey seeks to collect a balance owed to his legal business by a client for legal services performed on behalf of that client. Tingey performed the services on an hourly fee basis at the request of the client, and the client was regularly invoiced for the amount owed in accordance with ordinary business practice. The term “account receivable” encompasses the balance which Tingey seeks to collect, an amount owed to him for legal services performed in the ordinary course of his business. The six-year limitation of RCW 4.16.040(2) for “[a]n action upon an account receivable incurred in the ordinary course of business” provides the statute of limitations in this action.

B. The plain meaning of “account receivable” is corroborated by the absence of an absurd result produced in RCW 4.16.040(2)

WA[9,10] [9, 10]¶21 The Court of Appeals supported its finding that “account receivable” was ambiguous with the assertion that defining the term broadly produced an [***19] absurd result. HN10 Where the legislature provides no statutory definition and a court gives a term its plain and ordinary meaning by reference to a dictionary, the court “will avoid literal reading [*664] of a statute which would result in unlikely, absurd, or strained consequences.” *Fraternal Order of Eagles, Tenino Aerie No. 564 v. Grand Aerie of Fraternal Order of Eagles*, 148 Wn.2d 224, 239, 59 P.3d 655 (2002). A reading that produces absurd results must be avoided because “it will not be presumed that the legislature intended absurd results.” *State v. J.P.*, 149 Wn.2d 444, 450, 69 P.3d 318 (2003) (quoting *State v. Delgado*, 148 Wn.2d 723, 733, 63 P.3d 792 (2003) (Madsen, J., dissenting)). The outcome of plain language analysis may be corroborated by validating the absence of an absurd result. Where an absurd result is produced, further inquiry may be appropriate.

¶22 The Court of Appeals concluded that interpreting “account receivable” “to encompass all business debt” produced absurd results. *Tingey*, 129 Wn. App. at 115, P 12. The court suggested that the “account receivable” exception to the RCW 4.16.080(3) [***20] three-year limitation on oral contracts would “swallow[] the remainder of the statute. Business owners would no longer need to enter into written contracts to benefit

ordinary course of business. This six-year period applies *whether or not the account receivable is based on a written contract.*” H.B. REP. on Substitute S.B. 5213, *supra* (emphasis added).

from a six-year statute of limitations because RCW 4.16.040(2) would essentially convert all of their business debt into accounts receivable.” *Id.*

¶23 As the Court of Appeals noted, the impact on actions to collect business debt is significant, but substantial effect is not equivalent to an absurd result. Incorporating the technical definition of “account receivable” does except from the three-year limitation any action brought by a business to collect an amount due on account from a customer who **[**1027]** has bought merchandise or received services in the ordinary course of business. The exception does not swallow the rule, however, because [HN11](#) oral contracts between two private parties are still governed by the three-year limitation of [RCW 4.16.080\(3\)](#). Moreover, it is clear that the legislature considered the impact of the “account receivable” provision on the oral contract limitation because it amended that provision of former [RCW 4.16.080\(3\)](#) when **[***21]** it amended RCW 4.16.040(2).

[*665]

¶24 By contrast, as noted by Tingey, a more narrow definition of “account receivable” would produce a truly absurd, unworkable result. The appropriate statute of limitation in a collection action for attorney fees cannot reasonably turn on a fact-specific inquiry into the accounting and billing practices of the attorney, the transactional characterization of the legal services provided, and the client's history of payments on the account. Such a definition would produce a significant volume of litigation as parties attempted to determine precisely what accounting practices were required to benefit from the six-year limitation. The ramifications would extend well beyond attorney-client fee collection actions to other professional service providers, as well as general businesses.

¶25 Defining “account receivable” as “an amount due a business on account from a customer who has bought merchandise or received services” does not produce an absurd result. A more limiting definition of “account receivable” would. The absurd result test corroborates the meaning of “account receivable” arrived at through plain meaning analysis.

IV. CONCLUSION

¶26 **[***22]** [HN12](#) We hold that the plain meaning of “account receivable” as used in RCW 4.16.040(2) is “an amount due a business on account from a customer who has bought merchandise or received services.” This meaning encompasses a balance owed by a client to an attorney for legal services performed on behalf of the client on an hourly fee basis without a written fee agreement. RCW 4.16.040(2)'s six-year limitation for an action upon an account receivable incurred in the ordinary course of business applies to Tingey's action to collect attorney fees from Haisch. We reverse the Court of Appeals and

reinstate the trial court's **[*666]** ruling on summary judgment that the six-year limitation applies.

ALEXANDER, C.J., and SANDERS, BRIDGE, OWENS, and J.M. JOHNSON, JJ., concur.

MADSEN, J., concurs in the result.

Dissent by: Tom Chambers

Dissent

¶27 Chambers, J. (dissenting) — One fine spring day, a dairy farmer sold 200 gallons of milk to a customer, spent two hours repairing a neighbor's tractor at an agreed upon hourly rate, and loaned **[***23]** a utility trailer to another neighbor with the understanding that the trailer would be returned the next year when, in lieu of rent, the neighbor would install new wheels and tires on the trailer. Our farmer occasionally has similar transactions with both neighbors. That fine spring day, our industrious farmer also sold an old riding lawn mower, which he used mostly to mow the lawn around the farm house but occasionally to trim the grass and weeds from his fields. The used riding lawn mower was sold to an acquaintance across the valley for some money up front and the buyer's promise to mow the farmer's lawn and trim grass and weeds from some farm areas all summer. All of the farmer's transactions were oral, but he considered each an account receivable. The question we must answer is, if the farmer sought to judicially enforce any of these oral agreements, which statute of limitations applies?

¶28 Historically, those who rely on such oral contracts instead of written ones have had less time to seek judicial enforcement. The reason is obvious. Courts have more confidence in their ability to find the intent of the parties if that intent has been written down. Further, misunderstandings between **[***24]** parties concerning specific terms are greatly reduced if the specific terms are in writing. Memories often do not withstand the force of time, while written terms are precisely preserved **[**1028]** indefinitely. In recognition of these principles, our legislature provided six years to enforce written contracts, RCW 4.16.040(1), but only three years for other contracts, [RCW 4.16.080\(3\)](#).

[*667] THE AMBIGUOUS MEANING OF ACCOUNT RECEIVABLE

¶29 “Account receivable” is not defined in chapter 4.16 RCW or any other statute. Petitioner David Tingey argues that the word “receivable” is clear and means “a thing that can be received.” Pet. for Review at 5. Further, he argues that “account” is

defined as a “right to payment of a monetary obligation, whether or not earned by performance ... for service rendered or to be rendered.” Pet. for Review at 5 n.1 (quoting [RCW 62A.9A-102\(a\)\(2\)\(A\)\(ii\)](#)). Thus, Tingey concludes that “account receivable” means “any right to payment for ... services rendered which is not evidenced by an instrument or chattel paper ... ’ that can be received.” Pet. for Review at 6 [***25]. The majority has adopted Tingey's definition with the addition that the transaction must be in connection with a business. Majority at .660

¶30 According to the majority, “[t]he plain meaning of ‘account receivable’ in RCW 4.16.040(2) is an amount due a business on account from a customer who has bought merchandise or received services.” Majority at 663. I believe that under the majority's holding, likely all of our dairy farmer's spring day transactions, including the sale of the milk and the lawn mower, the tractor repair, and the leased utility trailer resulted in accounts receivable and are subject to a six-year statute of limitations. Their status is, at least, very debatable. This court can, over the next several decades and at the cost of numerous appellate cases, define “account receivable” in the ordinary course of business by case law or, much more preferably in my view, the legislature could define “account receivable” or “account receivable in the ordinary course of business” for us.

¶31 *Webster's Third New International Dictionary* defines an “account receivable” as “a balance due from a debtor on a current account.” WEBSTER'S THIRD NEW INTERNATIONAL [***26] DICTIONARY 13 (2002). A “current account” is defined as “an account between two parties having a series of transactions not covered by evidences of indebtedness (as notes or [*668] certificates) and usu. subject to settlements at stated intervals (as monthly or quarterly).” *Id.* at 557 (emphasis added).

¶32 This definition is inconsistent with the definition derived from the accounting dictionary. At the very least, the difference suggests the term is ambiguous. “Account receivable” means different things based on the context. The Court of Appeals explored some of the different uses:

[T]he term “account receivable” as it appears in legal proceedings, or as it is defined in dictionaries, has different meanings depending upon the context. In litigation, the term is used in the context of: (1) the sale and valuation of businesses, (2) adversary proceedings during bankruptcy proceedings, and (3) priority disputes between secured parties. In a legal dictionary, any balance owed by a debtor is considered an “account receivable.” Other times, an account receivable is the balance owed on (1) an unsettled account or (2) an open account. Finally, whether or not a particular debt constitutes [***27] an account receivable

may be a factual question.

[Tingey v. Haisch](#), 129 Wn. App. 109, 114, 117 P.3d 1189 (2005) (footnotes and citations omitted). The meaning of the term “account receivable,” let alone the phrase “account receivable in the ordinary course of business,” is not apparent from its face. A statute is unambiguous only “when the statutory language admits of only one meaning.” [State v. J.P.](#), 149 Wn.2d 444, 450, 69 P.3d 318 (2003). The variety of distinct definitions of “account receivable” demonstrates that the statutory language is susceptible to more than one interpretation. Faced with different reasonable definitions, we must examine the legislative history to determine which reasonable definition the legislature intended. [Dep't of Ecology v. Campbell & Gwinn, LLC](#), 146 Wn.2d 1, 12, 43 P.3d 4 (2002); see also majority at 657. The result of such an inquiry supports interpreting the statute [***1029] as referring to open accounts. This interpretation, in addition to reflecting the legislature's intent, is in accord with the principles supporting shorter statutory periods limiting claims based on oral rather than written [***28] contracts.

[*669]

¶33 If the legislature meant that all business contracts for goods and services should have a six-year statute of limitation, it would surely have said so. It did not. Instead, it added limiting language the majority would define to make meaningless. The legislature intended that an account receivable, not just any business contract, should be entitled to the same statute of limitations as written contracts.

¶34 Our goal is to determine the legislature's intent, and we will avoid absurd results. [J.P.](#), 149 Wn.2d at 450 (citing [Nat'l Elec. Contractors Ass'n v. Riveland](#), 138 Wn.2d 9, 19, 978 P.2d 481 (1999)). I admire the majority's ability to see clearly through cloudy water, but sometimes the water itself distorts the object of scrutiny. The most basic problem with the majority's definition is that it is so broad that the exception swallows the general rule. It means that all oral contracts for goods and services in the ordinary course of business have a six-year statute of limitation. Again, the legislature could have but did not say that all oral contracts for goods and services would enjoy a long statute of limitations usually reserved for written [***29] agreements. The result of the majority's interpretation is that the term “account receivable” has no meaning, and an interpretation making a statute's term superfluous must be rejected. We have held, time and again, that “[s]tatutes must be interpreted and construed so that all the language used is given effect, with no portion rendered meaningless or superfluous.” [Whatcom County v. City of Bellingham](#), 128 Wn.2d 537, 546, 909 P.2d 1303 (1996) (citing [Stone v. Chelan County Sheriff's Dep't](#), 110 Wn.2d 806, 810, 756 P.2d 736 (1988); [Tommy P. v. Bd. of County Comm'rs](#), 97 Wn.2d 385, 391, 645 P.2d

[697 \(1982\)](#).

LEGISLATIVE HISTORY

¶35 Confusion over the meaning of “account receivable” in the ordinary course of business was apparent during the debate over its passage in the senate. Even so, the legislature failed to define “account receivable” in the statute. [*670] However, the discussions held by the senate before it passed the bill that became RCW 4.16.040(2), SUBSTITUTE S.B. 5213, 51st Leg., Reg. Sess. (Wash. 1989), reveal that the legislature did not intend the definition we adopt today. Before the bill passed, then-Senator [***30] Philip A. Talmadge expressed his concerns that an “account receivable” is difficult to define, stating that the senate could simplify the bill to include all contracts, including oral ones. He said:

“The problem is, I think, that there is that difficulty in determining what is or is not an account receivable incurred in the ordinary course of business and an oral contract. It seems to me if we are going to reconsider this we may want to do it right and simply provide for a six year statute of limitations for all contracts.”

SENATE JOURNAL, 51st Leg., Reg. Sess., at 509 (Wash. 1989). [***31]¹⁷ The legislature declined and passed the bill “as is” despite Senator [*1030] Talmadge's concerns.¹⁸ Senator

¹⁷The full context of that exchange:

Senator Talmadge: “Senator Smitherman, the problem with this bill is what the definition of an account receivable is when incurred in the ordinary course of business. Would you define what an account receivable incurred in the ordinary course of business might be and maybe the difference between that and somebody just entering into an oral contract?”

Senator Smitherman: “I believe it's just an open account, Senator.”

Senator Talmadge: “Well, the problem is, if I enter into an oral contract with you, that's something that's a three year statute of limitations now and a three year statute of limitations under this bill. If I enter into an oral contract with you and you go back to your business and you say, ‘Well, I think I will carry that on my books,’ and you treat it as an account receivable, then it's something that would carry with it a six year statute of limitations. The problem is, I think, that there is that difficulty in determining what is or is not an account receivable incurred in the ordinary course of business and an oral contract. It seems to me if we are going to reconsider this we may want to do it right and simply provide for a six year statute of limitations for all contracts.”

SENATE JOURNAL, 51st Leg., Reg. Sess., at 509 (Wash. 1989)

¹⁸Senator Lee: “Senator Smitherman, is your reason for asking for

Smitherman explained the term “account receivable” meant just an open account, and the bill passed following his explanation and over [*671] Senator Talmadge's dissenting vote. The legislative history suggests that the bill was passed with the intent of limiting the definition of “account receivable” to open accounts. An “open account” is, “[a]n account that is left open for ongoing debit and credit entries by two parties and that has a fluctuating balance until either party finds it convenient to settle and close.”¹⁹ BLACK'S LAW DICTIONARY 20 (8th ed. 2004).

¶36 Tingey and the majority contend that the legislative history tells a different story, pointing out that the bill was amended before it passed. The original version, which did not pass, read: “A balance due upon a mutual, open, and current account, the items of which are in writing.” S.B. 5213, 51st Leg., Reg. Sess. (Wash. 1989). Although the legislature's rejection of this language is noteworthy, the subsequent comments by Senator Smitherman suggest “account receivable” was intended to encapsulate the “open account” language used in the first [***33] version. Apparently “receivable” modified “account” in the same way “open” did, making the phrase “open account receivable” redundant. The significant change was not the deletion of the “open account” language, it was the deletion of “the items of which are in writing,” and the addition of “in the ordinary course of business.” This suggests the legislature intended to expand the scope of the six-year statute of limitations to instances where a business' ordinary practices may not include writing down the terms of the account. It appears the legislature wanted to include in the six-year statute of limitations open accounts that were established without a written agreement. In such cases, bills are sent and paid without a formal contract. The changes suggest the legislature did not want to exclude such open accounts. They do not suggest the legislature intended to expand the six-year statute of limitations beyond open accounts.

¶37 The majority describes this reading of the legislative history as “implausible.” Majority at 661. In a vacuum, the [*672] majority may have a point. But we examine the legislative history in its full context and must reconcile the senate's decision to change the language of the bill with [***34] the

reconsideration so that it can be returned to second reading for purposes of an amendment or just simply to pass it as is?”

Senator Smitherman: “To pass it as is, Senator.”

Id.

¹⁹An “open account” is also defined as occurring “where the parties intend that the individual transactions in the account be considered as a connected series, rather than as independent of each other.” 1 AM. JUR. 2d *Accounts & Accounting* § 4, at 624 (2005).

definition of the term given before its passage. Senator Smitherman was of the view that an “account receivable” meant an open account; the change in language could not have been intended to expand the term “accounts receivable” beyond the definition the legislative history provides.

¶38 The majority argues that attention should be paid to the fact that “[f]urther debate ensued” following Senator Smitherman's definition. Majority at 662 (alteration in original) (quoting SENATE JOURNAL, 51st Leg., Reg. Sess., at 509 (Wash. 1989)). The majority argues that the fact the bill was not put “directly to a vote” following Senator Smitherman's definition of the term “undermines” my view that the “senate responded to Senator Smitherman's definition by passing the bill.” *Id.* at . It is correct that debate ensued, but what was its result? The senate was divided with respect to this bill. Senator Talmadge heard Smitherman's definition and offered a more expansive definition similar to the definition the majority adopts today. That expansive definition lost. No changes were made, and Senator Talmadge did not vote for the bill. Yes, there was debate. And there was an alternative position articulated by Senator Talmadge. But Smitherman's position won the day. We have in the legislative history [***35] an articulation of a definition of “account receivable.” The majority has chosen to ignore the legislative history and instead adopt a technical definition from an accounting dictionary.

CONCLUSION

¶39 I have observed that when I receive goods and services based upon verbal agreements [**1031] from businesses, the businesses often provide me with an invoice and regular statements showing the status of my account. I know that such an account is an account payable for me and an [*673] “account receivable” for the business. Such accounts, which benefit from regular written statements, have many of the merits of a written contract. Although there is no written agreement, the balance owing and many of the terms are memorialized in writing and, generally, may be enforced with confidence by a court of law. I am of the view and agree with the Court of Appeals that such “open” accounts are what the legislature had in mind when amending [RCW 4.16.080](#).

¶40 Despite the legislative history which indicates the legislature, wisely I believe, intended that “account receivable” under this bill would be limited to open accounts, we are urged to ignore this history because the term is plain on its face. [***36] The term, however, is anything but plain. It means different things in different contexts.

¶41 Finally, I am concerned by the lack of balance of briefing in

this case.²⁰ This case is brought by a lawyer against a client who is either unable or unwilling to pay. There was no written fee agreement between the parties. For more than three years the lawyer did not bill, nor did the client pay on the account. The lawyer subsequently turned the account over to a collection agency.

¶42 Given the posture of this case, the Court of Appeals attempted to avoid an absurd [***37] result of permitting the exception to swallow the general rule, concluding that “account receivable” meant “open account,” which is “[a]n account that is left open for ongoing debit and credit entries by two parties and that has a fluctuating balance until either party finds it convenient to settle and close.” [Tingey, 129 Wn. App. at 111](#) (quoting BLACK'S LAW DICTIONARY 20 (8th ed. 2004)). The Court of Appeals believed that the legislature intended to limit “account receivable” to revolving charge accounts. *Id.* at 116. The Court of Appeals made an [*674] admirable attempt at divining the intent of the legislature. I am not persuaded that the majority has the correct crystal ball. I appeal to the legislature to clear the waters and clearly define “account receivable” for RCW 4.16.040(2).

¶43 But I would further affirm because this is an egregious case. A lawyer failed to enter into a written fee agreement with a client, did not send statements for over three years, and then assigned his claim to another. Such claims have always been barred by the three-year statute of limitations, and I cannot believe the legislature intended this [***38] case to proceed. I respectfully dissent.

C. JOHNSON, J., concurs with CHAMBERS, J.

References

Annotated Revised Code of Washington by LexisNexis

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²⁰The respondents, Lloyd and Lucy Haisch, did not file briefs before this court. Tingey was supported by an amicus curiae brief and memorandum submitted by the trade organization ACA International, and association of credit and collection professionals. Tingey filed a petition for review, a supplemental brief, and a response to the amicus curiae brief of ACA International. In short, we were presented five briefs in favor of Tingey and none in favor of the Haischs.

EXHIBIT 21



AAA Northeast v. Port Auth. of N.Y. & N.J.

United States District Court for the Southern District of New York

November 18, 2016, Decided; November 18, 2016, Filed

11 Civ. 6746 (RKE) (HBP)

Reporter

221 F. Supp. 3d 374 *; 2016 U.S. Dist. LEXIS 160389 **; 2016 WL 6834013

AAA NORTHEAST and AAA NORTH JERSEY, INC.,
Plaintiffs, -against- THE PORT AUTHORITY OF NEW
YORK AND NEW JERSEY, Defendant.

Prior History: [Auto. Club of N.Y., Inc. v. Port Auth., 2011 U.S. Dist. LEXIS 135391 \(S.D.N.Y., Nov. 22, 2011\)](#)

Counsel: **[**1]** For Automobile Club of New York, Inc.,
doing business as AAA New York, Aaa North Jersey, Inc.,
Plaintiffs: Kevin P. Mulry, Farrell Fritz, P.C. (LIs), Uniondale,
NY USA; Michael Francis Fitzgerald, Farrell Fritz, PC, New
York, NY USA.

For Chairman David Samson, Commissioner Jeffrey H.
Lynford, Movants: Randy M. Mastro, LEAD ATTORNEY,
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For The Port Authority of New York And New Jersey,
Defendant: Kathleen Gill Miller, LEAD ATTORNEY, Arnold
Dennis Kolikoff, The Port Authority of New York and New
Jersey, New York, NY USA; Richard W. Mark, LEAD
ATTORNEY, Gibson, Dunn & Crutcher, LLP (NY), New
York, NY USA; Carlene V. McIntyre, David Robert Kromm,
Port Authority of New York and New Jersey, New York, NY
USA; Nancy Elizabeth Hart, Gibson, Dunn & Crutcher, LLP,
New York, NY USA.

Judges: Richard K. Eaton, Judge*.

Opinion by: Richard K. Eaton

Opinion

[*375] Before the court is the motion for summary judgment of defendant the Port Authority of New York and New Jersey ("defendant" or "the Port Authority"). *See* Def.'s Mem. of Law in Supp. of its Mot. for Summ. J. (ECF Dkt. No. 133)

("Def.'s **[**2]** Br."). Plaintiffs AAA Northeast and AAA North Jersey, Inc. ("plaintiffs" or "AAA") oppose the motion. *See* Pls.' Mem. of Law in Opp'n to Def.'s Mot. for Summ. J. (ECF Dkt. No. 153) ("Pls.' Br."). By its motion, defendant seeks to dispose of AAA's claims that certain toll and fare increases imposed by the Port Authority violate: (1) the [Commerce Clause of the United States Constitution](#), [U.S. Const. art. I, § 8, cl. 3](#), and (2) the [Surface Transportation and Uniform Relocation Assistance Act of 1987 \(the "Highway Act"\)](#), [33 U.S.C. § 508 \(2006\)](#).

[*376] For the following reasons, defendant's motion is GRANTED.

BACKGROUND

I. FACTS¹

AAA is a not-for-profit corporation that claims to represent the interests of nearly two million member-drivers. Def.'s Rule 56.1 Statement in Supp. **[**3]** of its Mot. for Summ. J. ¶¶ 1-2 (ECF Dkt. No. 134) ("Def.'s 56.1"); Compl. ¶ 5 (ECF Dkt. No. 1). The Port Authority is a bi-state governmental agency created by an interstate compact between the States of New York and New Jersey, which was approved by the U.S. Congress in 1921. Def.'s 56.1 ¶ 3; *see* N.Y. Unconsol. Law §§ 6401, 6404 (McKinney 2011); [N.J. Stat. Ann. §§ 32:1-1, 32:1-4](#) (West 2011).

The Port Authority operates facilities in and around New York City, including: four interstate bridges (the Outerbridge Crossing, Bayonne, George Washington, and Goethals Bridges);

¹The court has taken the facts from the parties' Rule 56.1 statements. *See* Def.'s Rule 56.1 Statement in Supp. of its Mot. for Summ. J. (ECF Dkt. No. 134) ("Def.'s 56.1"); Pls.' Statement Pursuant to Rule 56.1 (ECF Dkt. No. 154) ("Pls.' 56.1"). Where only one party's Rule 56.1 statement is cited, the opposing party does not dispute that fact or has offered no admissible evidence to controvert it, and it is otherwise supported by evidence on the record. Where no Rule 56.1 statement deals directly with a fact, a citation to an uncontroverted portion of the record is provided.

*Judge Richard K. Eaton, of the United States Court of International Trade, sitting by designation.

two interstate tunnels (the Holland and Lincoln Tunnels); the interstate Port Authority Trans-Hudson ("PATH") Rail System; three bus terminals (the Port Authority Bus Terminal, George Washington Bridge Bus Station, and Journal Square Transportation Center); two truck terminals; seven marine terminals; four airports; two heliports; and the sixteen-acre World Trade Center site. Def.'s 56.1 ¶¶ 12-13. These facilities are organized into five "line departments" within the Authority: (1) Tunnels, Bridges & Terminals consisting of the four interstate bridges, the two tunnels, and the three bus terminals; (2) the PATH Rail System; (3) Aviation; (4) Port Commerce; and ****4** (5) Real Estate & Development (including the World Trade Center site). *See* Def.'s 56.1 ¶¶ 13, 17. The Port Authority also operates a facility on Staten Island called the Teleport, the Newark Legal & Communication Center, a ferries program, and has some activity at the waterfronts of Hoboken and Queens. Def.'s 56.1 ¶ 14.

The Tunnels, Bridges & Terminals Line Department, the PATH Rail System Line Department, and the ferries program collectively comprise what has been termed the "Interstate Transportation Network" ("ITN"). *See* Def.'s 56.1 ¶ 23. While the concept of the ITN is rooted in the state laws implementing the compact that created the Port Authority, the term was first used in Judge Pollack's opinion in *Automobile Club of New York, Inc. v. Port Authority of New York & New Jersey* (AAA 1989 I), 706 F. Supp. 264 (S.D.N.Y. 1989), which was affirmed by Chief Judge Oakes' opinion in *Automobile Club of New York, Inc. v. Port Authority of New York & New Jersey* (AAA 1989 II), 887 F.2d 417 (2d Cir. 1989). In that case, AAA argued the "PATH [Rail] operations should not form a part of the Port Authority rate base in the absence of statutory authorization therefor." AAA 1989 I, 706 F. Supp. at 266. In his findings of facts and conclusions of law, Judge Pollack wrote:

At the present time, ****5** pursuant to its Compact powers, and subsequent amendments and supplements thereto, the Port Authority owns and/or operates various facilities within the boundaries of the Port of New York District including the following facilities *comprising its* **[*377]** *Interstate Transportation Network*: four interstate bridges, the George Washington Bridge (including the George Washington Bridge Bus Station), the Bayonne Bridge, the Goethals Bridge and the Outerbridge Crossing; two interstate tunnels, the Lincoln Tunnel and the Holland Tunnel; one bus terminal, located at 40th Street and 8th Avenue in Manhattan; the [PATH Rail System]; and the Port Authority Bus Programs.

Id. at 278 ¶ 7 (emphasis added). On appeal, Chief Judge Oakes agreed: "Judge Milton Pollack found that the Port Authority's bridges, tunnels, bus terminal, bus programs and PATH [Rail

System] form an 'integrated, interdependent transportation system.' Accordingly, [Judge Pollack] decided, it is proper to include [the] PATH [Rail System] in the rate base, from which it follows that the tolls are just and reasonable. We agree and affirm the decision below." [AAA 1989 II, 887 F.2d at 418](#) (citations omitted) (quoting AAA 1989 I, 706 F. Supp. at 276-77, 280). Although the concept ****6** of the ITN is a fixture in case law and the Port Authority may take it into account in its capital plan, it does not otherwise account for it separately on its books and records. *See* Def.'s 56.1 ¶¶ 10-11, 16.

The Port Authority has statutory authority to collect tolls on its bridges and tunnels. Def.'s 56.1 ¶ 9; *see* N.Y. Unconsol. Law § 6501; [N.J. Stat. Ann. §§ 32:1-118](#). On August 19, 2011, after public hearings and review by the governors of New York and New Jersey, the Port Authority's Board of Commissioners met and approved a toll and fare increase schedule for the ITN's bridges and tunnels, as well as phased fare increases for the PATH Rail System. Def.'s 56.1 ¶¶ 59-69. The proposed five-year schedule specified:

Tolls on EZPass will increase \$1.50 in September 2011 and then 75 cents in December of each year from 2012-2015; Tolls on cars paying with cash will have the same increase but will be subject to an additional \$2 penalty (rounded up to the nearest whole dollar); Tolls on trucks using EZPass will pay an additional \$2 per axle in September 2011, and then an additional \$2 per axle in December of each year from 2012-2015; Tolls on trucks paying cash will have the same increase but will be subject to an additional ****7** \$3 per axle cash penalty; and Fares on the PATH train will increase 25 cents a year for four years.

Def.'s 56.1 ¶ 66. Thereafter, "[o]n September 18, 2011, the Port Authority implemented the first step of the approved increases in ITN tolls. The ITN tolls have increased annually in 2012, 2013, and 2014," with the final increase in 2015. Def.'s 56.1 ¶ 70.

II. PROCEEDINGS

On September 27, 2011, AAA filed this action, seeking a preliminary injunction to reverse the toll and fare increases and a declaratory judgment that the toll and fare increases violate the Dormant [Commerce Clause](#) and the Highway Act. *See* Compl. ¶ 1. AAA alleged that, since the revenue from the toll and fare increases was "earmarked to fund cost overruns in the Port Authority's speculative real estate development at the World Trade Center," the increases were illegal because they were "not functionally related to the Port Authority's integrated, interdependent transportation network." Compl. ¶¶ 2, 42 ("The revenues resulting from the 2011 toll increase are to be used by

the Port Authority to unlawfully provide funding for the reconstruction of the World Trade Center which is totally unrelated to the Port Authority's integrated, interdependent [**8] transportation network.").

[*378] AAA further alleged that the increases were "unreasonable" under the Dormant [Commerce Clause](#) because the "inclusion of the World Trade Center . . . improperly distorts [the Port Authority's] rate of return, creating the illusion that a toll increase is justified when in fact the Port Authority's integrated, interdependent transportation system is providing a significant surplus." Compl. ¶ 43-44. Thus, the Complaint contains the single claim that the toll and fare increases were unlawful because a portion of the proceeds would be diverted for reconstruction of the World Trade Center site which, would cause an apparent, but sham, deficit for the ITN.

This claim stemmed from a press release distributed by the Port Authority in August 2011. See Compl. ¶ 34 ("The Port Authority has revealed in a public statement that \$11 billion of the toll increase will be used to rebuild the World Trade Center and fund significant cost overruns which the Port Authority has encountered because of delays in construction."); Decl. of Kevin P. Mulry in Opp'n to Mot. for Summ. J. Ex. D, at 1 (Aug. 21, 2015) (ECF Dkt. No. 151-4) ("Mulry Decl.") (Press Release, Port Auth. of N.Y. & N.J., Faced with [**9] Constrained Capacity due to Historic Economic Recession, Coupled with Billions in WTC and Post 9-11 Security Costs, and Unprecedented Need for Infrastructure Overhaul, Port Authority Proposes Toll and Fare Increase (Aug. 05, 2011)) ("Faced with three unprecedented challenges at once—(1) a historic economic recession that has sharply decreased revenue below projections, (2) steep increases in post-9/11 security costs, which have nearly tripled, and the overall cost of the [World Trade Center] rebuilding, and (3) the need for the largest overhaul of facilities in the agency's 90-year history—the Port Authority of New York and New Jersey today proposed a two-phase toll and fare increase to fully fund a new \$33 billion ten-year capital plan, which will generate 167,000 jobs."); see also *id.* ("The factors leading to the agency's financial position include . . . [m]ore than \$11 billion in funding necessary to rebuild the [World Trade Center] site.").

On November 4, 2011, the Port Authority moved to dismiss the action for failure to state a claim under the [Commerce Clause](#) or the Highway Act. On February 6, 2012, the court denied AAA's motion for a preliminary injunction and converted the Port Authority's motion [**10] to dismiss into a motion for summary judgment, but reserved ruling on the motion pending

discovery.² See [Auto. Club of N.Y., Inc. v. Port Auth. of N.Y. & N.J. \("AAA I"\)](#), 842 F. Supp. 2d 672, 681 (S.D.N.Y. 2012).³ In doing so, the court found AAA had not demonstrated irreparable injury or likelihood of success on the merits, as required for a preliminary injunction. See *id.* at 676-78, 680. The court noted, however, that "AAA's claim that the Port Authority's toll increases are earmarked for expenditures which do not reflect a 'fair approximation of use' or are 'excessive' in relation to the benefit conferred may be [**379] bolstered through discovery of financial documents or correspondence not yet provided for public review." *Id.* at 681. The case was then referred to Magistrate Judge Pitman to supervise discovery in connection with the Port Authority's motion for summary judgment. See [Auto. Club of N.Y., Inc. v. Port Auth. of N.Y. & N.J., No. 11 Civ. 6746, 2012 U.S. Dist. LEXIS 145417, 2012 WL 4791804, at *2 \(S.D.N.Y. Oct. 9, 2012\)](#).

Throughout discovery, Judge Pitman issued a number of opinions and orders resolving the parties' discovery disputes. For example, on May 7, 2012, after a conference with the parties, he issued an order stating: "In the absence of a further order of the Court, the scope of discovery is limited to [ITN] revenues and expenses for the years 2007 forward," thereby limiting the time period for which discovery with respect to financial matters could be sought. Ct. Order of May 7, 2012 (ECF Dkt. No. 41); see also [Auto. Club of N.Y., No. 11 Civ. 6746, 2012 U.S. Dist. LEXIS 145417, 2012 WL 4791804, at *2](#) ("I think right now the relevant inquiry is income from the tolls, 2007 forward, and the actual expenses of the ITN and the projected expenses of the ITN. If the toll revenue is equal to or less than the ITN expenses and by ITN expenses I'm referring to all the categories of expenses that [the Port Authority] described—capital, operating, debt service—it really doesn't matter how the World Trade Center site development is being funded. If, on the other hand, the [**12] tolls exceed the ITN expenses, then maybe we have a different situation." (quoting Tr. of Proceedings at 49 (May 4, 2012) (ECF Dkt. No. 58-3))).

²In a prior opinion, the court also granted the motion for leave to file an amicus curiae brief in support of AAA's motion for a preliminary injunction of then-Representative Michael G. Grimm, 13th Congressional District of New York, and then-Assemblywoman Nicole Malliotakis, New York State 60th Assembly District. See [Auto. Club of N.Y., Inc. v. Port Auth. of N.Y. & N.J., No. 11 Civ. 6746, 2011 U.S. Dist. LEXIS 135391, 2011 WL 5865296 \(S.D.N.Y. Nov. 22, 2011\)](#).

³Following Judge Holwell's opinion denying AAA's motion for [**11] a preliminary injunction and converting the Port Authority's motion to dismiss into a motion for summary judgment, the case was reassigned to the undersigned, while discovery matters were referred to Magistrate Judge Pitman.

On July 3, 2012, AAA moved to expand the scope of discovery "to include the accounting of ITN revenues within the Port Authority's Consolidated Bond Reserve Fund and General Reserve Fund." [Auto. Club of N.Y., No. 11 Civ. 6746, 2012 U.S. Dist. LEXIS 145417, 2012 WL 4791804, at *3](#). Plaintiffs also asked that discovery be expanded so that it could "ask questions of Port Authority witnesses with respect to areas of inquiry that could lead to further discovery." *Id.* The Port Authority opposed the motion, arguing that "since the [AAA's] underlying claims are based on objective analyses, discovery 'relating to the subjective intent of Port Authority decision makers' should be prohibited" because "such discovery would have the effect of infringing upon the Port Authority's deliberative process." [2012 U.S. Dist. LEXIS 145417, \[WL\] at *4](#).

On October 8, 2012, Judge Pitman found that, although AAA's request was titled a "Motion to Compel Discovery," it made "little attempt to identify specific, allegedly problematic discovery responses by defendant, instead focusing on broader discovery issues." [2012 U.S. Dist. LEXIS 145417, \[WL\] at *5-6](#) ("Rather than identifying specific deficient responses by defendant, plaintiffs' motion **[**13]** is comprised mainly of broad, conceptual arguments relating to the current scope of discovery, many of which were raised and addressed at the conference on May 4."). Judge Pitman denied the motion, concluding AAA "failed to provide a sufficient factual or legal basis for modifying [the Court's] May 7 Order." [2012 U.S. Dist. LEXIS 145417, \[WL\] at *6](#). Judge Pitman took care to clarify, however, that his May 7 discovery order "was issued in connection with a discussion of the scope of discoverable financial information, and must be read in that context. It was not intended to preclude discovery concerning the reasons for the toll increases." [2012 U.S. Dist. LEXIS 145417, \[WL\] at *7](#) (emphases added). Therefore, Judge Pitman concluded, "subject to the deliberative process privilege and any other objections defendant might raise, the May 7 Order does not preclude discovery concerning the reasons for the toll increases." *Id.*

Subsequently, by letter dated February 27, 2013, AAA claimed the privilege log submitted by the Port Authority pursuant to Federal Rule of Civil Procedure 26 and **[*380]** Local Civil Rule 26.2(c) was deficient, and sought an order requiring the Port Authority to amend the log and provide more information about the withheld documents. See [Auto. Club of N.Y., Inc. v. Port Auth. of N.Y. & N.J., No. 11 Civ. 6746, 297 F.R.D. 55, 56-57 \(S.D.N.Y. May 8, 2013\)](#). Specifically, the Port Authority's privilege log identified categories of **[**14]** withheld documents, rather than identifying each individual document that was withheld. While AAA did not object to the Port Authority's use of a categorical privilege log, it argued that eight of the categories did not contain the substantive information required by Rule 26. Judge Pitman agreed and ordered the Port

Authority to supplement its privilege log "by providing the number of individuals that comprise the 'Authors' and 'Recipients' of each of the eight challenged categories," as well as "the number of documents encompassed within each of the eight challenged categories," and by specifically identifying, by name and title, certain individuals within each category. [Id. at 63-64](#). The Port Authority subsequently submitted a revised privilege log providing this information.

On August 6, 2013, AAA moved to compel the production of 339 documents withheld by the Port Authority pursuant to the deliberative process privilege, and asked Judge Pitman to review the documents in camera "[i]f there is any question as to the applicability of the privilege or the balancing of factors." Pls.' Mem. of Law in Supp. of Mot. to Compel Produc. of Docs. Withheld Pursuant to the Deliberative Process Privilege 3 (ECF Dkt. **[**15]** No. 93) ("Mot. to Compel Mem."); see [Auto. Club of N.Y., Inc. v. Port Auth. of N.Y. & N.J., No. 11 Civ. 6746, 2014 U.S. Dist. LEXIS 77040, 2014 WL 2518959 \(S.D.N.Y. June 4, 2014\)](#). In his opinion of June 4, 2014, Judge Pitman denied AAA's motion to compel in its entirety. See [Auto. Club of N.Y., No. 11 Civ. 6746, 2014 U.S. Dist. LEXIS 77040, 2014 WL 2518959 at *11](#). While acknowledging that "[t]he deliberative process privilege does not provide a blanket basis upon which to withhold documents that an agency has created during its decision-making process," he found that "AAA's claims under the dormant [Commerce Clause](#) and the Highway Act do not turn on the Port Authority Commissioners' internal deliberations or motivations and that AAA's interests do not, therefore, outweigh the interests protected by the deliberative process privilege." [2014 U.S. Dist. LEXIS 77040, \[WL\] at *9](#). In other words, Judge Pitman found that preliminary discussions, concerning the use of the revenue from the toll and fare increases might be used for, were not central to resolution of this case; rather, the dispositive question was how the revenue was actually committed or spent.

On June 20, 2014, AAA objected to Judge Pitman's decision. See Pls.' Objs. to the Mag. J.'s Op. & Order of June 4, 2014 (ECF Dkt. No. 104). The court considered AAA's objections, but found them to be without merit, and therefore affirmed Judge Pitman's opinion of June 4, 2014. See [Auto. Club of N.Y., Inc. v. Port Auth. of N.Y. & N.J., No. 11 Civ. 6746, 2015 U.S. Dist. LEXIS 68484, 2015 WL 3404111, at *8 \(S.D.N.Y. May 27, 2015\)](#).⁴

⁴In another opinion, this court denied **[**16]** the motion of Yoel Weisshaus, proceeding pro se, for permissive intervention in this case pursuant to [Federal Rule of Civil Procedure 24\(b\)](#) in support of AAA's objections to the court's denial of AAA's motion to compel. See [Auto. Club of N.Y., Inc. v. Port Auth. of N.Y. & N.J., No. 11 Civ. 6746, 2014](#)

[*381] While discovery was proceeding, and after the scheduled 2012 and 2013 phased toll and fare increases went into effect, AAA filed a second motion for a preliminary injunction, seeking to enjoin the Port Authority from implementing the scheduled December 7, 2014 toll and fare increases. See *Auto. Club of N.Y., Inc. v. Port Auth. of N.Y. & N.J. (AAA II)*, No. 11 Civ. 6746, 2014 U.S. Dist. LEXIS 167453, 2014 WL 6772058, at *1 (S.D.N.Y. Dec. 2, 2014). These were the penultimate increases on the challenged schedule. In arguing for a preliminary injunction, AAA claimed, for the first time, that "[t]he post-approval rationale for the [t]oll [i]ncreases . . . includes \$3.8 billion that is not authorized, **[**17]** not for transportation, or not connected to any transportation project," and that information it acquired through discovery, following the court's denial of its first preliminary injunction motion, provided new grounds for its second motion to be granted. See 2014 U.S. Dist. LEXIS 167453, [WL] at *2 (alteration in original) (citation omitted). The court disagreed, finding AAA failed to show (1) that it was likely to prevail on the merits of its claims and (2) that should the December 7, 2014 toll increases go forward there would be irreparable injury. 2014 U.S. Dist. LEXIS 167453, [WL] at *7 ("While it may be that a second motion for a preliminary injunction may be granted when there are new facts on the record, here, there are few new facts and those that have been presented to the court do not serve as the basis for a preliminary injunction.").

Discovery having concluded, the Port Authority filed its second⁵ motion for summary judgment now before the court.

STANDARD OF REVIEW

Summary judgment is appropriate if "there is no genuine dispute as to any material fact and the movant is entitled to judgment **[**18]** as a matter of law." *Fed. R. Civ. P. 56(a)*. The party moving for summary judgment carries the burden of establishing that no genuine dispute exists. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 256, 106 S. Ct. 2505, 91 L. Ed. 2d 202

U.S. Dist. LEXIS 148098, 2014 WL 5315097, at *2 (S.D.N.Y. Oct. 17, 2014) (stating "Mr. Weisshaus has simply waited too long. . . . [T]he Magistrate Judge's order is on appeal. According to Mr. Weisshaus, he wishes to argue new legal theories for why the discovery he seeks should be granted. . . . To allow him to intervene now and to make arguments not considered by the Magistrate Judge in the first instance, would necessarily delay the process and potentially prejudice the Port Authority by requiring it to litigate matters not heard by [the Magistrate Judge]").

⁵There are, in fact, two motions for summary judgment. The first dated November 4, 2011, that was converted from a motion to dismiss, and a second dated January 6, 2015.

(1986). "A fact is material if it might affect the outcome of the suit under the governing law, and an issue of fact is genuine if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Ramos v. Baldor Specialty Foods, Inc.*, 687 F.3d 554, 558 (2d Cir. 2012) (quoting *Niagara Mohawk Power Corp. v. Hudson River-Black River Regulating Dist.*, 673 F.3d 84, 94 (2d Cir. 2012)). In assessing whether summary judgment is proper, the court must construe "the evidence in the light most favorable to the nonmoving party and draw[] all reasonable inferences in [the non-movant's] favor." *Sledge v. Kooi*, 564 F.3d 105, 108 (2d Cir. 2009).

"When the moving party has carried its burden under *Rule 56(a)*, its opponent must do more than simply show that there is some metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 586, 106 S. Ct. 1348, 89 L. Ed. 2d 538 (1986) (footnote omitted). Indeed, to defeat a motion for summary judgment, the non-movant must identify probative evidence on the record from which a reasonable factfinder could find in its favor. *Liberty Lobby*, 477 U.S. at 256-57.

DISCUSSION

I. AAA'S DORMANT COMMERCE CLAUSE CLAIM

The Commerce Clause gives Congress the power "[t]o regulate Commerce **[*382]** with foreign Nations, and among the several States." *U.S. Const. art. I, § 8, cl. 3*. From this federal grant of regulatory power flows "[t]he negative or dormant implication of the Commerce Clause, which] prohibits state taxation or regulation **[**19]** that discriminates against or unduly burdens interstate commerce and thereby impedes free private trade in the national marketplace." *Selevan v. N.Y. Thruway Auth.*, 584 F.3d 82, 90 (2d Cir. 2009) (quoting *GMC v. Tracy*, 519 U.S. 278, 287, 117 S. Ct. 811, 136 L. Ed. 2d 761 (1997)). The three-prong test of *Northwest Airlines, Inc. v. County of Kent* is used to determine whether the imposition of fees, for the use of state-provided facilities, violates the Dormant Commerce Clause. Under this test, a fee is reasonable, and thus constitutionally permissible, "if it (1) is based on some fair approximation of use of the facilities, (2) is not excessive in relation to the benefits conferred, and (3) does not discriminate against interstate commerce." *Nw. Airlines, Inc. v. Cty. of Kent*, 510 U.S. 355, 369, 114 S. Ct. 855, 127 L. Ed. 2d 183 (1994) (citation omitted); *Evansville-Vanderburgh Airport Auth. Dist. v. Delta Airlines, Inc.*, 405 U.S. 707, 716-17, 92 S. Ct. 1349, 31 L. Ed. 2d 620 (1972) ("At least so long as the toll is based on some fair approximation of use or privilege for use . . . and is neither discriminatory against interstate commerce nor excessive in

comparison with the governmental benefit conferred, it will pass constitutional muster, even though some other formula might reflect more exactly the relative use of the state facilities by individual users.").

As to AAA's claims under the Dormant [Commerce Clause](#), the Port Authority argues "the record establishes beyond genuine dispute that the ITN's costs exceed the ITN's revenues," and "[t]hat fact disposes of Plaintiffs' **[**20]** claims" because there were no surplus funds that could be used for projects such as the reconstruction of the World Trade Center site. Def.'s Br. 15. That is, the Port Authority contends that "AAA's discovery into the ITN's financials simply confirm[s] the facts presented by the Port Authority in opposing AAA's [second] preliminary injunction motion . . . : the ITN's costs outpaced revenues before the 2011 toll increases and the deficit continues even with the toll increases in effect"; "therefore the tolls, even with the increases, are necessarily reasonable." Def.'s Br. 15, 17. Accordingly, defendant argues, "[t]here is no excess ITN revenue that could be diverted to non-ITN work such as reconstruction of the [World Trade Center]." Def.'s Br. 15. Thus, for the Port Authority, because the amounts raised by the tolls were devoted exclusively to ITN projects, the toll and fare increases are necessarily reasonable under *Northwest Airlines* because they were "based on some fair approximation of use of the facilities," were "not excessive in relation to the benefits conferred," and were not discriminatory "against interstate commerce." See *Nw. Airlines*, 510 U.S. at 369.

In support of its contentions, the Port Authority relies on testimony **[**21]** relating to the cash flow of the ITN, including "operating revenues and expenses," "capital costs, the costs of financing capital improvements, and statutory reserve requirements." See Def.'s Br. 17. The figures referred to in this testimony, defendant contends, show that the ITN has historically operated with a negative cash flow (or deficit) and is projected to do so into the future. Def.'s Br. 17; see also Def.'s Br. 6 ("[T]he ITN does not generate excess cash that is supporting the World Trade Center redevelopment. In fact, as the schedules annexed hereto show, the ITN operates at a deficit and will continue to operate at a deficit even with the toll and fare increases. The Port Authority **[*383]** must consequently find revenue from other sources to support the ITN." (quoting Mulry Decl. Ex. E ¶ 22 (ECF Dkt. No. 151-5) (affidavit of Michael Fabiano, Chief Financial Officer, Port Authority, Nov. 4, 2011) ("Fabiano Aff."))); Def.'s Br. 8 ("The toll revenue from the George Washington Bridge, the toll revenue from the Lincoln and Holland Tunnel and the three Staten Island crossings, that total revenue, with revenue that comes from PATH, with revenue that comes through the bus stations, bus terminal, **[**22]** bus station, *that revenue is not enough to cover the expenses of those very facilities*; the operating

expense of those facilities, the expenses for keeping those facilities in what the engineers say is a state of good repair, and the longer term, long-term capital investment needs." (quoting Decl. of Richard W. Mark in Supp. of Def.'s Mot. for Summ. J. Ex. 9, at 36:16-37:4 (Jan. 6, 2015) (ECF Dkt. No. 135-9) ("Mark Decl.") (deposition of William Baroni, Deputy Executive Director, Port Authority, Nov. 30, 2012) ("Baroni Dep.")).

Defendant also cites two reports, prepared by independent third parties charged with completing a comprehensive review of the Port Authority, Navigant Consulting, Inc. and Rothschild Inc., neither of which was prepared for purposes of litigation. See Mark Decl. Ex. 11 (ECF Dkt. No. 135-11) (report of Navigant Consulting, Inc.) ("Navigant Report"); Mark Decl. Ex. 12 (ECF Dkt. No. 135-12) (report of Rothschild Inc.) ("Rothschild Report"). The Navigant Report concludes that the ITN's "operating cash flow is insufficient to cover its own capital expenditure needs" and that "the proceeds of [toll] increases are vital to fund Port Authority infrastructure projects." **[**23]** Navigant Report at 5, 47. The Report also states that, "[a]bsent the recent and scheduled toll increases, the Port Authority would need to significantly reduce its Preliminary 2011-2020 Capital Plan, compromising the ability to maintain infrastructure assets in a 'State-of-Good-Repair.'" *Id.* at 6. The Rothschild Report reached similar conclusions. See Rothschild Report at 1 ("Without the schedule[d] toll and fare increase (or other financial underperformance versus the forecast), the analysis indicates a shortfall versus target credit metrics and thereby risk to the stability of the credit rating and financing terms.").

In response, AAA does not attempt to counter the Port Authority's record evidence by citing to evidence of its own; rather, it first challenges the Port Authority's use of a cash flow analysis, insisting that the proper analysis is a rate of return analysis,⁶ which, if used, "depicts a substantially **[*384]**

⁶ A "rate of return" refers to the "annual percentage return . . . that actually occurs or is anticipated on an investment." Joel G. Siegel & Jae K. Shim, *Dictionary of Accounting Terms* 334 (2d ed. 1995). Thus, using a rate of return analysis, a company is able to formulate a reasonable rate change that both reflects its costs and achieves some monetary return on a project or investment. Here, for example, a rate of return analysis could be used to calculate a percentage return on the 2011 **[**25]** Preliminary Capital Plan for the ITN facilities if the plan was expected to produce such a return. By contrast, "cash flow" refers to "cash receipts minus cash disbursements from a given operation or asset for a given period." *Id.* at 63. Here, a cash flow analysis could be used to determine whether the toll and fare increases, combined with the Port Authority's other revenue generated by the facilities making up the ITN, are less than, equal to, or greater than its total capital costs, operating expenses and debt service.

Based on the testimony of its officers, the Port Authority claims that its

profitable ITN and brings into question the need for a toll increase." Pls.' Br. 2. In support of its argument, AAA maintains that "[a] cash flow analysis for the ITN had never even been done at the Port Authority prior to the AAA lawsuit and differs from the financial measures in the Port Authority's [**24] annual reports." Pls.' Br. 6; *see also* Pls.' Br. 12 ("[A] rate of return analysis was used by the Port Authority and the Court in both of the prior challenges to Port Authority toll increases. The Port Authority did not conduct or submit to the Court a rate of return analysis in this case, instead offering a cash flow analysis, a type of analysis that was not presented to the Commissioners and one which had not been previously used at the Port Authority."). Although AAA insists that a rate of return analysis must be used in this case, as shall be seen, it never clarifies precisely how the analysis would be applied for the 2011 Preliminary Capital Plan for the ITN facilities ("2011 ITN Capital Plan").

As to AAA's contention that a cash flow analysis is inappropriate, and a rate of return analysis must be employed, the Port Authority responds that "the deficit figures undermine AAA's criticism that the Port Authority failed to evaluate the toll increase on the basis of the 'rate of return' for the ITN from this revenue." Def.'s Br. 19. That is, the Port Authority argues that because the "cash flow analysis proves the ITN operates at

version of a cash flow analysis shows there was no surplus resulting from the toll and fare increases, and therefore no funds are available to be used on projects outside of the ITN. *See* Def.'s Br. 8. For example, William Baroni, the Port Authority's Deputy Executive Director, testified that "it was made clear repeatedly that the revenue that was being raised at the crossings, the PATH, the bus terminals, bus stations, that revenue number was growing a deficit when compared to the growing expenditure need of those very facilities. So we had a deficit of those facilities upon my arrival, we had a deficit [**26] prior to the August 5th memorandum [concerning the toll and fare increases], we have a deficit after the toll and fare increase went into effect, and we have a deficit today. I'm very aware of that." Baroni Dep. 90:5-90:16.

It is important to note that the cash flow and rate of return analyses are not mutually exclusive. Indeed, a cash flow analysis can be used to calculate a rate of return on a project if the revenue generated exceeds the operating costs (i.e., a return is realized). Here, however, the Port Authority insists a rate of return analysis is of no consequence in light of the negative cash flow scenario presented by the ITN. That is, as Michael Fabiano, the Port's Chief Financial Officer, testified, AAA's "reference to a rate of return analysis overlooks the fact that the cash flow analysis demonstrates that even taking into account the tolls and fare increases, the ITN will still operate at a deficit, and therefore, a rate of return analysis is simply irrelevant." Mulry Decl. Ex. F ¶ 12 (ECF Dkt. No. 151-6) (reply affidavit of Michael Fabiano, Chief Financial Officer, Port Authority, Nov. 29, 2011). In other words, for the Port Authority, because the cash flow analysis [**27] shows a deficit, the rate of return analysis would result in a negative percentage.

a loss, and there is nothing in the record that gives rise to a genuine dispute concerning that analysis," a rate of return analysis would not aid plaintiffs because it would not generate a positive percentage. Def.'s Br. 20.

While AAA maintains that a rate of return analysis is required here, the real substance of its argument is that three individual expenditures included in the 2011 ITN Capital Plan are not properly part of the ITN. *See* Pls.' Br. 24-25. AAA contends that if these expenditures are removed from the ITN, the toll and fare increases will be shown to generate revenue in excess of that required by it, and that the Port Authority will be shown to be diverting [**28] toll revenue to the reconstruction of the World Trade Center site, and possibly for other purposes.

With respect to these three expenditures, AAA first alleges that \$1.8 billion was set aside in the 2011 ITN Capital Plan for bridges and roads owned by the state of New Jersey. Pls.' Br. 8. Specifically, AAA claims that the costs related to the [**385] Lincoln Tunnel Access Project are not being spent on the Lincoln Tunnel itself, but, rather, for New Jersey state bridge and road facilities. Pls.' Br. 8; *see also* Pls.' Br. 16 ("These bridges and roads . . . are not owned by the Port Authority, are miles from the Lincoln Tunnel, and are completely outside the Port Authority's statutory authorization for funding.").

Second, AAA claims that \$1 billion of the 2011 ITN Capital Plan is being used for the "raising of the Bayonne Bridge roadway," and the roadway "is not being raised primarily for transportation, but instead for navigation . . . because new larger container ships cannot pass under the current roadway." Pls.' Br. 9. Although this project also involves the construction of a new roadway, AAA maintains that "[t]he fact that there will be a new roadway is only incidental; the roadway is only being [**29] replaced because it has to be raised for navigation." Pls.' Br. 24-25.

Third, AAA challenges the \$1 billion allocated to a "capital infrastructure fund" ("CIF"). Pls.' Br. 10. AAA claims that "close to \$1 billion was not yet allocated at the time of the 2011 Toll Increases," and this "\$1 billion cushion . . . inflates the 'ITN capital plan' to \$10.786 billion." Pls.' Br. 10. Based on these three areas of expenditure, AAA thus argues there are genuine factual disputes as to whether the toll and fare increases were a fair approximation of use of the ITN facilities under *Northwest Airlines*, and that "the unauthorized and non-ITN projects in the 'ITN capital plan' make the Toll Increases excessive for toll payers, in relation to the benefit conferred." Pls.' Br. 26-27.

The Port Authority responds there is no basis to exclude the challenged items from the ITN. Def.'s Br. 20-21. For the Port

Authority, although AAA claims in its brief⁷ that these projects are not part of the ITN, it has provided no evidence to support this contention. Thus, the Port Authority argues that AAA has waived any argument that these expenditures are not part of the ITN and that even if the court should entertain arguments **[**30]** with respect to these costs, AAA has not supported its arguments with record evidence. *See* Def.'s Br. 20-21 n.15 ("The three items raised in AAA's Second PI Motion as purported non-ITN matters . . . were all explicitly referenced as ITN projects in the Fabiano 11/4/11 Affidavit and supporting exhibits, and were the subject of inquiry at depositions of Port Authority officials in 2012. . . . Despite that, AAA has never sought leave to amend its Complaint . . . and its attempt to inject new issues at the time of the Second PI Motion is improper. . . . Accordingly, AAA is barred from seeking any relief based on its new theory that these disclosed ITN expense items should now be excluded from the ITN.") (citations omitted).

With respect to AAA's substantive arguments, the Port Authority quotes the court's opinion in *AAA II* that "there is not on the record before the court any evidence other than AAA's **[**31]** assertions that these items are not part of the ITN . . . [and] AAA presents nothing but conjecture to bolster its claim that it has found new evidence, as a result of discovery." *AAA II*, No. 11 Civ. 6746, 2014 U.S. Dist. LEXIS 167453, 2014 WL 6772058, at *6. Thus, to the Port Authority, the record in support of AAA's claims has not strengthened with time. Further, the defendant contends that AAA's argument fails even if the three challenged items are **[**386]** excluded from the ITN cash flow analysis "because there is no showing that a positive cash flow resulting from their exclusion would render the toll increase unreasonable." Def.'s Br. 22. In other words, defendant maintains that "[t]he law does not require public facilities to lose money in order for a toll to pass constitutional muster." Def.'s Br. 22.

As an initial matter, the court is unpersuaded by AAA's claim that a rate of return analysis, rather than a cash flow analysis, must be used in this case; the law does not require the use of any specific financial analysis for purposes of the Dormant Commerce Clause. *See Evansville*, 405 U.S. at 717 (noting a state's fee allocation "will pass constitutional muster, even though some other formula might reflect more exactly the relative use of the state facilities by individual users"). Moreover, as noted,

⁷AAA makes the claim that these expenditures are not part of the ITN for the first time in its papers in support of its second motion for a preliminary injunction and not in its Complaint. *Compare* Compl. with Pls.' Mem. in Supp. of Mot. for Prelim. Inj. 6-9 (Oct. 24, 2014) (ECF Dkt. No. 118).

the cash **[**32]** flow and rate of return analyses are not in tension, and AAA's insistence on a rate of return analysis is a bit of a puzzlement. A cash flow analysis can be used to calculate a rate of return, if any, on a project. If the revenue generated by a project or investment is less than its costs of construction, operation, and maintenance, however, there is no return on the invested funds. When, as here, AAA cites to no record evidence that the increased toll revenues would generate a surplus, a rate of return analysis would not affect the outcome of a case.⁸

Next, it is apparent that AAA's other arguments are without merit. First, as the Port Authority points out, and as revealed by the Navigant and Rothschild Reports, "even under the flawed rate of return analysis that the AAA sponsors, the ITN would show a deficit in 2010 leading up to the toll increase—and that deficit exists after improperly eliminating the expense of [the three] contested ITN projects." *See* Def.'s Reply Mem. in Supp. of Mot. for Summ. J. 6 n.5 (ECF Dkt. No. 159); *see also* Baroni Dep. 90:5-90:16 ("[I]t was made clear repeatedly that the revenue that was being raised at the crossings, the PATH, the bus terminals, bus stations, that revenue number was growing a deficit when compared to the growing expenditure need of those very facilities. So we had a deficit of those facilities upon my arrival, we had a deficit prior to the August 5th memorandum [concerning the toll and fare increases], **[**34]** we have a deficit after the toll and fare increase went into effect, and we have a deficit today."); Mark Decl. Ex. 7, at 141:16-141:21 (ECF Dkt. No. 135-7) (declaration of Rosemary Chiricolo, Deputy Director for Management & Budget, Port Authority, Oct. 3, 2012) ("[T]here would have been negative cash flows from the ITN during the period [from 2007-2010], which means that there would not have been sufficient cash to maintain the **[**387]** general reserve fund at its required level."). In the absence of evidence that the tolls have or will produce a surplus in the ITN, AAA's rate of return arguments fail.

⁸In AAA's two prior challenges to the Port Authority's toll increases, a rate of return was discussed in the context of determining whether certain projects or facilities should be included in the rate base. *See AAA 1989 II*, 887 F.2d at 419 ("[T]he rate of return is reasonable, regardless of the method of accounting used, if PATH is properly included in the rate base."); *Auto. Club of N.Y., Inc. v. Cox*, 592 F.2d 658, 670 (2d Cir. 1979) ("The serious question . . . is the inclusion of PATH. . . . [I]f PATH were excluded, the projected 1976 rate of return would be 14.32%."). In both cases, because the PATH Rail System was properly included in the ITN, a positive return on toll increases was anticipated, so a rate **[**33]** of return analysis resulted in a positive percentage. It is worth mentioning that the earlier case from 1979 did not involve a Dormant Commerce Clause claim; rather, the claims were brought under the *General Bridge Act of 1946*, 33 U.S.C. § 529, and a former version of the Highway Act, the *Federal-Aid Highway Act of 1973*, 33 U.S.C. § 526a.

The court is equally unpersuaded by AAA's emphasis on creating a surplus by removing projects from the ITN. *See, e.g.,* Pls.' Br. 13 ("If the realized revenue is greater than the required revenue—then the toll and fare rates as a package are excessive. If the realized revenue is less than the required revenue—then the shortfall in revenue is the amount that could be raised by higher tolls or fares."). First, even if removing the projects would create a surplus, plaintiffs offer no support for the proposition that a positive revenue number necessarily means the toll and fare increases are violative of **[**35]** the Dormant [Commerce Clause](#). Indeed, the cases indicate that tolls are permitted to generate "a fair profit or rate of return." [Angus Partners LLC v. Walder](#), 52 F. Supp. 3d 546, 565 (S.D.N.Y. 2014) (quoting [Molinari v. N.Y. Triborough Bridge & Tunnel Auth.](#), 838 F. Supp. 718, 725 (E.D.N.Y. 1993)). Thus, as the Supreme Court has clarified, it "has never held that the amount of a user fee must be precisely calibrated to the use that a party makes of Government services." [United States v. Sperry Corp.](#), 493 U.S. 52, 60, 110 S. Ct. 387, 107 L. Ed. 2d 290 (1989); *see also* [Selevan](#), 584 F.3d at 98 ("There need not be a perfect fit between the use of the [Bridge] and the support of [the Bridge] by the toll. The *Northwest Airlines* test is not inflexible; it simply requires 'reasonableness.'") (alterations in original) (citations omitted); [Bridgeport & Port Jefferson Steamboat Co. v. Bridgeport Port Auth.](#), 567 F.3d 79, 86 (2d Cir. 2009) ("[T]here need not be a perfect fit between the use of the facilities and the support of those facilities by the fee."). Importantly, AAA has simply not done the math demonstrating that, even using its preferred method of calculation, the increased tolls will create a positive rate of return for the ITN, let alone an unreasonably high rate of return.

Moreover, AAA has not pointed to any record evidence that calls into question the accuracy of the Port Authority's financials, or otherwise undermines the evidence demonstrating that the revenue collected from the toll and fare increases is insufficient to fund the ITN's operations, capital needs, **[**36]** and debt service, nor that any such revenue was allocated to the reconstruction of the World Trade Center site.

With regard to AAA's challenge to the inclusion of certain projects in the 2011 ITN Capital Plan (i.e., the Lincoln Tunnel Access Project, Bayonne Bridge project, and the CIF), the court is mindful that no challenge to these projects was made until AAA's second motion for a preliminary injunction in 2014, nor did AAA seek to amend its Complaint to question the propriety of the inclusion of these projects in the 2011 ITN Capital Plan. *See* [Cruz v. City of New York](#), No. 15 Civ. 2265, 2016 U.S. Dist. LEXIS 6116, 2016 WL 234853, at *6 (S.D.N.Y. Jan. 19, 2016) (finding a plaintiff could not add allegations in a brief when the allegations were absent from the complaint); [Olde Monmouth Stock Transfer Co., Inc. v. Depository Tr. & Clearing Corp.](#), 485 F.

[Supp. 2d 387, 393 \(S.D.N.Y. 2007\)](#) ("[I]t is long-standing precedent in this circuit that parties cannot amend their pleadings through issues raised solely in their briefs.") (citation omitted). As defendant points out, "[r]ecognizing that the objective financial facts about the ITN defeat [AAA's] claim, in its recent (and denied) Second PI Motion, AAA purported to challenge for the first time certain items included in the preliminary ITN capital project plan—three years after its submission—in the hopes it could narrow the gap." Def.'s Br. 20. Plaintiffs' sole contention in their **[**37]** Complaint **[**388]** was that funds raised by the increase in tolls would be diverted to the reconstruction of the World Trade Center.⁹ This claim is not even alluded to in their papers in opposition to defendant's motion for summary judgment.

Under [Rule 8\(a\)\(1\)](#), a plaintiff's pleading must contain a "short plain statement" which shows that it is entitled to relief. [Fed. R. Civ. P. 8\(a\)\(1\)](#). This statement is required to allege "factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." [Ashcroft v. Iqbal](#), 556 U.S. 662, 678, 129 S. Ct. 1937, 173 L. Ed. 2d 868 (2009); *see also* [Vega v. Hempstead Union Free Sch. Dist.](#), 801 F.3d 72, 86 (2d Cir. 2015). Should a plaintiff fail to raise certain factual content or issues in its complaint, it may seek leave to amend its complaint under [Rule 15](#). *See* [Fed. R. Civ. P. 15\(a\)\(2\)](#). Here, there is nothing in AAA's Complaint that would have alerted the Port Authority that the actual claim of diversion of funds was not related to the World Trade Center reconstruction, but to the "unrelated" **[**38]** expenditures. Having failed to raise allegations about other projects in their pleadings, or to amend their pleadings to include a challenge to these three projects, which AAA has been aware of since 2011, the court cannot allow plaintiffs to add them through their brief on summary judgment. *See* [Alali v. DeBara](#), No. 07-CV-2916, 2008 U.S. Dist. LEXIS 86760, 2008 WL 4700431, at *3 n.6 (S.D.N.Y. 2008) ("[I]t is inappropriate to consider claims not pleaded in the complaint in opposition to summary judgment." (citing [Kearny v. City of Rockland](#), 373 F. Supp. 2d 434, 440-41 (S.D.N.Y. 2005))); [Thomas v. Egan](#), 1 F. App'x 52, 54 (2d Cir. 2001). Accordingly, these claims are not properly before the court, and therefore are dismissed.

Were the court to consider these arguments, however, they would not carry the day. AAA insists that the Port Authority's "cash flow analysis, and its conclusion that the ITN would lose

⁹The only claim in AAA's Complaint was "[t]he revenues resulting from the 2011 toll increase are to be used by the Port Authority to unlawfully provide funding for the reconstruction of the World Trade Center which is totally unrelated to the Port Authority's integrated, interdependent transportation network." *See* Compl. ¶¶ 2, 42.

\$55 million over a ten year period (an average of only \$5.5 million a year), are completely undercut when the billions of dollars for the Pulaski Skyway and New Jersey roads project, the Bayonne Bridge projects and the billion dollar 'placeholder' are deducted from the ITN capital plan." Pls.' Br. 11.

The standard for whether a facility or project should be included in the ITN's capital base was first considered in *AAA 1989 II*. See *AAA 1989 II*, 887 F.2d at 422. In that case, AAA contended that only an "origin [**39] and destination" analysis could be used to prove a "functional relationship" between certain river crossings, and therefore only those facilities should be included in the ITN's rate base. *Id.* Under an "origin and destination" analysis, a functional relationship would exist if one mode of transportation can be easily substituted for another. *Id.* ("If a large percentage of the people traveling between *A* in New Jersey and *B* in New York freely choose to use either river crossing *X* or river crossing *Y*, then *X* and *Y* have a functional relationship.").

In *AAA 1989 II*, however, the Port Authority maintained that AAA's proposed analysis alone was too narrow, as it overlooked the "spillover" effect. *Id.* The "spillover" effect recognizes that when certain facilities or functions are eliminated from the ITN, others will suffer as a result. *Id.* ("If [70,000 PATH passengers] were to use the tunnels instead, the tunnels would become [**389] overcrowded. Congestion in the tunnels would lead many travelers . . . to use the George Washington Bridge. Others . . . could shift to the Staten Island bridges."). Chief Judge Oakes agreed that "origin and destination" data is "useful but not sufficient" in determining [**40] functionality because "[i]t fails to take into account the full extent of the Port Authority's responsibilities." *Id.* As a result, in looking for a functional relationship to the ITN, this Circuit has adopted an approach that is aware of the Port Authority's "systemwide" interdependence. *Id.* ("A functional relationship exists, then, among those facilities that contribute to the Port Authority's performance of its duty efficiently to provide transportation to travelers over and under the waterways between southern New York and northern New Jersey.").

It is apparent that AAA has failed to point to evidence that the three challenged projects are not functionally related to the ITN. See *id.* ("As anyone who has ever sat in a line of traffic or a railroad station for a length of time is aware, the Port Authority's employees cannot think only in terms of traffic flowing smoothly and trains running on time; they must also anticipate and respond to disruptions and delays. The Port Authority is entitled to prove that PATH is related to the bridges and tunnels with evidence that a 'spillover' effect links even those river crossings that travelers do not normally use interchangeably.") (emphasis added). [**41]

Here, the Port Authority has cited to sufficient record evidence to establish that the three challenged areas of expenditure are sufficiently functionally related to the ITN so as to be included in it. For instance, it is not disputed that the Lincoln Tunnel itself is part of the ITN. See *id.* at 418. As to the Lincoln Tunnel Access Project, the Port Authority cites, in addition to the 2011 ITN Capital Plan, deposition testimony that the Project includes

expenditures for those roadway projects that we are building that *have been certified as part of the Lincoln Tunnel facility* that align with the traffic routes on Wittpen Bridge . . . and the *Pulaski Skyway*]. They're a lead-in to creating a flow of traffic . . . to expedite traffic into the Lincoln Tunnel. So it's supposed to improve traffic flows for our patrons into the Lincoln Tunnel.

Mark Decl. Ex. 8, at 185:20-186:8 (deposition of Michael Fabiano, Chief Financial Officer, Port Authority, Nov. 29, 2012) ("Fabiano Dep.") (emphasis added). Also, the Port Authority points to the Rothschild Report, which states: "Significant projects include . . . (ii) infrastructure projects at the *Lincoln Tunnel to accommodate increasing traffic volumes and [**42] reduce congestion*." Rothschild Report at 8 (emphasis added).

AAA has produced no evidence that the Lincoln Tunnel Access Project would not improve traffic flow to the tunnel. Rather, plaintiffs merely assert "[t]he Pulaski Skyway and New Jersey roads, miles away from the Lincoln Tunnel, cannot be considered 'approaches,' unless the Port Authority considers any road that eventually leads to the Lincoln Tunnel . . . to be an 'approach' to the Lincoln Tunnel." Pls.' Br. 20. This assertion, however, is not evidence. AAA also cites to state statutes that it says demonstrate that the bridges and roadways making up the project are not all owned by the Port Authority.¹⁰ While this [**390] may be true, it is difficult to see how these statutes affect whether or not the bridges and roadways are functionally related to the ITN.

Second, as to the Bayonne Bridge project, the Port Authority offers a project overview from the record that describes some of the anticipated benefits of the project, including that "[w]ider lanes, shoulders and median dividers will make the bridge safer for drivers," a "bikeway and walkway the entire length of the

¹⁰ Although AAA cites to statutory provisions that it claims demonstrate that amounts spent on these projects would be improper, it makes no argument in its Complaint that these expenditures are *ultra vires* or otherwise unlawful and should therefore be stopped by this court. Rather, these citations to statutes are presented for the sole purpose of demonstrating that these projects are not [**43] properly part of the ITN. Thus, AAA has waived any claim that it might have made that the expenditures would be unlawful.

bridge will make traveling the bridge easier for all of us," "[s]tairs will be replaced with access ramps," "[n]ew piers, a new roadway deck and new approach roads will ensure the bridge will be built to last for generations," and "[t]he design allows for future mass transit service." Decl. of Richard W. Mark in Opp'n to Pls.' Mot. for Prelim. Inj. Ex. G (Nov. 10, 2014) (ECF Dkt. No. 126-7) ("Mark P.I. Decl.") (Bayonne Bridge Navigational Clearance Project Description, Nov. 7, 2014) ("The new conceptual design highlights safety and design improvements: wider lanes, shoulders, a median divider, and the potential for future transit options."); *see also* Fabiano Aff. ¶ 7 ("The Bayonne Bridge over the Kill Van Kull will be rehabilitated to increase its vertical clearance to accommodate ****44** shipping and to meet modern highway and structural design standards."). Again, AAA points to no evidence that the project, although it will concededly aid navigation, will not result in a safer bridge for motor traffic, a safer bridge for bike riders, or provide for the installation of mass transit in the future. AAA's entire claim rests on arguments, not facts. Pls.' Br. 24 ("[T]he raising of the Bayonne Bridge roadway is a project undertaken . . . primarily for the benefit of navigation and Port Commerce, not for the benefit of the ITN.").

Third, as to the amounts credited to the CIF, it should be clear what the CIF is. It is not, as plaintiffs seem to suggest, a parking place for funds that the Port Authority can later allocate to projects outside the ITN. Rather, the amounts allocated to the fund can be spent only on ITN projects. In keeping with this restriction, the Port Authority offers testimony that the \$966 million, which was freed up after the Cross Hudson Tunnel Project was terminated, was thereafter allocated to the reserve fund titled the CIF "to be used within the [ITN] infrastructure." Fabiano Dep. at 191:6-191:19 ("It's a place holder that identifies what remained from [the ****45** cancelled project] until the [Port Authority Board of Commissioners] makes a collective decision on . . . what addition[al] capital projects it comes out of But it's still anticipated that those dollars will be available to be used within the infrastructure."); Fabiano Dep. at 50:18-51:11 ("[T]here's hundreds of projects that comprise our capital plan, and these major projects were competing with [a] state of good repair work. . . . [S]o you have to address [a] state of good repair, and then you need to layer these major capital initiatives on top of that. So it's a balancing act, and that's what the capital group's role is, we provide the envelope and the window of capacity, how much, and it's up to capital people to determine which projects can get into the mix and which don't; engineering assessments are done on the criticality and timeliness of it and whether or not it can be delayed without impacting life safety and operational efficiencies."). Indeed, each item in the 2011 ITN Capital Plan represents an estimate of future costs for various projects within the ITN and, as ****391** the Port Authority contends, the CIF is no different.

Because the only evidence cited by the parties demonstrates that ****46** moneys accounted for in the CIF can only be used for ITN projects, even if an amount on the CIF books is a "placeholder," it can only be committed to, and spent on, ITN projects and only ITN projects. Time, moreover, has overtaken AAA's argument. That is, although the CIF was not allocated to any specific project at the time of the 2011 ITN Capital Plan, it still reflected the anticipated costs for future ITN projects to be approved at a later date. Indeed, this is apparently what has occurred. While there was indeed a \$996 million amount credited to the CIF in the 2011 ITN Capital Plan, the Port Authority's 2014 Capital Plan reveals that this amount was reduced to zero. Even with the full amount of the CIF having been committed to ITN projects, however, the ITN's capital needs exceeded those projected in the 2011 ITN Capital Plan. *See* Mulry Decl. Ex. N (Capital Plan Summary 2014-2023, Feb. 2014); Def.'s Reply Br. 14.

As with the other items of expenditures that it disputes, plaintiffs' claims about the CIF offer nothing beyond the assertions set forth in their brief.¹¹ Importantly, AAA does not dispute that CIF money can only be spent on ITN projects or that subsequent plans indicate ****47** the money has already been committed to ITN projects. Indeed, none of AAA's assertions are tied to any facts drawn from discovery or elsewhere.

Viewing the evidence in the light most favorable to AAA, it is apparent that plaintiffs have presented no evidence tending to show that revenue from the toll and fare increases was, or would be, used in a manner that violated the Dormant [Commerce Clause](#). First, AAA points to no evidence that toll

¹¹ For instance, plaintiffs' argument with respect to the Lincoln Tunnel Access Project is that "[t]he connection to the Lincoln Tunnel . . . is illusory. The money is being spent not on the Lincoln Tunnel, but on New Jersey state bridge and road facilities: the Pulaski Skyway, N.J. Route 1 & 9, N.J. Route 7, and the WittPenn Bridge." Pls.' Br. 8. Next, AAA argues, "[t]he Pulaski Skyway is more than eight miles from the Lincoln Tunnel, and cannot in any way be considered an access roadway to the Lincoln Tunnel." Pls.' Br. 8. With respect to the Bayonne Bridge project, plaintiffs' entire argument is that, "[w]hile this project involves construction at a bridge, the Bayonne Bridge roadway is not being raised primarily for transportation, but instead for navigation and the Port Commerce line of business, because new larger container ships cannot pass under the current roadway." Pls.' Br. 9. Finally, as to the CIF, plaintiffs acknowledge that these funds were previously committed to a tunnel project that was cancelled, leaving "close to \$1 billion [that] was not yet ****48** allocated at the time of the 2011 Toll Increases." Pls.' Br. 10. Therefore, AAA argues, the CIF "was included as simply a line item in the capital plan that did not reflect any transportation project" and is therefore "a \$1 billion cushion that inflates the ITN capital plan." Pls.' Br. 10.

money will be spent on the new World Trade Center. Nor do plaintiffs cite to any evidence that the three challenged projects are not functionally related to the ITN. Indeed, AAA simply relies on its own arguments, rather than record support, to bolster its assertion that subtracting the costs of the three projects (i.e., the Lincoln Tunnel Access Project, the Bayonne Bridge project, and the CIF) would eliminate \$3.8 billion worth of costs from the 2011 ITN Capital Plan, thereby freeing up funds for projects such as the reconstruction of the World Trade Center. *See* Pls.' Br. 11 ("Subtracting \$3.8 billion from the 'ITN **[**49]** capital plan' turns CFO Fabiano's cash flow analysis positive."). Rather than citing to record evidence, AAA repeats verbatim the unsupported arguments it offered **[*392]** in its second motion for a preliminary injunction.

Finally, this case is distinguishable from *Bridgeport and Port Jefferson Steamboat Co. v. Bridgeport Port Authority*, in which the steamboat company successfully challenged several Bridgeport Port Authority projects, funded by ferry passenger fees, that provided no benefit to ferry passengers. *See* [Bridgeport](#), 567 F.3d at 87 ("The limits of . . . excessiveness are plainly exceeded when the fees support a [Bridgeport Port Authority] budget that includes, for example, a development project for reducing traffic on the I-95, the interstate highway running generally along the Connecticut shore."). Here, unlike in *Bridgeport*, plaintiffs have not shown the challenged expenditures are of no "actual or potential" benefit to toll payers in their capacity as bridge and tunnel users, or that there is any evidence that the increased tolls will result in a surplus that could be used for other projects.¹² *See id.*

It is worth repeating that the court's task in this case with respect to the Dormant [Commerce Clause](#) claims is to determine whether the toll and fare increases were (1) "based on some fair approximation of use of the facilities"; (2) "not excessive in relation to the benefits conferred"; and (3) not discriminatory "against interstate commerce." *Nw. Airlines*, 510 U.S. at 369. Here, AAA's argument is that there was revenue from the increases and that revenue was illegally allocated to fund the reconstruction of the World Trade Center site. To support these allegations, however, AAA points to no record evidence that tends to show the increases were not a fair

¹² Indeed, AAA's concept of what amounts to a "benefit" to toll payers is noticeably narrow, as it consists only **[**50]** of the "ability to cross from New York to New Jersey over Port Authority bridges and tunnels," and does not include other potential benefits such as decreased congestion or increased efficiency within the ITN. *See* Pls.' Br. 26; *see also* [AAA 1989 I](#), 706 F. Supp. at 269 ("Similarly, improvements to one facility benefit the users of the others by reducing the congestion on others, thereby making the entire network more efficient.").

approximation of the use of the ITN by its users, or were excessive in relation to the benefits conferred on them. Such evidence might include something from the **[**51]** record showing that revenue from the toll and fare increases was put to uses that bore no "functional relationship" to the Port Authority's operations. Under "our broad definition of 'functional relationship' [that] might extend to other facilities outside the Port Authority's domain," however, such a claim would need to include more than speculation as to particular items in the Port Authority's 2011 ITN Capital Plan or the deliberations of its Board of Commissioners. [AAA 1989 II](#), 887 F.2d at 422 n.5. "[T]he requirement of a 'fair approximation' seeks reasonableness and broad proportionality. It does not require precise tailoring, or a *pre-enactment administrative record*, for toll amounts to be justified." *Janes v. Triborough Bridge & Tunnel Auth.*, 977 F. Supp. 2d 320, 340 (S.D.N.Y. 2013), *aff'd*, 774 F.3d 1052 (2d Cir. 2014), *cert. denied*, 136 S. Ct. 80, 193 L. Ed. 2d 207 (2015) (emphasis added). Finally, AAA makes no mention of the third prong of the *Northwest Airlines* test: that the increases discriminated against interstate commerce. At bottom, plaintiffs have simply failed to create a triable issue of fact as to whether the toll and fare increases are not a "fair approximation of use of the facilities" and are "excessive in relation to the benefits conferred" to users of the ITN. *See* [Nw. Airlines](#), 510 U.S. at 369.

Based on the foregoing, the court finds that **[**52]** there is no triable issue of fact that **[*393]** would tend to support AAA's Dormant [Commerce Clause](#) claim and that the Port Authority is entitled to judgement on this claim as a matter of law.

II. AAA'S CLAIMS UNDER THE HIGHWAY ACT

Pursuant to the Highway Act, a toll and fare increase must be "just and reasonable." [AAA 1989 II](#), 887 F.2d at 418 ("Tolls on the Port Authority's bridges must be 'just and reasonable.' This requirement originated in section 4 of the Bridge Act of 1906, [33 U.S.C. § 494 \(1982\)](#). In 1987, Congress repealed the statutory provision that gave the Secretary of Transportation the power to prescribe 'just and reasonable' tolls. At the same time, Congress retained the requirement that tolls be 'just and reasonable.' The House Conference Report accompanying the Highway Act explained that the 'just and reasonable' requirement 'is not intended to interfere with or in any way restrict existing authority granted to multi-modal transportation agencies, such as the Port Authority of New York and New Jersey, that operate bridges along with other facilities to use bridge toll revenues for nonbridge purposes or the pooling or combination of the revenues from all of their facilities.'") (citations omitted).

As a threshold **[**53]** matter, the Port Authority argues there is no private right of action under the Highway Act. Def.'s Br. 26.

In support of its position, it points to Third Circuit law and to the decision of a district court case in this Circuit that has considered the issue, both of which found that [33 U.S.C. § 508](#) does not create a private right of action. See [Am. Trucking Ass'ns v. Del. River Joint Toll Bridge Comm'n](#), 458 F.3d 291, 302-04 (3d Cir. 2006); [Molinari v. N.Y. Triborough Bridge & Tunnel Auth.](#), 838 F. Supp. 718, 724 (E.D.N.Y. 1993).

Moreover, the Port Authority argues that, even if a private right of action is assumed for purposes of this motion, AAA's claim fails on its merits. Def.'s Br. 28. The Port Authority contends the test under the Highway Act is the same as that under the [Commerce Clause](#), and therefore AAA's Highway Act claim "must be dismissed because there is no dispute that the toll increase revenues do not [fully] cover the ITN's expenses." Def.'s Br. 29 ("AAA's contention that revenue is being diverted to support the [World Trade Center] reconstruction (or used to fund non-ITN projects) is belied by the uncontroverted financial state of the ITN.").

As to whether the Highway Act creates a private right of action, AAA responds by describing the statutory schemes that preceded the enactment of the Highway Act, which it believes demonstrate there is a private right of action under the Highway [\[**54\]](#) Act. Pls.' Br. 33. Specifically, AAA points out that "[p]rior to the enactment of the Highway Act, aggrieved parties had the right to challenge tolls first to the [Highway] Administrator and then to the federal courts. Congress eliminated the first step, but it did not eliminate the second level of review, the courts." Pls.' Br. 37. Furthermore, plaintiffs contend that in amending the prior statute, Congress retained the "just and reasonable" standard, which shows that "Congress impliedly approved the previous system for challenging tolls." Pls.' Br. 34. "In other words," according to AAA, "Congress intended that parties aggrieved by unjust and unreasonable tolls would continue to challenge such tolls, albeit without the burdensome administrative procedure." Pls.' Br. 34.

With respect to the merits, AAA responds that there are material factual issues as to whether the toll and fare increases [\[**394\]](#) violate the Highway Act.¹³ AAA argues that "there is no question based upon the testimony and documents from the Port Authority that the Commissioners approved a toll increase that was based on the needs of the *entire* Port Authority, not the

¹³ It should be noted, however, that like AAA's Dormant [Commerce Clause](#) claim, AAA's Complaint only contends that the 2011 toll [\[**56\]](#) and fare increases violate the Highway Act because they will be used to fund the World Trade Center reconstruction. See Compl. ¶¶ 2, 45, 48 ("[T]he Port Authority forces bridge and tunnel users to fund cost overruns and subsidize the speculative and unprofitable reconstruction and operation of the World Trade Center.").

needs of the ITN."¹⁴ Pls.' Br. 29 (emphasis added). Thus, plaintiffs [\[**55\]](#) argue that "[t]he toll increases cannot be just and reasonable where they are not based on the needs of the ITN." Pls.' Br. 30. In other words, AAA argues the toll and fare increases fail the "just and reasonable" test "because there are issues of fact concerning whether they are supporting projects outside the ITN and its transportation mission." Pls.' Br. 31. In support of their position, plaintiffs repeat their claims, first raised in their second motion for preliminary injunction, regarding the inclusion of the Lincoln Tunnel Access Project, the Bayonne Bridge project, and the CIF in the 2011 ITN Capital Plan, which they claim "add at least \$3.8 billion to the supposed 'ITN capital plan,'" and conclude "the toll increases based on that plan, inflated by almost \$4 billion of non-ITN expense[s], is not 'just and reasonable.'" Pls.' Br. 32. Plaintiffs also repeat their financial analysis argument, contending "a rate of return analysis demonstrates that a toll increase was not just and reasonable, and certainly not a massive toll increase spanning five years into the future." Pls.' Br. 32.

As to the threshold question of whether a private right of action exists under [§ 508](#), the court agrees with Judge Holwell's analysis at an earlier stage in this case and finds it doubtful that Congress would provide for a "just and reasonable" requirement in the plain text of [§ 508](#) with no real enforcement mechanism:

American Trucking focused on legislative history and relied on the four factor test in [Cort v. Ash](#), 422 U.S. 66, 95 S. Ct. 2080, 45 L.Ed.2d 26 (1975) to find no private right of action under [Section 508](#). 458 F.3d at 304. But more recent cases in this circuit and at the Supreme Court have emphasized that the "text and structure" of a statute are the primary indicators of a private right of action. [Alexander v. Sandoval](#), 532 U.S. 275, 288, 121 S. Ct. 1511, 149 L.Ed.2d 517 (2001); [Lopez v. Jet Blue Airways](#), 662 F.3d 593, 596 (2d Cir. 2011); see also [Lindsay v. Ass'n of Prof'l Flight Attendants](#), 581 F.3d 47, 52 n.3 (2d Cir. 2009) (noting that the [\[**57\]](#) four-factored test in *Cort v. Ash* is subordinate to an analysis of the statutory text). The text of the Highway Act made two main changes to the laws regarding interstate bridges and bridges over navigable waters. First, it eliminated administrative review of tolls on these bridges by repealing sections of the General Bridge Acts of 1906 and 1946. Second, it added [33 U.S.C. § 508](#), mandating that tolls on these bridges "shall be just and reasonable." See [Molinari](#), 838 F. Supp. at 722-23.

¹⁴ Despite AAA's arguments, as stated above, the relevant question in this case is what the revenue from the toll and fare increases was actually used for, not what potential uses were considered during preliminary planning and budgeting.

The statutory construction in *American Trucking* leaves no means for enforcement of this deliberate latter addition, [*395] making the words "just and reasonable" mere surplusage and conflicting with the text and structure of the rest of the act. "[C]ourts should avoid statutory interpretations that render provisions superfluous" *State Street Bank and Trust Co. v. Salovaara*, 326 F.3d 130, 139 (2d Cir. 2003); see also *Williams v. Taylor*, 529 U.S. 362, 404, 120 S. Ct. 1495, 146 L.Ed.2d 389 (2000) (describing the rule against surplusage as a "cardinal principle of statutory construction"). The *American Trucking* court's suggestion that "the state political process could be the venue that Congress had in mind for the airing of toll grievances" is a bit of a dodge, as one state's legislature cannot unilaterally modify tolls on a bi-state bridge without impinging on the rights of the other state's citizens in violation [**58] of the *Commerce Clause*. See *Covington & C. Bridge Co. v. Commonwealth of Kentucky*, 154 U.S. 204, 222, 14 S. Ct. 1087, 38 L.Ed. 962 (1894). And, if the *American Trucking* court's reliance on legislative history was even appropriate, it waved away Committee reports from two earlier (but unpassed) versions of the Highway Act containing similar "just and reasonable" language, reports which stated that "the Committee has created a basis for which a user may commence suit in Federal court" upon belief "that actions of a toll authority are not just and reasonable." *American Trucking Association*, 458 F.3d at 301.

The Third Circuit noted with favor Judge Korman's observation in *Molinari* that "the Supreme Court long ago refused to find a private right of action in statutory language indistinguishable from that used in § 508." *American Trucking Association*, 458 F.3d at 304 (citing *Molinari*, 838 F. Supp. at 724). But the cases cited in *Molinari* as containing similar "just and reasonable" requirements, *T.I.M.E. Inc. v. United States*, 359 U.S. 464, 79 S. Ct. 904, 3 L.Ed.2d 952 (1959) and *Montana-Dakota Utilities Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 71 S. Ct. 692, 95 L.Ed. 912 (1951), are readily distinguishable as addressing statutes which included comprehensive regulatory enforcement mechanisms. See *T.I.M.E.*, 359 U.S. at 469, 79 S. Ct. 904 ("language of this sort in a statute which entrusts rate regulation to an administrative agency in itself creates only a 'criterion for administrative application in determining a lawful rate' rather than a 'justiciable legal right[.]'" (quoting *Montana-Dakota*, 341 U.S. at 251, 71 S. Ct. 692) (emphasis added). A better parallel might be drawn to *Wilder v. Virginia Hospital Association*, 496 U.S. 498, 110 S. Ct. 2510, 110 L.Ed.2d 455 (1990), which found that [**59] Congress "left no doubt of its intent for private enforcement" when it required States to pay an entitlement to Medicare providers that was reasonable and

adequate, "with no sufficient administrative means of enforcing the requirement against States that failed to comply." *Gonzaga University v. Doe*, 536 U.S. 273, 280-81, 122 S. Ct. 2268, 153 L.Ed.2d 309 (2002).

AAA I, 842 F. Supp. 2d at 679 n.5. Accordingly, the court finds that there is a private right of action under § 508.

Nonetheless, AAA's arguments on the merits are unpersuasive. First, as with their claim regarding the Dormant *Commerce Clause*, the only claim plaintiffs actually raise in their Complaint with respect to the Highway Act is that the 2011 toll increases violate the Act by providing funding for the World Trade Center reconstruction. See Compl. ¶¶ 2, 45, 48. As has been discussed, AAA has presented no evidence tending to prove this claim. In addition, plaintiffs never sought leave to amend their Complaint, and thus the claims regarding [*396] the inclusion of the Lincoln Tunnel Access Project, the Bayonne Bridge project, and the CIF in the 2011 ITN Capital Plan cannot be heard. Finally, for the court, the "just and reasonable" standard found in § 508 is aligned with the *Northwest Airlines* test for reasonableness. See *AAA I*, 842 F. Supp. 2d at 679-80. That is, having found that AAA failed to "come forward [**60] with 'specific facts showing that there is a genuine issue for trial'" with respect to its Dormant *Commerce Clause* claims, its identical claims made under the Highway Act, if viable, would similarly fail. See *Matsushita*, 475 U.S. at 587 (quoting *Fed. R. Civ. P. 56(c)*). In sum, because AAA raises the same arguments with regard to its claims under the Highway Act that it raised with respect to the Dormant *Commerce Clause*, those claims must also be dismissed.

CONCLUSION

For the foregoing reasons, defendant's motion for summary judgment is GRANTED, and plaintiff's claims are dismissed in their entirety.

Dated: November 18, 2016

New York, New York

/s/ Richard K. Eaton

Richard K. Eaton, Judge

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EXHIBIT 22

Caldwell v. City of San Francisco

United States District Court for the Northern District of California

April 13, 2021, Decided; April 13, 2021, Filed

Case No. 12-cv-01892-DMR

Reporter

2021 U.S. Dist. LEXIS 72358 *; 2021 WL 1391464

MAURICE CALDWELL, Plaintiff, v. CITY OF SAN FRANCISCO, et al., Defendants.

Prior History: [Caldwell v. City of San Francisco, 2015 U.S. Dist. LEXIS 35232, 2015 WL 1265048 \(N.D. Cal., Mar. 19, 2015\)](#)

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Judges: Donna M. Ryu, United States Magistrate Judge.

Opinion by: Donna M. Ryu

Opinion

ORDER GRANTING DEFENDANTS' MOTION IN LIMINE NO. 18

Re: Dkt. No. 549

Plaintiff Maurice Caldwell retained Martin Cunniff to "analyze Mr. Caldwell's earning capacity had he not been wrongfully convicted, and to calculate the economic loss that Mr. Caldwell

incurred due to his wrongful conviction [*2]" [Docket No. 654-6 ("Cunniff Expert Report") at 2.] Defendants move to exclude Cunniff's testimony entirely. [Docket No. 549 ("MIL").] Caldwell opposes. [Docket No. 640 ("Opp.").]

For the reasons stated below, Defendants' motion is granted, contingent on Defendants' ability to reach agreement with Plaintiff on proposed language to be read to the jury regarding the parties' positions on the cost of therapeutic services reduced to present value.

I. BACKGROUND

Cunniff's report offers these five opinions:

1. "Maurice Caldwell suffered total past economic damages from loss of earnings capacity because of his wrongful incarceration and imprisonment in the range of **\$3,209,976 to \$6,651,259** including prejudgment interest; if prejudgment interest was not included, then the range would be **\$1,681,909 to \$3,515,225.**"
2. "Maurice Caldwell has suffered total future economic damages from loss of earnings capacity because of his wrongful imprisonment in the range of **\$1,012,918 to \$2,035,397** after adjustment to present value, and a loss in the range of **\$293,854 to \$423,102** for impaired Social Security retirement benefits."
3. "Maurice Caldwell has suffered lost investment earnings from retirement [*3] accounts in the amount of **\$601,919.**"
4. "[I]he cost for Mr. Caldwell for the psychotherapeutic services which Prof. Paul Abramson has determined are necessary for Mr. Caldwell, reduced to present value, is **\$415,366.**"
5. "Maurice Caldwell has suffered hedonic damages for the loss of ability to enjoy life because of his wrongful conviction in the amount of **\$749,400.**"

Cunniff Expert Report at 2 (emphasis in original). With respect to the first and second opinions, Cunniff explains that a loss of earnings capacity calculation is appropriate where a plaintiff has a lack of established work history. *Id.* at 5. Cunniff states that his calculations look at "the earning capacity of career choices that the plaintiff had a reasonable probability of achieving." *Id.*

Cunniff was instructed by Caldwell's counsel to assume that Caldwell had a reasonable probability of pursuing at least three careers if he had not been incarcerated: (a) carpenter; (b) insurance salesperson; and (c) construction manager. Cunniff Expert Report at 2; *see* Opp. at 2. Cunniff then calculated the estimated earnings for individuals in these professions over the period that Caldwell was incarcerated to reach his ultimate opinions about Caldwell's [*4] damages for loss of earnings capacity. Cunniff acknowledges that at the time of Caldwell's 1990 imprisonment, he "had not selected a career, and had worked occasionally as a warehouseman and as a carpenter but did not have an established work history in any occupation." Cunniff Expert Report at 5.

On March 11, 2021, the court ordered Caldwell to file an offer of proof that "discloses all admissible foundational facts supporting the underlying assumptions Cunniff used to calculate Plaintiff's economic damages based on the identified professions," including a detailed explanation about how that information will be offered into evidence. [Docket No. 685.] Caldwell responded on March 16, 2021. [Docket No. 703.] The court determined that the filing went "far beyond the court's order" because it included "additional legal argument and citations [and] additional argumentative analysis about how the anticipated evidence meets the cited legal standards." [Docket No. 705.] It accordingly struck the filing and ordered Caldwell to file an amended offer of proof, which he did on March 17, 2021. [Docket No. 707 ("Offer of Proof").] The court found that portions of the new filing "continue to contain [*5] improper argumentative analysis" and accordingly struck the argumentative portions of the offer of proof. [Docket No. 709.] The court accepted the portions of the offer of proof that were purely factual.

The offer of proof explains that Caldwell began working a paper route when he was 12 years old. Offer of Proof at 1. He then spent close to five years in the custody of the California Youth Authority and was discharged in August 1988. During the 2-year period from August 1988 to his arrest in September 1990, Caldwell was "constantly looking for work." *Id.* From about November 1988 to September 1990, he worked two to three days a week, for two to four hours per day, at a hair salon. *Id.* From February to July 1990 he worked full-time as a warehouseman and forklift operator. *Id.* Caldwell "regularly took on other short-term work when possible." *Id.* For approximately

five months from October 1988 through February 1989, Caldwell worked full-time on several remodeling projects with a family friend who had a carpentry and contracting business. *Id.* He continued working with that individual on an intermittent basis until his arrest in September 1990. *Id.* at 2. He estimates that he worked on about ten different projects [*6] between March 1989 and September 1990, and that each project took between one to eight weeks. *Id.* Between July or August 1989 through November 1989, Caldwell worked full-time on carpentry projects with another family friend. *Id.* Caldwell took on several other miscellaneous day labor jobs when such opportunities arose, including janitorial work, carpentry, and painting. *Id.* While he was incarcerated, Caldwell worked as a porter and doing laundry and kitchen work. *Id.* at 3.

II. LEGAL STANDARD FOR EXPERT TESTIMONY

[Federal Rule of Evidence \("FRE"\) 702](#) governs testimony by expert witnesses. It provides that:

A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if:

- (a) the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue;
- (b) the testimony is based on sufficient facts or data;
- (c) the testimony is the product of reliable principles and methods; and
- (d) the expert has reliably applied the principles and methods to the facts of the case.

[Fed. R. Evid. 702](#). [FRE 702](#) "contemplates a broad conception of expert qualifications," which may be obtained [*7] through "knowledge, skill, experience, training, or education." [Thomas v. Newton Int'l Enterprises](#), 42 F.3d 1266, 1269 (9th Cir. 1994) (emphasis added). "In *Daubert* the Court charged trial judges with the responsibility of acting as gatekeepers to exclude unreliable expert testimony." [FRE 702](#), Advisory Committee Notes, 2000 Amendments (citing [Daubert v. Merrell Dow Pharmaceuticals, Inc.](#), 509 U.S. 579, 113 S. Ct. 2786, 125 L. Ed. 2d 469 (1993)). The standards outlined in *Daubert* apply to all expert testimony, not just testimony based in science. [Kumho Tire Co. v. Carmichael](#), 526 U.S. 137, 156-57, 119 S. Ct. 1167, 143 L. Ed. 2d 238 (1999). However, "the rejection of expert testimony is the exception rather than the rule." [FRE 702](#), Advisory Committee Notes, 2000 Amendments (citing cases). "Vigorous cross-examination, presentation of contrary evidence, and careful

instruction on the burden of proof are the traditional and appropriate means of attacking shaky but admissible evidence." [Daubert](#), 509 U.S. at 595.

III. DISCUSSION

Defendants move to exclude Cunniff's testimony on the basis that (1) he is not qualified to testify as an expert witness on Caldwell's earning capacity; (2) his methodologies regarding Caldwell's economic losses and hedonic damages are unreliable; and (3) his testimony is prejudicial and confusing.

A. Expert Qualifications

Cunniff is an attorney. He graduated from Loyola University in May 1983 with a bachelor's degree in business administration and from Frederic Levin [*8] College of Law in December 1989. Cunniff Expert Report, Ex. 1. He describes himself as a "[s]easoned litigator with over thirty years of extensive, in-depth experience in all types of business litigation including antitrust, intellectual property, securities fraud, securities enforcement, consumer finance, and economic valuation issues." *Id.*, Ex. 1. He states that his career has focused on the calculation of damages, and as a litigator, he has handled "the damages case for hundreds of cases including approximately two dozen commercial trials and arbitrations." *Id.* at 3. Cunniff is the co-author and co-editor of a treatise on damages, "Calculating and Proving Damages," which was published by Law Journal Press in 2011. *Id.* Cunniff avers that he has read "hundreds, if not thousands, of cases, articles and economic analyses on damages" and has "kept up with developments in the field." *Id.*

Cunniff has made presentations at various law firms on "building the damages case in litigation." Cunniff Expert Report at 3. He has also taught damages-related courses at the FBI Academy in Quantico, VA, the FBI National Convention of Accountants, and training programs and conferences put on by the American Institute [*9] of Certified Public Accountants. *Id.* He has experience in "developing competency models to evaluate employees on their skills and aptitudes," although it appears that he has only applied those skills in evaluating lawyers. *Id.* Finally, Cunniff states that he has "been involved in working with hundreds of economists on various pieces of complex litigation." *Id.* Cunniff has never served as an expert witness in a lawsuit.

Defendants argue that Cunniff is not qualified to testify as an expert on Caldwell's loss of earning capacity. MIL at 5. They point out that Cunniff is a lawyer and that his experience assessing economic damages relates exclusively to his

commercial litigation practice. *Id.* They assert that Cunniff is not a certified vocational rehabilitation counselor, a professional economist, a certified public accountant, or in any other profession qualified to testify about earning capacity. *Id.* at 5-6. Caldwell responds that [Rule 702](#) "contemplates a broad conception of expert qualifications," and that experts do not need to have official credentials in the subject matter of their testimony in order to meet [Rule 702](#) standards. Opp. at 3 (quoting [Thomas v. Newton Intern. Enterprises](#), 42 F.3d 1266, 1269 (9th Cir. 1994)). He argues that Cunniff is an "experienced professional in the calculation of [*10] damages," is the co-author and co-editor of a peer-reviewed treatise on damages, and as a commercial litigator, has "investigated, evaluated, and presented damages in hundreds of cases." *Id.* at 3-4.

It appears undisputed that Cunniff's purported qualifications come from his experience rather than any particular credentials. [Rule 702](#) "expressly contemplates that an expert may be qualified on the basis of experience. In certain fields, experience is the predominant, if not sole, basis for a great deal of reliable expert testimony." [Fed. R. Evid. 702](#) (Advisory Committee Notes, 2000 Amendments). However, if an expert witness "is relying solely or primarily on experience, then the witness must explain how that experience leads to the conclusion reached, why that experience is a sufficient basis for the opinion, and how that experience is reliably applied to the facts." *Id.* In evaluating a proposed expert's qualifications, the court looks not at the "qualifications of a witness in the abstract, but whether those qualifications provide a foundation for a witness to answer a specific question." [Berry v. City of Detroit](#), 25 F.3d 1342, 1351 (6th Cir. 1994).

Neither Cunniff's report nor Caldwell's opposition brief explain how Cunniff's experience as a commercial litigator is a sufficient [*11] basis for his opinions regarding loss of earning capacity in a wrongful imprisonment case. Cunniff testified in his deposition that he has only ever assessed earning capacity loss in the context of commercial litigation. Cunniff Depo. at 31:7-15. It is unclear whether any of the cases Cunniff worked on involved a similar analysis to the one he offers in this case—namely, loss of earnings capacity for an individual with minimal prior work experience. Cunniff has never completed a transferable skills analysis or analyzed labor market access. *Id.* at 31:4-9. He has only ever assessed vocational aptitude in a law firm environment assessing lawyer competencies. *Id.* at 30:11-23. He also did not consult with any other professionals in forming his opinions in this case, including any vocational rehabilitation counselors or economists. *Id.* at 60:6-15. It is not clear whether Cunniff has ever worked on any damages modeling outside of his role as a legal advocate in the area of commercial litigation.

Caldwell's primary argument on this point is that Cunniff is not testifying as a vocational rehabilitation counselor but instead only opining as to the quantum of damages. Opp. at 4. This argument is disingenuous [*12] and ignores Cunniff's report, which makes clear that he purports to have evaluated Caldwell's vocational aptitudes in order to formulate his opinions:

California, and many other jurisdictions, uses a "reasonable probability" standard, i.e., using the earning capacity of career choices that the plaintiff had a reasonable probability of achieving. I have used the reasonable probability standard in conducting this analysis

Based on my interview with Mr. Caldwell, review of his deposition transcript, information from his lawyers as to speaking engagements that Mr. Caldwell has had since his release, and information from a correctional officer who supervised Mr. Caldwell while he was incarcerated, I assume there is a reasonable probability that Mr. Caldwell could have followed at least the following careers had he not been incarcerated: (1) carpenter; (b) insurance salesperson; and (c) construction manager

Based on my interview with Mr. Caldwell, he does have an aptitude for building things and was engaged in various jobs in prison that required manual dexterity, physical strength, and physical stamina. His public speaking and public testimony experience also support the existence [*13] of business skills and problem-solving skills. . . .

[Caldwell's] decades-long battle against his wrongful conviction shows persistence and he clearly has a high energy level. His public speaking and public testimony experience show emotional intelligence and a desire to put the needs of others before his own. He is proficient with technology and likes to learn new technologies. . . .

Mr. Caldwell does have excellent communication skills and has been able to work in teams during his time in prison. He indicated that he often became the team leader or manager in the jobs he had in prison.

Cunniff Expert Report at 5-7. As discussed more below, Cunniff also makes reference to a few websites to inform his opinions about Caldwell's vocational aptitudes. Cunniff's damages calculations rely on his evaluation of Caldwell's work-related experience and skills. It does not make sense to say that Cunniff is only testifying about the "quantum" of damages when that testimony relies on his explicit assessment of Caldwell's vocational aptitudes.

In sum, Caldwell has not established by a preponderance of the evidence that Cunniff is qualified to testify about the economic

damages he suffered as a result [*14] of his wrongful conviction. See *Bourjaily v. United States*, 483 U.S. 171, 175-76, 107 S. Ct. 2775, 97 L. Ed. 2d 144 (1987) (stating that the proponent of witness testimony has the burden of establishing its admissibility by a preponderance of the evidence). Although (with one exception) the court excludes the entirety of Cunniff's testimony on the basis of Cunniff's qualifications, the court examines Cunniff's particular opinions below to further illustrate the disconnect between Cunniff's qualifications and the subject of his testimony, as well as to identify other serious problems that lead to the conclusion that his opinions should be excluded.

B. Methodology

1. Past and Future Economic Damages

Cunniff's first and second opinions relate to Caldwell's total past and future economic damages from loss of earnings capacity. As explained above, Caldwell's attorneys instructed Cunniff to assume that Caldwell could have pursued a career as a carpenter, insurance salesperson, or construction manager. Opp. at 2. Cunniff has no background as a vocational expert, did not consult with any vocational experts, and did not rely upon any well-established vocational texts such as the Dictionary of Occupational Titles ("DOT"). Instead, Cunniff "tested" this assumption by interviewing Caldwell for [*15] about an hour on the phone. Opp. at 2; see Cunniff Depo. at 62:23-63:14. Based on that interview, information from Caldwell's attorneys' about the speaking engagements Caldwell has had since his release, and (unspecified) information from Christopher Buckley, Cunniff determined that there was "enough evidence for [him] to make a reasonable assumption that there is a reasonable probability that Mr. Caldwell could have pursued a career" in any of those three professions. See Cunniff Expert Report at 6-7. To explain what skills those three careers require, Cunniff cites various websites, including Truity (a publisher of online personality and career tests), Investopedia (a website providing information and advice about the financial market), and Construction World (a website for news and resources relating to the construction industry). Cunniff Expert Report at 6-7. For example, Investopedia states that insurance agents must have good people skills and emotional intelligence.¹ Cunniff opines that Caldwell has those skills based on his public speaking experiences following his incarceration. *Id.* at 7.

¹ Investopedia, *8 Qualities That Make a Good Insurance Agent*, <https://www.investopedia.com/financial-edge/1212/8-qualities-that-make-a-good-insurance-agent.aspx> (last accessed March 30, 2021).

Under [FRE 703](#), expert opinions may be based on facts or data that are **[*16]** derived from three possible sources: (1) "firsthand observation of the witness with opinions based thereon traditionally allowed" (e.g., an opinion by a treating physician); (2) evidence presented at trial; and (3) "presentation of data to the expert outside of court and other than by his own perception." [Fed. R. Evid. 703](#), Advisory Committee Notes. Although the facts or data underlying an expert's opinion need not be admissible, they must be the kind that "experts in the particular field would reasonably rely on . . . in forming an opinion on the subject." [Fed. R. Evid. 703](#). The Ninth Circuit has recognized that experts cannot insert non-existent facts into the record through their expert reports. In affirming a district court's decision to exclude expert testimony at summary judgment, the Ninth Circuit cautioned that "[a] party's own speculation is insufficient to create a genuine issue of material fact, and a party cannot make it sufficient simply by finding an expert who is willing to assume its correctness." [Stephens v. Union Pac. R.R. Co.](#), 935 F.3d 852, 857 (9th Cir. 2019); see also [In re Citric Acid Litig.](#), 191 F.3d 1090, 1102 (9th Cir. 1999) ("[A]n expert report cannot be used to prove the existence of facts set forth therein."). Thus, courts have rejected attempts to use experts as mere "conduits" for otherwise inadmissible evidence. **[*17]** See [Marvel Characters, Inc. v. Kirby](#), 726 F.3d 119, 136 (2d Cir. 2013) ("Although the Rules permit experts some leeway with respect to hearsay evidence, . . . a party cannot call an expert simply as a conduit for introducing hearsay under the guise that the testifying expert used the hearsay as the basis of his testimony." (cleaned up)). For example, in *United States v. Mejia*, the expert witness whose testimony was challenged "identified hearsay as the source of much of his information." [545 F.3d 179, 197 \(2d Cir. 2008\)](#). The Second Circuit determined that at least part of the witness's testimony inappropriately "involved merely repeating information he had read or heard" without an explanation of "how he had pieced together bits of information from different sources and reached a studied conclusion that he then gave the jury." [Id. at 197-98](#). Accordingly, expert witnesses may not simply repeat hearsay without "bring[ing] their expertise to bear" on it. [Marvel Characters, Inc.](#), 726 F.3d at 136; see [Wi-LAN Inc. v. Sharp Elecs. Corp.](#), 992 F.3d 1366, 2021 U.S. App. LEXIS 9909, 2021 WL 1257074, at *7 (Fed. Cir. Apr. 6, 2021) (rejecting a party's attempt to use expert testimony as a "backdoor" to "allow the admission into evidence of otherwise inadmissible declarations and other materials").

In this case, Cunniff's analysis is not proper expert testimony. He is not a vocational expert. His sources about job skills are non-scholarly websites with no clear indication **[*18]** of how the cited material was developed or on what expertise. Cunniff did not consult any of Caldwell's records, including standardized test scores, employment records or educational history. Cunniff did not administer any vocational tests or rely on the testimony

of a vocational expert. Instead, Cunniff's aptitude assessments are based on Caldwell's self-reported skills, information from Caldwell's attorneys, and unidentified opinions offered by Buckley. Many of those facts do not otherwise appear in the record. There is no indication of how Cunniff applied his purported expertise to synthesize or analyze the facts upon which he relied. Thus, instead of offering his own opinions, Cunniff is essentially functioning as a "mouthpiece of the [individuals] on whose statements or opinions [he] purports to base his opinion." [Wi-LAN Inc.](#), F.3d., 2021 U.S. App. LEXIS 9909, 2021 WL 1257074, at *6. Accordingly, Cunniff's testimony as to Caldwell's ability to perform in any of the identified positions is not "specialized knowledge" that will "help the trier of fact to understand the evidence or to determine a fact in issue" and must be excluded. See [Fed. R. Evid. 702\(a\)](#).

Caldwell's arguments to the contrary are not persuasive. First, Caldwell argues that "Defendants do not present **[*19]** any evidence to support their assertions that Mr. Cunniff's methodology is flawed," such as "learned treatises or professional literature critiquing his methodology." Opp. at 5. This argument turns the burden of proof for admissibility on its head, since the proponent must show by the preponderance of the evidence that testimony offered is admissible. See [Bourjaily](#), 483 U.S. at 175-76. Thus, it is Caldwell's burden to show that the methodologies Cunniff employed are reliable. As explained above, Cunniff does not apply specialized knowledge in analyzing the facts underlying his opinion. He also does not provide any information about how experts usually analyze loss of earnings capacity for people like Caldwell who did not have significant prior earnings.²

Second, Caldwell argues that Defendants' concerns go to the weight of the evidence rather than its admissibility. See Opp. at 5. He cites *Alaska Rent-A-Car, Inc. v. Avis Budget Grp., Inc.* for the proposition that "the judge is supposed to screen the jury from unreliable nonsense opinions, but not exclude opinions merely because they are impeachable." 738 F.3d 960, 969 (9th Cir. 2013). However, that case also says that the district court is "not tasked with deciding whether the expert is right or wrong, just whether **[*20]** his testimony has substance such that it would be helpful to a jury." [Id. at 969-70](#). It is not helpful for the jury

²Cunniff provides several factors for calculating earning capacity generally, including work-life expectancy, actual or mitigating earnings, the present value of the net earnings loss, and the personal consumption expenditures that were "saved" because of the occurrence leading to the loss. Cunniff Expert Report at 5-6. However, Cunniff does not point to any authorities that explain how to calculate loss of earnings capacity for someone without significant prior work experience.

to hear what a carpenter, insurance salesperson, or construction worker could have made over the course of 20 years if there is not a proper foundation, expert or otherwise, that Caldwell had the reasonable ability to pursue those careers. Cunniff is not a vocational expert, and his report does not lay out a proper factual basis for his assumption that Caldwell could have pursued each of the identified professions. Caldwell's offer of proof does little to shed light on these issues. While it does discuss unspecified carpentry projects and other miscellaneous jobs Caldwell completed during a relatively short time period, it does not explain any of the specific skills that he developed, and does not offer a sufficient basis for Cunniff's assumption that Caldwell could have immediately began full-time employment as a professional carpenter.³ It contains virtually no factual basis for the insurance salesperson and construction manager assumptions. While Caldwell will have the opportunity to offer his own testimony about his work-related skills and experiences, there is not a sufficient [*21] foundation for expert testimony about earnings capacity in the three specific skilled professions discussed by Cunniff.

Third, Caldwell asserts that Cunniff is opining about Caldwell's loss of earnings capacity rather than actual lost earnings. The difference, he explains, is that a plaintiff does not have to prove what he *would* have made absent an injury (e.g., based on past earnings history) but only what he *could* have made. See Opp. at 7-9. Caldwell relies mainly on *Licudine v. Cedars-Sinai Med. Ctr.* to explain how to calculate loss of earnings capacity. Opp. at 9; see [3 Cal. App. 5th 881, 894, 208 Cal. Rptr. 3d 170 \(2016\)](#). That case states that such damages are calculated based on what the plaintiff was "capable of earning, rather than what he was actually earning" and so "proof of the plaintiff's prior earnings, while relevant to demonstrate earning capacity, is not a prerequisite to the award of these damages." *Id.* at 893. In *Licudine*, the court examined at length how the jury is supposed to decide which careers are "available" to the plaintiff and determined that the jury must look at career choices that the plaintiff had a "reasonable probability of achieving." [3 Cal. App. 5th at 894](#).

Licudine actually cuts against the admissibility of Cunniff's testimony. As Caldwell acknowledges, [*22] he had a minimal work history before his incarceration. *Licudine* notes that where a

plaintiff does not have a prior work history (such as for a young plaintiff), courts have "fixed the lost earning capacity as the average salary of all workers in the workforce," under the assumption that it was reasonably probable that the plaintiff was fit to do *something* in the workforce. [3 Cal. App. 5th at 896](#). "However, where a young plaintiff's injury prevents him or her from pursuing a *specific* career, courts have generally required some proof that the plaintiff is far along in his or her training or experience." *Id.* (emphasis added). Here, Cunniff is not just offering testimony about the average earning capacity across the entire workforce; he analyzes Caldwell's damages based on three specific professions. There is nothing in the record establishing that Caldwell had any training or experience in construction management or insurance sales, and insufficient evidence that Caldwell could have instantly qualified as a full-time professional carpenter based on his work experiences with family friends. Notably, in *Licudine*, the court determined that the plaintiff had not presented sufficient evidence that she could have [*23] become qualified to earn a lawyer's salary even though she was about to start law school before she was injured. *Id.* at 899 ("Absent from the record is any evidence of her likelihood of graduating from Suffolk Law School, her likelihood of passing the Bar, or her likelihood of obtaining a job as a lawyer."). Caldwell does not cite any cases where a court permitted expert testimony about earnings capacity for specific professions based on cursory assumptions about a plaintiff's ability to pursue those professions. *Licudine* and the other cases cited by Caldwell only establish that damages for loss of earnings capacity can be awarded, not that testimony like Cunniff's is reliable to establish the amount of such damages.⁴

In sum, Cunniff starts from minimally supported assumptions to extrapolate significant and specific economic damages. His speculative testimony does not meet the minimum standards required for expert opinions. See [Stephens, 935 F.3d at 856](#) ("[An] expert's opinion must rest on 'facts or data in the case that the expert has been made aware of or personally observed,' not merely assumptions and speculation." (quoting [Fed. R. Evid. 703](#))). Accordingly, Caldwell has not established that Cunniff's testimony regarding his loss of [*24] earnings capacity for specific, skilled professions is "based on sufficient facts or data"

⁴Cunniff's opinion about impaired social security retirement benefits is similarly flawed because it relies upon the same vocational assumptions.

³The DOT uses a Specific Vocational Preparation ("SVP") rating that indicates the amount of training or experience an individual needs to perform their job at an average performance level. Carpentry has an SVP rating of 7, indicating skilled work. See [DOT 860.381-022](#). Cunniff did not provide an analysis of how Caldwell's past experience working intermittently for family friends would immediately qualify him for skilled labor as a carpenter.

Caldwell requests that the court allow Cunniff to testify, at minimum, about the earnings of a warehouseman or janitor (the professions Defendants identify as those that Caldwell had a reasonable probability of achieving) or as to the average salary of all workers in the workforce. [Docket No. 703 at 8.] The court denies this request. Caldwell may not bring in last minute expert testimony for which there is no expert report and no opportunity for Defendants to examine or rebut.

or "the product of reliable principles and methods." See [Fed. R. Evid. 702](#).

2. Lost Investment Income

Another example of an opinion disconnected from a factual basis is Cunniff's opinion that "Caldwell has suffered past economic damages from loss of investment income on retirement savings because of his wrongful imprisonment in the amount of \$601,919." Cunniff Expert Report at 11. He states, "Like most American workers, I assume Mr. Caldwell would have invested in a retirement account like a 401K retirement savings account." *Id.* Cunniff also assumes a \$500 per month investment increased by the inflation rate to reach his damages calculation.

Cunniff provides no support for his factual assumptions. He does not cite any evidence showing that "most American workers" have a 401k or other retirement savings, or that it is reasonable to assume that Caldwell (or an average worker) would or could invest \$500 per month in such an account even if he had one. Further, his report assumes without support that Caldwell would have started investing \$500 per month in retirement savings in 1991, which (based on the minimal amount [*25] of evidence about Caldwell's pre-incarceration employment) is entirely speculative.

Cunniff's unsupported speculation about Caldwell's lost investment income is indicative of his unreliable methodology and provides further support for the exclusion of his testimony.

3. Hedonic Damages

Cunniff's opinion on hedonic damages suffers from a flawed methodology. Hedonic damages are based on "the loss of the pleasure of being alive." [Mark H. v. Lemahieu, 513 F.3d 922, 930 n. 6 \(9th Cir. 2008\)](#) (quoting Black's Law Dictionary 417 (8th ed. 2004)). Cunniff opines that Caldwell suffered hedonic damages because of his wrongful imprisonment in the amount of \$749,400. Cunniff Expert Report at 12. Cunniff reaches this figure by examining the cost of "pay-to-stay" jails, which allow incarcerated people who can afford it to pay for a safer, cleaner facility. *Id.* Prices for these paid options vary by city, usually in the range of \$75-\$251 for California jails, but Cunniff settles on a rate of \$100 per day as a "useful proxy for how much a consumer would pay to still 'enjoy life' while incarcerated." *Id.* He states that it is a conservative price because presumably people would be willing to pay more to avoid jail altogether. *Id.* He calls this kind of calculation [*26] a "real world" market experiment. *Id.* Cunniff concludes that Caldwell's hedonic

damages are \$100 per day multiplied by the 7,494 days he was wrongfully imprisoned, for a total of \$749,400.

Some courts have entirely excluded expert testimony on the issue of hedonic damages. A number of courts have rejected such testimony as scientifically dubious because it attempts to quantify, as a scientific matter, the value of an average human life. See, e.g., [Smith v. Ingersoll-Rand Co., 214 F.3d 1235, 1245 \(10th Cir. 2000\)](#) ("[F]ederal courts which have considered expert testimony on hedonic damages in the wake of *Daubert* have unanimously held quantifications of [hedonic] damages inadmissible.") (citing cases); [Rascon v. Brookins, 2018 U.S. Dist. LEXIS 20088, 2018 WL 739696, at *6 \(D. Ariz. Feb. 7, 2018\)](#) (rejecting an expert economist's hedonic calculations as "too speculative and unconnected to how an individual values their life"); [McMullin v. United States, 515 F. Supp. 2d 914, 924 \(E.D. Ark. 2007\)](#) (finding that expert calculations on hedonic damages do not meet the *Daubert* standard because they are "attempting to quantify something which cannot truly be determined" (cleaned up)); [Crespo v. City of Chicago, 1997 U.S. Dist. LEXIS 12820, 1997 WL 537343, at *2 \(N.D. Ill. Aug. 22, 1997\)](#) ("The area of hedonic damages does not appear to survive scrutiny under th[e] *Daubert* framework."). Other courts have determined that expert testimony about hedonic damages is not helpful to the jury because jurors can decide based on their [*27] own experience what value to attach to such loss. See [Davis v. ROCOR Int'l, 226 F. Supp. 2d 839, 842 \(S.D. Miss. 2002\)](#) ("[T]he jury, composed of laypersons who presumably value their own life and loved ones, is equally equipped to place a quantitative value on . . . companionship, affection and society should the case call for such a determination." (cleaned up)); [Est. of DuBose v. City of San Diego, 2002 U.S. Dist. LEXIS 28297, 2002 WL 34408963, at *2 \(S.D. Cal. Oct. 1, 2002\)](#) ("[T]he jury will have the knowledge and life experience to determine a fair damages award based upon the testimony received at trial."); [Crespo, 1997 U.S. Dist. LEXIS 12820, 1997 WL 537343, at *3](#) ("We presently are of the opinion that the jury is able to decide for itself, without the assistance of an economics expert, the value that our society places on a human life.").

Courts have been particularly skeptical of the methodology employed by Cunniff here, which is a "willingness-to-pay" method of calculating hedonic damages. See, e.g., [Kurnicz v. Honda N. Am., Inc., 166 F.R.D. 386, 388 \(W.D. Mich. 1996\)](#) ("The willingness to pay model on the issue of calculating hedonic damages is a troubled science in the courtroom, with the vast majority of published opinions rejecting the evidence.") (citing cases); [Est. of DuBose, 2002 U.S. Dist. LEXIS 28297, 2002 WL 34408963, at *2 \(S.D. Cal. Oct. 1, 2002\)](#) ("The willingness-to-pay evidence would not assist the jury in a way more meaningful than would occur if the jury asked a group of wise courtroom bystanders for their opinions." (cleaned up)). The court in

Ayers [*28] *v. Robinson* determined that several considerations "go a long way toward undermining the basic premise behind the willingness-to-pay model," including "(1) the assumption that people have freedom of choice in deciding to confront risk, (2) the assumption that people perceive risk accurately, (3) the nonmonetary factors that drive many consumer purchases (e.g., advertising) and employment decisions (e.g., civic pride), and (4) the political aspects of government regulation (e.g., budgets, lobbyists)." 887 F. Supp. 1049, 1063 (N.D. Ill. 1995). These basic criticisms highlight that there are many factors that influence a certain market, like "pay-to-stay" jails, that have nothing to do with an accurate valuation of an individual's enjoyment of life.

Accordingly, the court finds that a "willingness-to-pay" model of calculating hedonic damages is not "the product of reliable principles and methods" sufficient to pass muster under the Federal Rules of Evidence or *Daubert*. See [Fed. R. Evid. 702](#).

IV. CONCLUSION

For the reasons stated above, the court finds that Cunniff is not qualified to offer expert testimony about Caldwell's lost earnings capacity damages. Cunniff is not qualified as a vocational expert, yet his economic damage calculations rest [*29] upon pseudo-vocational opinions. His report relies on speculative factual assumptions and attempts to "backdoor" facts that do not exist and are not expected to be elicited at trial. He uses unsupported methodologies. All of these problems independently warrant exclusion. Cunniff's testimony is therefore excluded almost in its entirety.

Cunniff's opinion 4 regarding the present value cost for psychotherapeutic services which Prof. Paul Abramson determined to be necessary appears to fall within Cunniff's expertise, and rests on a sufficient factual basis and methodology. It makes little sense for Cunniff to be called to testify on this single relatively simple matter. The court orders the parties to meet and confer to agree upon a statement to be read to the jury on the facts to which Cunniff and the opposing expert would testify on this subject. The parties shall file a joint statement to this effect by **April 22, 2021**.

Defendants' expert Reg Gibbs provided a rebuttal report to Cunniff's testimony and Caldwell's expert Halford Fairchild wrote a reply to Gibbs' testimony. The parties filed respective motions to exclude the testimony of these experts. See Docket No. 580, Plaintiff's Motion [*30] in Limine No. 4; Docket No. 538, Defendants' Motion in Limine No. 7. Because Cunniff's testimony is largely excluded, the rebuttal and reply opinions addressing that testimony are also excluded and the

corresponding motions are therefore denied as moot.

IT IS SO ORDERED.

Dated: April 13, 2021

/s/ Donna M. Ryu

Donna M. Ryu

United States Magistrate Judge

End of Document

EXHIBIT 23



<https://www.investopedia.com/terms/g/grossincome.asp>

What Is Gross Income? Definition, Formula, Calculation, and Example

By WILL KENTON Updated March 23, 2026

Reviewed by ANDY SMITH

Fact checked by VIKKI VELASQUEZ

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DEFINITION:

Gross income is the total amount of money earned by an individual before any taxes or deductions are applied.

KEY TAKEAWAYS

- Gross income for a business is its total revenues minus the cost of goods sold.
- An individual's gross income is entered on

[SKIP TO CONTENT](#) tax return, and it becomes

individuals may also be required to report gross income when they're attempting to secure a loan.

- Businesses often use gross income instead of net income to better gauge the product-specific performance of the business.


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Gross Income
[grōs 'in-.kəm]
An individual's total earnings before taxes or other deductions.

Investopedia

On the other hand, net income is the amount left over after deductions are taken out.

Credit: Investopedia / Tara Anand

What Is Gross Income?

An individual's gross income is their total earnings before taxes or other deductions are taken out. It includes [income](#) from all sources, not just from employment. It's not limited to income that's received

les property or services

[SKIP TO CONTENT](#)



gross margin or [gross profit](#). A company's gross income is found on the [income statement](#). It's the revenue from all sources minus the firm's [cost of goods sold \(COGS\)](#).

How Gross Income Works




An individual's and a company's gross incomes have different components. An individual will easily be able to determine their gross income by consulting a recent pay stub or calculating their hours worked and wage. The gross income of a company can require a bit more computation.

An individual's gross income is used by [lenders](#) or [landlords](#) to determine whether that person is a worthy borrower or renter. Gross income is the starting point before subtracting deductions when preparing federal and state [income tax](#) returns.

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expenses are included in the analysis. A company doesn't want to see its rent expense included in performance if it wants to know how a specific product line is performing. Rent is an unrelated, administrative expense.

How to Calculate Gross Income

The approach to determining gross income for an individual is slightly different from the approach for a business. Both calculations are similar, but each entity uses different classifications of income and expenses.

Individual Gross Income

The gross income metric used on an individual's income [tax return](#) doesn't just include wages or salary but other forms of income as well such as [tips](#), [capital gains](#), rental payments, [dividends](#), [alimony](#), pension, and [interest](#). The result is [adjusted gross income \(AGI\)](#) after subtracting above-the-line tax deductions, ^[1]

Some income sources aren't included in gross income for tax purposes, but they may still be included when calculating gross income by a lender or [creditor](#). Common nontaxable income sources are certain Social Security benefits, [life insurance](#) payouts, some [inheritances](#) or [gifts](#), and state or [municipal bond](#) interest. ^[2] ^[3]

Individuals can usually use their total wages as gross income for non-tax purposes. Individual gross income will equal the amount of money the individual earns before any taxes are deducted or any expenses are [deductible](#); considered, because they're

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Business Gross Income

Gross income is a line item that's sometimes included in a company's income statement. It's calculated as gross revenue minus COGS if it's not displayed.

$$\text{Gross Income} = \text{Gross Revenue} - \text{COGS}$$

where:

$$\text{COGS} = \text{Cost of Goods Sold}$$

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Gross income is sometimes referred to as [gross margin](#) in business terms. There's also [gross profit margin](#) which is more correctly defined as a percentage and is used as a profitability metric. The gross income for a company reveals how much money it's made on its products or services after subtracting the direct costs to make the product or provide the service.

Business gross income can be calculated on a company-wide basis or a product-specific basis. A company can see how much profit each product is making as long as it's using a chart of accounts that allows tracking of revenue and cost by product.

IMPORTANT

The gross income metric factors in the direct cost of producing or providing goods and services, but it doesn't include costs related to selling activities, administration, taxes, and other costs related to running the overall business.

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can also be used to explain how much money a household is making or taking home.

Net income for an individual is the total residual amount remaining after all personal expenses have been paid for. Personal net income is calculated as the total amount of revenue earned less the total amount of personal expenses. This differs from gross income, which limits what can be deducted from total revenue earned.

An individual's net income more closely resembles their final paycheck amount. The individual likely has more expenses than what is deducted from their pay, but their paycheck is a good example of their revenue being reduced by costs.

Net income for a business is the total amount of revenue less the total amount of expenses. These expenses include the cost of goods sold, just like gross income, but net income also includes selling, [general, and administrative expenses](#), tax, interest, and other expenses that aren't included in the calculation of gross income.

Gross income is a much higher view of a company. Net income incorporates every facet of cost.

 **FAST FACT**

Gross income incorporates both revenue and specific expenses of driving that revenue, so it's often a better gauge for comparing dissimilar



Individual Gross Income Example

Assume that an individual has a \$75,000 annual salary, generates \$1,000 a year in interest from a savings account, collects \$500 per year in stock dividends, and receives \$10,000 a year from [rental property](#) income. Their gross annual income is therefore \$86,500. The individual can calculate that their monthly gross income is approximately \$7,200.

Now let's say that this individual pays \$1,500 per month in rent, \$450 in student loans, and \$300 toward an auto loan. All three of these expenses are excluded from the calculation of gross income for non-tax purposes. An individual's gross income only considers the revenue earned.

As for the individual's federal income tax, we'll say that the individual paid \$500 in student loan interest for the prior year. Student loan interest is an above-the-line deduction on their tax return that's used to factor adjusted gross income. The individual's AGI is \$86,000 (\$86,500 - \$500 assuming they earned the same amount of money this year as last year).

Business Gross Income Example

Apple's [consolidated](#) statement of operations reported total net sales of \$89.5 billion for the three months ending September 2023. The company spent \$42.59 billion to generate those products and spent an additional \$6.49 billion on services as part of its cost of goods sold. Apple reported a gross income of \$40.43 billion.



calculating gross income. A company's gross income includes only the company's net sales less COGS.^[4]

What's the Difference Between Gross and Net Income?

[Net income](#) is the money that you effectively receive from your endeavors. It's the take-home pay for individuals. It's the revenues that are left after all expenses have been deducted for companies. A company's gross income only includes COGS and omits all other types of expenses.

How Is Gross Business Income Calculated?

The gross income of a company is calculated as gross revenue minus the cost of goods sold (COGS). Its gross income would be \$400,000 if a company registered \$500,000 in product sales and the cost to produce those products was \$100,000.

Does Gross Income Include Money That Will Be Paid in Taxes?

Gross income is the total amount of income a person or company has earned before tax deductions have been made from that income. It's calculated as the total amount of revenue earned before subtracting expenses like costs, interest, and taxes.

The Bottom Line

An individual's gross income is the total amount earned before taxes or other deductions are taken out. An employee's pay stub will usually state their gross pay as well as their take-home pay. They'll also have to

[SKIP TO CONTENT](#) income that they've generated to



You can determine your monthly gross income by calculating the amount of money you earn each month. This will likely be different from the amount of money you take home or receive as payment directly from your employer. You can also calculate it as your monthly salary before taxes or the number of hours you work in a given month multiplied by your hourly pay rate.

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EXHIBIT 24



Neutral

As of: March 29, 2026 9:43 PM Z

Isakina v. ReAlpha Tech. Corp.

United States District Court for the Southern District of Ohio, Eastern Division

November 3, 2023, Filed

Case No. 2:21-cv-5901

Reporter

2023 U.S. Dist. LEXIS 198497 *; 2023 WL 7304994

Valentina Isakina, Plaintiff, v. ReAlpha Tech Corp, Defendant.

Subsequent History: Appeal dismissed by [Isakina v. ReAlpha Tech. Corp., 2024 U.S. App. LEXIS 4619 \(6th Cir., Feb. 21, 2024\)](#)

Counsel: [*1] For Tracy L Turner, Mediator: Tracy L Turner, LEAD ATTORNEY, Law Office of Tracy L. Turner, New Albany, OH.

For Valentina Isakina, Plaintiff: Michael J. Anthony, LEAD ATTORNEY, Anthony Law, Columbus, OH; Vincent P. Zuccaro, Columbus, OH.

For ReAlpha Tech Corp, Defendant: Geoffrey J Moul, LEAD ATTORNEY, Murray Murphy Moul + Basil LLP, Columbus, OH; James Richard Staley, PRO HAC VICE, Murray Murphy Moul Basil LLP, Columbus, OH.

Judges: MICHAEL H. WATSON, UNITED STATES DISTRICT JUDGE. Magistrate Judge Vascura.

Opinion by: MICHAEL H. WATSON

Opinion

OPINION AND ORDER

ReAlpha Tech Corp. ("Defendant") moves for summary judgment on Valentina Isakina's ("Plaintiff") claims against it. ECF No. 34. For the following reasons, the motion is **GRANTED**.

I. FACTS

In October 2020, Giri Devanur ("Devanur"), Defendant's Chief Executive Officer, reached out to Plaintiff, who has significant experience in business strategy. Isakina Dep. 64:4-9, ECF No. 51-1; Isakina Decl. ¶ 4, ECF No. 71-1 After some discussions, Devanur offered Isakina a "cofounder and Chief Financial

Officer" position with Defendant. Isakina Decl. ¶ 9, ECF No. 71-1

By December 2020, the parties agreed in principle that Plaintiff would work for Defendant as a board member and [*2] in other leadership positions in exchange for compensation, but the parties were still negotiating the details. *Id.* ¶¶ 9-11. During these negotiations, Plaintiff performed work for Defendant. *Id.* ¶ 13.

In January 2021, the parties continued to negotiate. *Id.* ¶¶ 18-20. Plaintiff was not yet willing to commit to joining the board but was willing to serve as an advisor until she eventually joined the board. *Id.* ¶ 18. The parties began negotiating the terms of a founder advisor agreement (the "FA Agreement"). *Id.* ¶¶ 18-20. As part of the FA Agreement, Plaintiff was expected to perform three hours of work per month in exchange for one percent of fully diluted stock. FA Agreement, ECF No. 71-2, PAGEID # 1733-37. The FA Agreement provides that the stock would vest as follows:

All shares shall vest on a pro rata basis monthly over a 2-year period with a 3-month cliff period. 100% of unvested shares shall vest on closing of sale of the Company of a liquidity event, whichever occurs earlier.

FA Agreement 4, ECF No. 71-2, PAGEID # 1736.

Plaintiff was concerned because the FA Agreement did not provide for an hourly rate for hours worked above three hours per month. Isakina Decl. ¶ 20, ECF No. 71-1. [*3] Eventually, Devanur orally promised Plaintiff that Defendant would pay her \$1,000.00 per hour for any time she worked above three hours a month. *Id.* After hearing that promise, Plaintiff agreed that the hourly rate did not need to be included in the FA Agreement. *Id.* The parties executed the FA agreement in mid-January, 2021. FA Agreement, ECF No. 71-2, PAGEID # 1733-37.

Over the next few months, the parties continued to negotiate the terms of Plaintiff's appointment to the board of directors. *E.g.*, Isakina Decl. ¶¶ 24, ECF No. 71-1. Throughout negotiations, a sticking point was Plaintiff's time commitment and compensation. *Id.*

By mid-April 2021, the parties' relationship had soured, and Defendant terminated Plaintiff and the FA Agreement. *Id.* ¶¶ 47-48. Defendant did not issue Plaintiff the one percent shares and never paid Plaintiff for at least some hours she worked above three hours per month. *Id.* ¶ 51; Isakina Dep. 224:5-10, ECF No. 51-1

II. STANDARD OF REVIEW

The standard governing summary judgment is set forth in [Federal Rule of Civil Procedure 56\(a\)](#): "The court shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of [*4] law."

The Court must grant summary judgment if the opposing party "fails to make a showing sufficient to establish the existence of an element essential to that party's case" and "on which that party will bear the burden of proof at trial." [Celotex Corp. v. Catrett](#), 477 U.S. 317, 322, 106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986). When reviewing a summary judgment motion, the Court must draw all reasonable inferences in favor of the nonmoving party, who must set forth specific facts showing there is a genuine dispute of material fact for trial, and the Court must refrain from making credibility determinations or weighing the evidence. [Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.](#), 475 U.S. 574, 587, 106 S. Ct. 1348, 89 L. Ed. 2d 538 (1986) (citation omitted); [Anderson v. Liberty Lobby, Inc.](#), 477 U.S. 242, 248-49, 255, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986). The Court disregards "all evidence favorable to the moving party that the jury would not be required to believe." [Reeves v. Sanderson Plumbing Prods., Inc.](#), 530 U.S. 133, 150-51, 120 S. Ct. 2097, 147 L. Ed. 2d 105 (2000) (citation omitted). Summary judgment will "not lie if the dispute about a material fact is 'genuine,' that is, if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." [Anderson](#), 477 U.S. at 248 (internal citations and quotation marks omitted).

The Court is not "obligated to wade through and search the entire record for some specific facts that might support the nonmoving party's claim." [InterRoyal Corp. v. Sponseller](#), 889 F.2d 108, 111 (6th Cir. 1989). The Court may rely on the parties to call attention to the specific portions of the record that demonstrate [*5] a genuine issue of material fact. [Wells Fargo Bank, N.A. v. LaSalle Bank N.A.](#), 643 F. Supp. 2d 1014, 1022 (S.D. Ohio 2009).

III. ANALYSIS

Plaintiff asserts the following claims against Defendant: (1)

declaration "action" arising out of the FA Agreement; (2) breach of contract (FA Agreement); (3) breach of contract (a different agreement); (4) promissory estoppel; and (5) unjust enrichment. Compl. ¶¶ 39-61, ECF No. 1. Defendant moves for summary judgment on all claims. ECF No. 34.

A. Choice of Law

Before addressing the merits of Plaintiffs claims, the Court must decide what law applies. The parties agree that Delaware law applies to the claims arising from the FA Agreement. *See* Mot. 4, ECF No. 34; Resp. 11, ECF No. 71. From a review of the FA Agreement, the Court agrees and, therefore, will analyze Plaintiffs claims under Delaware law. *See* FA Agreement 4, ECF No. 71-2, PAGEID # 1736.

As to the other claims, the parties briefed their arguments using Delaware law; the Court agrees that Delaware is the applicable law. Mot. 12-20, ECF No. 34; Resp. 16-20, ECF No. 71. When a contract has a broad choice-of-law provision, as the FA Agreement does, the choice-of-law provision can cover claims that are closely related to the contract. *See* [Mkt. Am., Inc. v. Google, Inc.](#), No. C.A. 09-494-GMS, 2011 U.S. Dist. LEXIS 42099, 2011 WL 1485616, at *3 (D. Del. Apr. 19, 2011) (citing Delaware law). Here, Claims III (breach [*6] of a different, yet related, contract), IV (promissory estoppel), and V (unjust enrichment) are all closely related to the FA Agreement. Thus, Delaware law governs Claims III, IV, and V.

B. FA Agreement Claims (Claims I and II)

To succeed on a breach-of-contract claim under Delaware law, a plaintiff must prove: "(1) the existence of a contract, (2) the breach of an obligation imposed by the contract, and (3) damages that the plaintiff suffered as a result of the breach." [Johnson v. GEICO Cas. Co.](#), 672 F. App'x 150, 155 (3d Cir. 2016) (quoting Delaware law).

The parties dispute the second element. The FA Agreement provides that shares vest monthly on a pro rata basis. FA Agreement 4, ECF No. 71-2, PAGEID # 1736. That said, all unvested shares vest immediately on the "closing of sale of the Company" or a "liquidity event." *Id.* Plaintiff argues that, before her termination, Defendant entered into a SAFE note (the "SAFE Note") with another company (the "Investor") and that the SAFE Note was a liquidity event. Resp., 11-16, ECF No. 71. Thus, Plaintiff argues, because there was a liquidity event before her termination, all her shares vested, and she is entitled to receive her fully vested shares. *Id.* Defendant disagrees, arguing that the SAFE Note was [*7] not a liquidity event.

The heart of the parties' dispute is the definition of "liquidity event," which the FA Agreement does not define. *See generally*, FA Agreement, ECF No. 71-2, PAGEID # 1733-37. When "the plain language of a contract is unambiguous *i.e.*, fairly or reasonably susceptible to only one interpretation," courts "construe the contract in accordance with that plain meaning and will not resort to extrinsic evidence to determine the parties' intentions." [BLGH Holdings LLC v. enXco LFG Holding, LLC, 41 A.3d 410,414 \(Del. 2012\)](#) (citation omitted). Thus, the Court must determine the plain meaning of "liquidity event."

Under "well settled" Delaware law, "courts look to dictionaries for assistance in determining the plain meaning of terms which are not defined in a contract." [Lorillard Tobacco Co. v. Am. Legacy Found., 903 A.2d 728,738 \(Del. 2006\)](#). The parties do not dispute the general correctness of this rule but do dispute *which* dictionaries the Court may consult. Plaintiff particularly resists the use of Investopedia. Resp. 11-12, ECF No. 71. The Court could not find any courts within the Third Circuit or in Delaware that have addressed the propriety of a court relying on Investopedia.

Other courts have considered, at least in passing, the propriety of relying on Investopedia, with mixed results. *Compare* [Process Equip. & Serv. Co., Inc. v. New Mexico Tax'n Revenue Dep't, 2023-NMCA 060, 534 P.3d 1043, 1049 \(New Mex. 2023\)](#) (concluding [*8] the Court could properly adopt one of Investopedia's definitions) *with* [Steel Supplements, Inc. v. Blitz NV, LLC, No. 8:20-CV-2971-WFJ-TGW, 2023 U.S. Dist. LEXIS 4441, 2023 WL 145322, at *5 \(M.D. Fla. Jan. 10, 2023\)](#) (finding Investopedia "highly questionable" and "unacceptable" as the sole support for a proposed definition) (citation omitted). And several federal courts have expressly taken judicial notice of Investopedia definitions. *See* [Padilla v. Cmty. Health Sys. Inc., No. 3:19-CV-00461, 2022 U.S. Dist. LEXIS 147151, 2022 WL 3452318, at *3, n.10 \(M.D. Tenn. Aug. 17, 2022\)](#) ("The Court is able to take sua sponte judicial notice of the definitions of investment terms which are publicly available on the Investopedia website" (citing cases)); [Luma v. Dib Funding, Inc., No. CV ELH-20-2504, 2022 U.S. Dist. LEXIS 10528, 2022 WL 181156, at *15, n.14 \(D. Md. Jan. 19, 2022\)](#) ("We take judicial notice definitions of 'cryptocurrency' provided by Investopedia[.]"); *but see* [Merritt v. Countrywide Fin. Corp., No. 09-CV-01179-BLF, 2016 U.S. Dist. LEXIS 194613, 2016 WL 6573989, at *10, n.14 \(N.D. Cal. June 29, 2016\)](#) (declining to take judicial notice of Investopedia because it "can be edited at any moment by users" (citation omitted)).

The two cases that decided against relying on Investopedia had one of two reasons: (1) Investopedia should not be the sole source in support of a party's argument; and (2) Investopedia is not suitable for judicial notice because it can be edited by users.

See [Steel Supplements, 2023 U.S. Dist. LEXIS 4441, 2023 WL 145322, at *5; Merritt, 2016 U.S. Dist. LEXIS 194613, 2016 WL 6573989, at *10, n.14.](#)

The first of these concerns is easily addressed: as discussed more fully below, neither Defendant nor the Court relies *solely* on Investopedia. *See supra*. As to the second concern, it seems that Investopedia has changed its editing policy since *Merritt*. [*9] [Merritt, 2016 U.S. Dist. LEXIS 194613, 2016 WL 6573989, at *10, n.14](#) (citation omitted).

On Investopedia's policy page, it explains its "quality standards" as follows:

Our editorial team approves all story ideas independently, and our expert contributors each have deep subject matter expertise in the topics that we assign them. Our team of professional editors, fact checkers, and producers review content to ensure it upholds our values of being empowering, inclusive, unbiased, and accurate.

Editorial Standards, Investopedia, available at <https://perma.cd7G4Z-9K4M>.

Thus, whatever Investopedia's *prior* editing policy that led the *Merritt* court to conclude it was "not adequate" for judicial notice, **Investopedia now operates much like a traditional encyclopedia, which is appropriate for judicial notice.** *See, e.g., Big Easy Studios, LLC v. United States, 147 Fed. Cl. 539, 547 (2020)* ("This Court has previously taken judicial notice of: definitions in dictionaries and encyclopedias" (citing cases)). In sum, the Court may rely on Investopedia.

Having concluded that the Court may rely on Investopedia, the Court now considers the proper definition of "liquidity event." Investopedia defines "liquidity event" as:

A liquidity event is an acquisition, merger, initial public offering (IPO), or other action that allows founders and early [*10] investors in a company to cash out some or all of their ownership shares.

Liquidity Event: Definition, Purpose, Example, Investopedia, available at <https://perma.cc/93UR-9XZR>.

Although other dictionaries do not define "liquidity event," they do define "liquidity." For example, the Oxford English Dictionary's defines "liquidity" as "[t]he interchangeability of assets and money." *Liquidity, Oxford English Dictionary, available at* https://www.oed.com/dictionary/liquidity_n?tab=meaning_and_use#39277302. Merriam-Webster defines "liquid" as "consisting of or capable of ready conversion into cash." *Liquid,*

Merriam-Webster Dictionary, *available at* <https://perma.cc/M4NM-WRMJ>.

Putting all these definitions together, a "liquidity event" is an event that allows an investor to easily convert assets into cash. To put it colloquially, a "liquidity event" is an event that allows investors to "cash out." Some examples of liquidity events include an acquisition, merger, or initial public offering.

Applying that definition to this case, the SAFE Note is not a "liquidity event." The SAFE Note offered Defendant cash and, in return, promised the Investor equity. *See generally*, SAFE Note, ECF No. 34-1, PAGEID [*11] # 254-70.¹ The SAFE Note did not allow any early investors or founders to "cash out" their shares for money. True, the SAFE Note *exchanged* future shares for immediate money, but it did not *convert* assets to money in the way assets are converted during, say, an IPO.

Plaintiff disagrees. First, Plaintiff argues that defining "liquidity event" so narrowly makes it synonymous with "sale of the company," which is also a triggering event. Thus, Plaintiff argues, such a narrow definition renders "sale of the company" superfluous. To the contrary, the Court's definition of "liquidity event" encompasses not only the sale (or "acquisition") of the Company, but also mergers, IPOs, and similar events. Thus, Plaintiffs "superfluous" argument is unavailing.

Plaintiff also relies on extrinsic evidence to support a broader reading of "liquidity event." Resp. 13, ECF No. 71. However, because the meaning of "liquidity event" (and, therefore, the meaning of the FA Agreement as a whole) is clear and unambiguous from the face of the contract, the Court may not consider extrinsic evidence. *See First Wheel Mgmt. Ltd. v. Inventist, Inc.*, No. CV 17-1059 (MN), 2023 U.S. Dist. LEXIS 129898, 2023 WL 4824856, at *4 (D. Del. July 27, 2023) ("When the contract is clear and unambiguous, Delaware courts give effect to the plain-meaning of the contract's [*12] terms and provisions, without resort to extrinsic evidence" (cleaned up and quoting Delaware law)). Accordingly, this argument is unpersuasive.

Finally, Plaintiff argues that it would be inappropriate to adopt the definition of "liquidity event" from any of the cases Defendant cites. Resp. 14, ECF No. 71. According to Plaintiff, those cases take their definitions from the at-issue contracts and, therefore, the definitions do not automatically graft on to this

contract. *Id.* The Court agrees with Plaintiffs reading of those cases. However, because the Court does not rely on those cases in reaching its conclusion, the cases do not change the outcome.

In sum, the SAFE Note was not a liquidity event. Plaintiff points to no other event that could be a "liquidity event" and, therefore, Plaintiff has not identified any event that triggered Defendant's obligation to vest Plaintiffs shares. As a result, Defendant is entitled to summary judgment on Claims I and II.

C. Breach of Contract (Claim III)

Plaintiff asserts another claim for breach of contract arising not out of the FA Agreement, but another contract. Compl. ¶¶ 47-51, ECF No. 1. Plaintiff argues that she and Defendant had a separate agreement [*13] under which Defendant would pay Plaintiff an hourly rate for all hours she worked over three hours per month. Resp. 16-18, ECF No. 71.

In Delaware, "a binding and completely integrated agreement discharges prior agreements to the extent that they are within its scope." *Doehler N. Am., Inc. v. Davis*, No. CV 22-501-RGA, 2023 U.S. Dist. LEXIS 87871, 2023 WL 3569775, at *3 (D. Del. May 19, 2023) (cleaned up and citing Delaware law). When there is a fully integrated contract, courts do not consider parol evidence. *See Wilmington Tr. Co. v. Justice*, No. CIV.A. S11C-02005RFS, 2012 Del. Super. LEXIS 425, 2012 WL 4149367, at *1 (Del. Super. Ct. Aug. 20, 2012) ("There is no room for parol evidence where there is no ambiguity and the agreement is fully integrated" (citations omitted)).

Here, the FA Agreement is fully integrated. The FA Agreement provides in relevant part: "This Agreement, including any schedules hereto, constitute the sole agreement of the parties and supersedes all oral negotiations and prior writings with respect to the subject matter hereof." FA Agreement 3, ECF No. 71-2, PAGEID # 1735. Further, the FA Agreement covers Plaintiffs expected time commitment and compensation. *Id.* at 5, PAGEID # 1737. Therefore, any discussions or "agreements" related to Plaintiffs hours worked or compensation that pre-date the FA Agreement are superseded by the same.

Plaintiff disagrees, arguing that the face of the FA Agreement shows it was not the complete [*14] agreement between the parties. Resp. 16-18, ECF No. 71. Essentially, Plaintiff argues that the FA Agreement's provisions for Plaintiffs time commitment (that is, three hours per month), was "grossly insufficient to cover her responsibilities." *Id.* This insufficiency, argues Plaintiff, shows that the parties did not include their full agreement in writing and, therefore, the FA Agreement is not fully integrated. *Id.* Plaintiff also argues that, at the time of executing the FA Agreement, the parties understood that two

¹There are, in fact, two SAFE notes that pre-date Plaintiffs termination. *See* ECF No. 34-1, PAGEID # 254-70. The parties seem to treat these as one note. *E.g.*, Mot. 7, ECF No. 71. Whether these notes are properly viewed as one or two notes, the outcome is the same: neither note was a liquidity event.

contracts existed—the FA Agreement and an oral agreement for Plaintiff's compensation. *Id.*

This argument fails. Contrary to Plaintiffs assertions, it is not clear from the face of the contract that three hours per month is "grossly insufficient." That is, the FA Agreement does not suggest that Plaintiff could not possibly complete her duties in three hours a month. That the parties may have had other, informal agreements or understandings about Plaintiff's time and compensation makes no difference. Because the face of the FA Agreement is unambiguous, the Court may not consider any extrinsic evidence, including evidence of other agreements. See [First Wheel Mgmt. Ltd.](#), 2023 U.S. Dist. LEXIS 129898, 2023 WL 4824856, at *4 ("When the contract is clear [*15] and unambiguous, Delaware courts give effect to the plain-meaning of the contract's terms and provisions, without resort to extrinsic evidence" (cleaned up and quoting Delaware law)). Thus, Plaintiffs argument is unavailing.²

In sum, the FA Agreement is a fully integrated contract, and, thus, Plaintiffs breach-of-contract claim based on alleged promises not contained in the FA Agreement fails.

D. Promissory Estoppel and Unjust Enrichment

Plaintiff asserts claims for unjust enrichment and promissory estoppel. Under Delaware law, a plaintiff may not succeed on unjust enrichment or promissory estoppel claims when an express contract governs the parties' relationship. See [Tolliver v. Christina Sch. Dist.](#), 564 F. Supp. 2d 312, 315 (D. Del. 2008) (explaining, when ruling on a motion to dismiss, that "the existence of an express, enforceable contract that controls the parties' relationship will defeat an unjust enrichment claims"); [White Winston Select Asset Funds, LLC v. Good Times Restaurants, Inc.](#), No. 1:19-CV-2092-SB, 2022 U.S. Dist. LEXIS 194629, 2022 WL 13976042, at *4 (D. Del. May 5, 2022) ("Promissory estoppel does not apply . . . where a fully integrated, enforceable contract governs the promise at issue" (cleaned up)).

Here, the parties' contract covers the subject matter underlying the unjust enrichment and promissory estoppel claims: Plaintiffs expected time commitment and compensation. There is no dispute that the parties [*16] had a valid contract (the FA Agreement) that addressed those subjects. Thus, any unjust

enrichment or promissory estoppel claim based on Plaintiffs expected time commitment and compensation fails. See [Donnelly v. Propharma Grp. Topco LLC](#), No. CV 21-894-MAK, 2022 U.S. Dist. LEXIS 233571, 2022 WL 18007351, at *4 (D. Del. Dec. 30, 2022) (explaining that an unjust enrichment claim based on alleged nonpayment of compensation failed "as a matter of law" because the parties' express contract governed compensation (citing Delaware law)).

Plaintiff argues against this conclusion. Plaintiff asserts that Defendant made additional promises not included in the Contract: promises to pay Plaintiff for any hours worked above three hours per month. Resp. 18-20, ECF No. 71. Even assuming that Defendant made these promises, these additional promises all closely relate to the subject matter of the Contract—Plaintiff's business relationship with Defendant, including her time commitment and compensation. See [GEA Sys. N. Am. LLC v. Golden State Foods Corp.](#), No. CVN18C11242EMDCCLD, 2020 Del. Super. LEXIS 282, 2020 WL 3047207, at *11 (Del. Super. Ct. June 8, 2020) (explaining that "a claim for unjust enrichment cannot stand if the parties' relationship and the claims asserted are the subject of an express contract[.]" (quotation marks and citation omitted)). Thus, Plaintiff's argument is unavailing.

At bottom, because an express contract covers the subject matter of the unjust enrichment and [*17] promissory estoppel claim, Plaintiff cannot proceed with those claims. As a result, Defendant is entitled to summary judgment on the unjust enrichment and promissory estoppel claims.

IV. CONCLUSION

For these reasons, Defendant's motion for summary judgment is **GRANTED**. The Clerk shall enter judgment for Defendant and close the case.

IT IS SO ORDERED.

/s/ Michael H. Watson

MICHAEL H. WATSON, JUDGE

UNITED STATES DISTRICT COURT

End of Document

²The parties also argue over whether the FA Agreement was a type of enforceable preliminary agreement and, if so, whether Defendant breached that agreement. E.g., Mot. 12-18, ECF No. 34; Resp. 16-18, ECF No. 71. Because the Court concludes that the FA Agreement is a fully integrated contract (and, by extension, not a preliminary agreement), the Court need not address these arguments.

EXHIBIT 25

Padilla v. Cmty. Health Sys.

United States District Court for the Middle District of Tennessee, Nashville Division

August 17, 2022, Filed

NO. 3:19-cv-00461

Reporter

2022 U.S. Dist. LEXIS 147151 *; 2022 WL 3452318

CALEB PADILLA, individually and on behalf of all others similarly situated, Plaintiff, v. COMMUNITY HEALTH SYSTEMS, INC., et al., Defendants.

Subsequent History: Later proceeding at [Padilla v. Cmty. Health Sys., Inc., 2023 U.S. Dist. LEXIS 193566 \(M.D. Tenn., Oct. 16, 2023\)](#)

Counsel: [*1] For Caleb Padilla, Individually and on behalf of all others similarly situated, Plaintiff: Benjamin A. Gastel, James Gerard Stranch, IV, Branstetter, Stranch & Jennings, PLLC, The Freedom Center, Nashville, TN; Casey E. Sadler, Charles H. Linehan, Lesley F. Portnoy, Lionel Z. Glancy, Pavithra Rajesh, Robert V. Prongay, Glancy Prongay & Murray LLP, Los Angeles, CA; Howard G. Smith, Law Offices of Howard G. Smith, Bensalem, PA; Jared Schneider, Joshua B. Silverman, Pomerantz LLP (Chicago Office), Chicago, IL; Louis C. Ludwig, Pomerantz LLP (Chicago Office), Chicago, IL.

For Community Health Systems, Inc., Wayne T. Smith, Larry Cash, Thomas J. Aaron, Defendants: Carson W. King, Milton S. McGee, III, Steven Allen Riley, Riley & Jacobson, PLC, Nashville, TN.

For Arun Bhattacharya, Intervenor Plaintiff: J. Alexander Hood, II, Jeremy A. Lieberman, Pomerantz LLP (NY Office), New York, NY; Paul Kent Bramlett, Robert P. Bramlett, Bramlett Law Offices, Nashville, TN; James Gerard Stranch, IV, Branstetter, Stranch & Jennings, PLLC, Nashville, TN.

For Morta Vaisyte, Movant: Gregory M. Nespole, Levi & Korsinsky, LLP, New York, NY; Jerry E. Martin, Barrett Johnston Martin & Garrison, LLC, Nashville, [*2] TN.

For Michael Gaviria, Movant: Benjamin A. Gastel, James Gerard Stranch, IV, Branstetter, Stranch & Jennings, PLLC, The Freedom Center, Nashville, TN; Charles H. Linehan, Lesley F. Portnoy, Lionel Z. Glancy, Pavithra Rajesh, Robert V. Prongay, Glancy Prongay & Murray LLP, Los Angeles, CA.

Judges: ELI RICHARDSON, UNITED STATES DISTRICT JUDGE.

Opinion by: ELI RICHARDSON

Opinion

MEMORANDUM OPINION

Pending before the Court is Defendants' Motion to Dismiss (Doc. No. 65, "Motion"), which is accompanied by a supporting Memorandum of Law (Doc. No. 66). Plaintiffs¹ have responded. (Doc. No. 69). Defendants have replied. (Doc. No. 70). Plaintiffs also filed a Notice of Supplemental Authority (Doc. No. 76).

For the reasons discussed herein, the Court will deny Defendants' Motion.

BACKGROUND²

¹Despite the case currently being captioned in the singular ("Plaintiff") in the name of Caleb Padilla, the Court has appointed putative class members Arun Bhattacharya and Michael Gaviria as co-Lead Plaintiffs in this action (Doc. No. 52 at 2). Accordingly, the Court herein uses the plural term "Plaintiffs," as do the parties in their briefing on the Motion.

²The facts set forth herein are alleged in Plaintiffs' Amended Complaint (Doc. No. 61) and are accepted as true for purposes of the Motion. To the extent that allegations referred to below are legal conclusions, however, they are not accepted as true but rather are identified as merely what Plaintiffs claim, and not what the Court is accepting as true for purposes of the Motion. At times herein, the Court exercises some discretion (guided by common sense and the apparent context at issue) in choosing language to paraphrase the allegations, but whether it does that or paraphrases by using virtually or exactly the same words used in the Amended Complaint, the Court is confident that it has accurately represented the substance of the allegations recounted herein.

This putative class action³ is grounded on alleged violations of the [Securities Exchange Act of 1934 \(15 U.S.C. § 78a et seq., "Exchange Act"\)](#). Defendant Community Health Systems, Inc. ("CHS" or "the Company")⁴ is one of the largest publicly traded hospital companies in the United States. (Doc. No. 61 at ¶ 25). As of December 31, 2016, Defendant CHS's affiliates owned or leased 155 hospitals in 21 states, with roughly 26,222 hospital beds. (*Id.*). Defendant CHS generates revenue from general and specialized hospital [*3] and outpatient healthcare services, such as general acute care, emergency room care, surgery, critical care, internal medicine, obstetrics, diagnostic, psychiatric, and rehabilitation. (*Id.* at ¶ 26). The patients Defendant CHS serves have private insurance, Medicare, Medicaid, or are uninsured (which Defendant CHS refers to as a "self-pay" patient). (*Id.*).

Between 2007 and 2014, Defendant CHS grew rapidly via acquisition of other companies, which it financed by debt. (*Id.* at ¶ 27). In order to avoid default, Defendant CHS had to adhere to strict financial ratio covenants. (*Id.*). In 2014, Defendant CHS acquired Health Management Associates, Inc. ("HMA") for roughly \$7.3 billion, including assuming \$3.8 in indebtedness. (*Id.* at ¶ 29). This exacerbated Defendant CHS's already precarious financial position. (*Id.* at ¶¶ 29-31). In 2015, Defendant CHS lost approximately one-third of its value when its earnings were substantially below expectations, in part due to an increase in self-pay patients. (*Id.* at ¶ 32). In 2016, the spin-off of thirty-eight hospitals severely underperformed expectations. (*Id.* at ¶ 33).

The real problems started in 2017, according to the Complaint. In February 2017, [*4] Defendant CHS reported a net loss attributable to shareholders of \$1.7 billion for 2016, and its fourth quarter earnings before interest, taxes, depreciation, and amortization ("EBITDA") of \$564 million, about 6.6% higher than analyst's average estimate. (*Id.* at ¶¶ 34, 100). The next day, Defendant Cash's resignation as Chief Financial Officer ("CFO") was announced, and Defendant Aaron was appointed the Executive Vice President and CFO of Defendant CHS. (*Id.* at ¶ 35). Defendant Aaron had been Defendant CHS's independent auditor at Deloitte & Touche LLP. (*Id.*). Defendant

Smith, Defendant CHS's CEO, remained in his position and was the highest earner among hospital executives. (*Id.* at ¶ 38). (Plaintiffs refer to Defendants Cash, Aaron, and Smith collectively as the "Individual Defendants," (*Id.* ¶ 23), and the Court herein will do likewise). That year, Defendant CHS sold thirty hospitals in order to pay down its debt, but it faced criticism for selling some of the best hospitals in its portfolio. (*Id.* at ¶ 36).

During this time, Defendant CHS faced internal problems. A confidential witness who worked at CHS between March 2016 and December 2017 reports that Defendant CHS attempted to automate [*5] the process of billing payors, which required hiring people to fix the resulting mess. (*Id.* at ¶ 39). This confidential witness's job at CHS was to find errors in the automated system, and there were often bills with underpaid claims of tens of thousands of dollars. (*Id.* at ¶¶ 40, 41). This confidential witness also reports that self-pay patients would often speak with the billing department and agree on a fee lower than the fee at which the services were. (*Id.* at ¶ 44).

At all relevant times to this action, Defendant CHS was constrained by covenants in a \$1 billion credit facility (referred to by Defendant CHS at times as its "senior secured credit facility") it maintained and used for financing the acquisition of HMA and refinancing existing indebtedness. (*Id.* at ¶ 45). Defendant CHS had to satisfy the covenants in order to avoid default: under its agreement with its creditor, Defendant CHS had to keep its "secured net leverage ratio"⁵ below a maximum level and its "interest coverage ratio"⁶ above a minimum level. (*Id.* at ¶ 45). Essentially, in order to avoid default, Defendant CHS had to manage its Consolidated EBITDA⁷. (*Id.* at ¶ 46).

Despite the importance of the metric represented [*6] by Consolidated EBITDA, Defendant CHS refused to report its Consolidated EBITDA to investors or explain its process for

⁵This was defined in the Third Amended and Restated Credit Agreement as the ratio of Defendant CHS's Total Secured Debt less cash and cash equivalents to Defendant CHS's consolidated EBITDA.

⁶This was defined in its 2016 10-k as the "ratio of consolidated EBITDA, as defined in the Credit Facility, to consolidated interest expense for the period."

⁷The Court capitalizes this term when referring to this metric as defined in CHS's 2016 10-K: "a trailing 12-month calculation that begins with net income attributable to us, with certain pro forma adjustments to consider the impact of material acquisitions or divestitures, and adjustments for interest, taxes, depreciation and amortization, net income attributable to noncontrolling interests, stock compensation expense, restricting costs, and the financial impact of other non-cash or nonrecurring items recorded during any such 12-month period." (Doc. No. 61 at 13 n.12).

³Plaintiffs bring the present action as a class action pursuant to [Fed. R. Civ. P. 23\(a\)](#) and [\(b\)\(3\)](#), "on behalf of a class, consisting of all persons and entities that acquired Community Health securities between February 20, 2017 and February 27, 2018, inclusive, and who were damaged thereby (the 'Class')." (Doc. No. 61 at ¶ 186). The allegations set forth in the Amended Complaint in support of class certification (*Id.* at ¶¶ 186-195) are not relevant for purposes of resolving the instant Motion and will not be discussed herein.

⁴In their briefing, the parties sometimes refer to CHS as "CHSL."

calculating its Consolidated EBITDA. (*Id.* at ¶ 47). The Securities and Exchange Commission ("SEC") requested that Defendant CHS "revise" its EBITDA disclosure to present it "as it is calculated in [the covenant agreement with CHS's senior secured credit facility]." (*Id.* at ¶ 47-48). In response, Defendant CHS stated that it would not disclose the Consolidated EBITDA and instead would disclose only the "Adjusted EBITDA"⁸ to investors, all the while noting that the Consolidated EBITDA was "a key component in the determination of our compliance with some of the covenants under our senior secured credit facility (including our ability to service debt and incur capital expenditures)." (*Id.* at ¶ 49). Defendants negotiated before the start of the Class Period⁹ for the ability to exclude from the debt covenant measurements any charge CHS could attribute to "changes in accounting principles." (*Id.* at ¶¶ 50, 51). Defendant CHS also renegotiated its secured net leverage ratio levels and its required interest coverage ratio. (*Id.* at ¶ 52).

The SEC requires that Generally Accepted Accounting Principles ("GAAP") be used in the preparation of financial statements, and if they are not, then the financial statements are presumed to be misleading and inaccurate. (*Id.* at ¶¶ 53, 54). The GAAP requires that an entity with significant receivables (like Defendant CHS) must reflect its assets at their proper carrying value¹⁰ and must regularly assess the collectability of its

⁸The Complaint describes the "Adjusted EBITDA" calculation, as defined in CHS's 2016 10-K, as "starting with its standard EBITDA—its net income less interest, income taxes, depreciation and amortization—and then:

. . . add[ing] back net income attributable [*7] to noncontrolling interests and [] exclud[ing] the effect of discontinued operations, loss from early extinguishment of debt, impairment and (gain) loss on sale of business, gain on sale of investments in unconsolidated affiliates, acquisition and integration expenses from the acquisition of HMA, expense incurred related to the spin-off of QHC, expense incurred related to the sale of a majority ownership interest in our home care division, expense related to government and other legal settlements and related costs, and (income) expense from fair value adjustments on the CVR agreement liability accounted for at fair value related to the HMA legal proceedings, and related legal expenses.

See 2016 10-K at 13." (Doc. No. 61 at 19).

⁹The Class Period is defined as the period from February 21, 2017 to February 27, 2018. (Doc. No. 61 at ¶ 1).

¹⁰"Carrying value is an accounting measure of value in which the value of an asset or company is based on the figures in the respective company's balance sheet." *Carrying Value*, Investopedia, <https://www.investopedia.com/terms/c/carryingvalue.asp> (last visited August 15, 2021). The Court is able to take *sua sponte* judicial notice of

receivables at each reporting date. (*Id.* at ¶ 63). An entity must deduct credit [*8] losses¹¹ directly from the allowance¹² when the entity becomes aware that a balance is no longer collectible. (*Id.*).

Until January 1, 2018, Defendant CHS recognized its revenue under ASC 605.¹³ This allows revenue to be recognized if "(a) persuasive evidence of an arrangement existed, (b) delivery had occurred, (c) the vendor's fee was fixed or determinable, and (d) collectability was probable." (*Id.* at ¶ 65). Defendant CHS's gross service revenue (*i.e.*, what the revenue would be at the full established rates) was substantially greater than the revenue that Defendant CHS actually expected to collect. (*Id.* at ¶ 66). Therefore, Defendant CHS reported a figure for "net operating revenue" (gross service revenue less deductions from such revenue, *i.e.*, the sum of its contractual adjustments and

the definitions of investment terms which are publicly available on the Investopedia website. See *e.g.*, *Terraza v. Safeway, Inc.*, 241 F.3d 1057, 1067 (N.D. Cal. 2017) ("[T]he Court takes judicial notice of the definitions of various investment terms, which are publicly available on the Investopedia website."); *In re California Bail Bond Antitrust Litig.*, No. 19-CV-00717-JST, 2020 U.S. Dist. LEXIS 92836, 2020 WL 3041316, at *3 (N.D. Cal. Apr. 13, 2020) (taking judicial notice of the Investopedia definition of "loss ratio"); *United States v. Harris*, 331 F.2d 600, 601 (6th Cir. 1964) ("The Court may take judicial notice *sua sponte*."); *Energy Automation Sys., Inc. v. Saxton*, 618 F. Supp. 2d 807, 810 n.1 (M.D. Tenn. 2009) ("A court may take judicial notice of the contents of an Internet website."). To provide background information, the Court herein will refer to the Investopedia website to define or explain certain terms.

¹¹The Court takes the term "credit losses" to refer to "losses that a company might experience due to credit risk," such as losses from "delinquent and bad debt." *Provision for Credit Losses*, Investopedia, <https://www.investopedia.com/terms/p/provision-for-credit-losses.asp> (last visited August 15, 2022).

¹²"An allowance for doubtful accounts is a contra account that nets against the total receivables presented on the balance sheet to reflect only the amounts expected to be paid. The allowance for doubtful accounts estimates the percentage of accounts receivable that are expected to be uncollectible." *Allowance for Doubtful Accounts*, Investopedia, <https://www.investopedia.com/terms/a/allowancefordoubtfulaccounts.asp> (last visited August 15, 2021).

¹³An "ASC" is a particular numbered accounting standard set forth in the Accounting Standard Codification, which is the current single source of GAAP. U.S. GAAP Codification of Accounting Standards, Codification Topic 105: Generally Accepted Accounting Principles, A Brief History, <https://accountinginfo.com/financial-accounting-standards/asc-100/105-gaap-history.htm> (last visited July 18, 2022). The Court herein references the ASC by the citations provided by Plaintiffs in the Amended Complaint.

discounts). (*Id.*). As a result of this accounting method, though Defendant CHS's gross service revenue increased by 12.8%,¹⁴ its net operating revenue decreased in the periods leading up to the Class Period. (*Id.* at ¶ 68).¹⁵

The net operating revenue also functions [*9] as a component of "adjusted EBITDA," which is not related to GAAP but is disclosed in Defendant CHS's annual and quarterly financial reports. As a result, during the Class Period, Defendant CHS:

(i) subtracted its expenses from its net operating revenue to arrive at its "net income" and (ii) calculated its Adjusted EBITDA by starting with its standard EBITDA—its net income less interest, income taxes, depreciation and amortization—and then:

. . . add[ing] back net income attributable to noncontrolling interests and [] exclud[ing] the effect of discontinued operations, loss from early extinguishment of debt, impairment and (gain) loss on sale of business, gain on sale of investments in unconsolidated affiliates, acquisition and integration expenses from the acquisition of HMA, expense incurred related to the spin-off of QHC, expense incurred related to the sale of a majority ownership interest in our home care division, expense related to government and other legal settlements and related costs, and (income) expense from fair value adjustments on the CVR agreement liability accounted for at fair value related to the HMA legal proceedings, and related legal expenses.

(*Id.* at ¶ 70). Considering [*10] how adjusted EBITDA is calculated, bad debt impacted Defendant CHS's adjusted EBITDA and net operating income. (*Id.* at ¶ 71).

Pursuant to ASC 945-605, Defendant CHS reported top-line revenue using the amount it billed for a given service, even if it did not expect to collect the full amount. (*Id.* at ¶ 72). This meant, essentially, that if an uninsured patient was billed \$100, and Defendant CHS expected the patient would pay \$10, it could still record \$100 as top-line revenue, together with a \$90

¹⁴ Paragraph 68 of the Amended Complaint seems to use the term "Total Revenue" as a synonym for gross service revenue.

¹⁵ The Amended Complaint here alleges, more specifically, that net operating revenue was lower in 2016 than in either 2014 or 2015. On the other hand, the Amended Complaint alleges that that net operating revenue was more than \$1B higher in 2015 than in 2014, so the Amended Complaint cannot be taken to allege that net operating revenue *continually* declined in the periods leading up to the Class Period.

contra-revenue line item for bad debt. (*Id.* at ¶ 73).

For periods beginning after December 15, 2017 (*i.e.*, beginning with the 2018 reporting year), public companies like Defendant CHS were required to adopt ASC 606 (which supersedes the principles set forth in ASC 605). (*Id.* at ¶ 75).¹⁶ ASC 606 narrows what healthcare providers can report as bad debt. (*Id.* at ¶ 78). Unlike ASC 605, ASC 606 allows entities to recognize revenue only to the extent that the entity expects to receive the recognized amount, and an entity cannot recognize revenue until it can determine how much it expects to collect. (*Id.* at ¶ 80). To use the previous example referenced in discussing ASC 605, under ASC 606, if Defendant CHS expected [*11] to receive \$10 of a \$100 invoice, it would record \$10 (as opposed to \$100) in revenue and nothing (as opposed to \$90) under bad debt, and bad debt would be reported only if the patient paid less than the expected \$10. (*Id.* at ¶ 81). So "for healthcare providers with 'self-pay' patients, the switch from ASC 605 to ASC 606 generally resulted in a significant reduction in what was previously reported as revenue, with a corresponding reduction in bad debt." (*Id.* at ¶ 82). However, "[e]ven though the 'gross revenue' and 'bad debt' figures were different between ASC 605 and 606, the 'net operating revenues' (*i.e.*, gross revenue less contractual adjustments, discounts, and bad debts) should have been the same." (*Id.*).

Plaintiffs allege both that Defendant CHS's management was responsible for the reliability of financial statements prepared for external purposes and that Defendant CHS should have issued restatements to promptly correct them. (*Id.* at ¶¶ 84-99).

In addition to providing the above-referenced allegations serving to provide relatively general (alleged) background information surrounding the claims, Plaintiffs point to several instances when Defendants allegedly issued materially [*12] false and misleading statements during the Class Period. The Court will briefly review each of these statements. Plaintiffs have multiple theories for why the statements were materially false and/or misleading, and these theories variously are invoked repeatedly throughout the Amended Complaint. For ease of reference, the Court below coins a respective term to refer to each such theory and (by reference to such term) notes various places in the Amended Complaint where Plaintiffs invoke each particular theory.

A. February 20, 2017 8-K¹⁷

¹⁶ Defendant CHS could have adopted this standard earlier, but it adopted the new standard on January 1, 2018. (Doc. No. 61 at ¶¶ 75-77).

¹⁷ According to Investopedia (which strikes the undersigned as reasonably reliable on this point, which seems uncontroversial in any

The 8-K document contained the Company's statement of the specific figures for net operating revenues, Adjusted EBITDA, and provision for bad debt for both the fourth quarter of 2016 and the full year of 2016. (*Id.* at ¶ 100). Plaintiffs allege that these statements (*i.e.*, the stated figures):

were materially false and/or misleading and failed to disclose material adverse facts about the Company's business, operations, and prospects. Specifically, Defendants failed to disclose to investors: (1) that the Company excluded from its "bad debt" calculations revenue receivable from "self-pay" patients, especially aged receivables, for which [*13] collection was not probable; (2) that the Company had excluded from its "bad debt" calculations evidence that collection of amounts due from insured patients as co-pays or deductibles was not probable for large groups of patients and hospitals; (3) that the Company had "anticipated denials" from third-party payors that it had not reflected in its "bad debt" calculations; (4) that the Company had understated its provision for bad debts and allowance for doubtful accounts; (5) that, as a result, the Company had overstated its net operating revenue, EBITDA, and financial results; and (6) that, as a result of the foregoing, Defendants' positive statements about the Company's business, operations, and prospects were materially misleading and/or lacked a reasonable basis.

(*Id.* at ¶ 101). This theory (which the Court will refer to below as the "Bad Debt Theory") is repeated at various places throughout the Complaint. As indicated, its purpose is to explain why particular statements (stated financial figures) "were materially false and/or misleading, and failed to disclose material adverse facts about the Company"; it includes a description of five things that Defendants allegedly failed to [*14] disclose to investors, plus a summary statement that these alleged failures rendered the statements at issue materially misleading and lacking in a reasonable basis. Notably, the Court appropriately accepts as true the allegation that Defendants did not disclose these five things to investors, but it does not accept as true the allegation that such non-disclosure constituted a "fail[ure]," as

event), an 8-K is a report of unscheduled material events or corporate changes at a company that could be of importance to the shareholders or to the Securities and Exchange Commission (SEC). Also known as a Form 8-K, the report notifies the public of events, including acquisitions, bankruptcy, the resignation of directors, or changes in the fiscal year. *8-K (Form 8-K)*, Investopedia, <https://www.investopedia.com/terms/1/8-k.asp> (last visited August 15, 2021). Official information as to the purpose (and proper completion) of Form 8-K can be discerned from the online version of Form 8-K (and its accompanying instructions). *See Form 8-K*, <https://www.sec.gov/files/form8-k.pdf> (last visited August 15, 2022).

such allegation essentially implies a legal conclusion (which the Court does not accept as true) that the non-disclosure constituted a "fail[ure]" to comply with—*i.e.*, a violation of—applicable securities law(s).

B. Q4 2016 Earnings Call

On February 21, 2017, Defendants had a conference call with investors ("Q4 2016 Earnings Call"), wherein Defendant Smith, speaking on behalf of Defendant CHS, stated that "EBITDA of \$564 million for the fourth quarter was within our guidance." Defendants Cash and CHS also stated that (with respect to Defendant CHS's credit facility and related covenants):

On December 5, we completed amendment with revolving credit facility term loan Ag lenders of the credit agreement to modify our financial covenants and enhance certain credit features through December 2017. With [*15] the amendment, the maximum security net leverage ratio is 4.5 during the fourth quarter of 2017, and the minimum interest coverage is 2.0 for each of the four quarters of 2017. We were in compliance with both these covenants on December 31 with secured ratio of 3.96 and an interest rate coverage of 2.43. ***EBITDA cushion on the senior net leverage ratio was 12%, and the cushion on interest coverage is 18%***. [Emphasis added.]

(*Id.* at ¶ 102). Invoking the Bad Debt Theory Plaintiffs claim that these statements were materially false and misleading. (*Id.* at ¶ 103).

Additionally, during this call, Defendant Smith stated that "we expect one result of our divestiture were [sic] to be a stronger, sustainable group of hospitals in markets where we can invest and grow." (*Id.* at ¶ 104). Plaintiffs claim that "[t]his statement was materially false and misleading because the Company's divestitures included many of the Company's strongest hospitals, and accordingly, the remaining portfolio of hospitals was weaker, not stronger." (*Id.*)

C. 2016 10-K¹⁸

¹⁸A 10-K [or Form 10-K] is a comprehensive report filed annually by a publicly-traded company about its financial performance and is required by the U.S. Securities and Exchange Commission (SEC). The report contains much more detail than a company's annual report, which is sent to its shareholders before an annual meeting to elect company directors." *10-K*, Investopedia, <https://www.investopedia.com/terms/1/10-k.asp> (last visited August 15, 2022). Official information as to the purpose (and proper completion) of Form 10-K can be discerned from the online version of Form 10-K (and its accompanying instructions). *See Form 10-K*, <https://www.sec.gov/files/form10-k.pdf> (last visited August 15, 2022).

On the same date, the Company filed its 2016 10-K. (*Id.* at ¶ 105). The 10-K stated that Defendant CHS had the ability to "estimate the allowance [*16] for doubtful accounts" at the time of payment, and it also affirmed the previously reported financial results. (*Id.*) The 10-K also stated, "The Company collects substantially all of its third-party insured receivables, which include receivables from governmental agencies." (*Id.*) Additionally, the 10-K stated that the Company's "provision for bad debts decreased to \$2.8 billion, or 13.3% of operating revenues (before the provision for bad debts) for the year ended December 31, 2016, from \$3.1 billion, or 13.9% of operating revenues (before the provision for bad debts) for the year ended December 31, 2015." (*Id.*) Plaintiffs claim that each of these statements was materially false and/or misleading; in so claiming, they invoke the Bad Debt Theory, plus an additional (seventh) reason: "[C]ollection of substantially all receivables from third-party insured patients, including government insured patients was not probable, and neither the Company nor the signatories so believed." (*Id.* at ¶ 106).

The 2016 10-K contained, in addition to the statements discussed above, Defendants Smith and Cash's signed certifications under the Sarbanes Oxley Act of 2002 ("SOX"), affirming that Defendant CHS's "financial statements [*17] fairly presented all material aspects of its financial condition and results of operations, and that the Company's disclosure controls and procedures were effective, and provided reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP." (*Id.* at ¶ 107).

Plaintiffs allege that the statements in these certifications "were materially false and/or misleading, and failed to disclose material adverse facts about the Company's business, operations, and prospects." (*Id.* at ¶ 108). In an apparent effort to specify the nature of the alleged failure(s) to disclose, Plaintiffs further allege that "Defendants" (a term that Plaintiffs here do not expressly limit to Defendants Smith and Cash):

failed to disclose to investors: (1) that the Company's financial statements did not fairly present its financial condition, particularly with respect to its "bad debt" exposure that the Company excluded from its "bad debt" calculations revenue receivable from "self-pay" patients, especially aged receivables, for which collection was not probable; and (2) that the Company's disclosure controls and procedures were not effective, and [*18] did not provide reasonable assurance regarding the reliability of financial reporting, particularly with respect to the assessment and reporting of "bad debt."¹⁹

(*Id.* at ¶ 108). This theory—that Defendants did not make these particular disclosures in a Sarbanes-Oxley certification signed by Defendants Smith and Cash, that Defendants thereby are culpable of failing to disclose material facts about the Company, and that for this reason the statements in the certification were materially false and/or misleading—will be referred to as the "SOX Theory" below.

D. February 23, 2017 RBC Capital Markets Health Care Conference

Defendants Cash and Aaron spoke at the RBC Capital Markets Health Care Conference, where Defendant Cash had an exchange with the managing director of health care services equity research at RBC Capital Markets, regarding Defendant CHS's credit facility. (*Id.* at ¶ 109). During this exchange, Defendant Cash stated:

We're in good shape and we did it with — anybody who wants a little bit of cushion, we got a fair amount of debt and *we've got a little bit of cushion for 2017. We're in good shape.* At the end of December, we'll be in good shape in the quarters this year and then we [*19] should be in good shape going into 2018 on the covenants we have. And then there'd be some refinancing activities along the way. [Emphasis added.]

(*Id.*) Plaintiffs allege that this statement was materially false and/or misleading because:

Defendants failed to disclose to investors: (1) that the Company would have defaulted in 2016 absent the referenced covenant changes; and (2) that the Company was not "in good shape" but instead either would be in default or close to default even with the covenant changes if it recorded the full amount of its "bad debt" expense.

(*Id.* at ¶ 110). Analysts and investors reacted favorably to Defendant Cash's claims at the conference. (*Id.* at ¶ 111).

E. May 1, 2017 8-K

Defendant CHS announced its first quarter 2017 financial results in another 8-K, reporting its net operating revenues, adjusted EBITDA, and provision for bad debt. (*Id.* at ¶ 112). Invoking the Bad Debt Theory, Plaintiffs allege that these statements were materially false or misleading. (*Id.* at ¶ 113).

Theory, the Court: (i) appropriately accepts as true the allegation that Defendants did not disclose these two things to investors, but (ii) does not accept as true the allegation that such non-disclosure constituted a "fail[ure]," in the sense that it constituted (or effected) a violation of applicable securities law(s). The Court affords similar treatment to allegations of additional such "fail[ures]" referred to herein.

¹⁹ Consistent with its above-described approach regarding the Bad Debt

F. 2017 Q1 10-Q²⁰

This form noted the adoption of a new accounting standard (ASC 606) that would impact the provision for bad debts and stated that "[w]e believe [*20] that we collect substantially all of our third-party insured receivables, which include receivables from governmental agencies." (*Id.* at ¶¶ 114, 115). Plaintiffs allege that this statement was materially false and/or misleading, invoking the Bad Debt Theory, and for the additional reason that it failed to disclose "that collection of substantially all receivables from third-party insured patients, including government insured patients was not probable, and neither the Company nor the signatories so believed." (*Id.* at ¶ 116). This form also contained SOX certifications, signed by Defendants Smith and Cash, that were materially false and misleading using the SOX Theory. (*Id.* at 117).

G. Q1 2017 Earnings Call

Defendants held a conference call with investors and analysts on May 2, 2017 ("Q1 2017 Earnings Call"), during which Defendant Smith stated that "[w]e're working to not only improve our debt-EBITDA ratio, but also working to reduce the overall amount of our debt." (*Id.* at ¶ 118). Defendant Cash stated that "[o]ur EBITDA cushion on the senior secured ratio was 11% and our EBITDA cushion on our interest coverage was 16%," "adjusted EBITDA of \$527 million was in line with our expectations" [*21] and "the improvement in AR days more than offset third-party [settlements]." (*Id.*). Invoking the Bad Debt Theory, Plaintiffs allege that these statements were materially false and misleading. (*Id.* at ¶ 119).

On the call, Defendant Smith also said, regarding Defendant CHS's hospital divestitures, "[o]ur current divestiture plan will also allow us to move to a portfolio of hospitals that are better positioned in our markets with better volume growth, higher EBITDA margin, [and] improved cash flow." (*Id.* at ¶ 120). Plaintiffs allege that "[t]his statement was materially false and misleading because the Company's divestitures included many of the Company's strongest hospitals, and accordingly, the remaining portfolio of hospitals was weaker, not stronger." (*Id.*).

²⁰ A Form 10-Q is "a comprehensive report of financial performance that must be submitted quarterly by all public companies to the Securities and Exchange Commission (SEC). In the 10-Q, firms are required to disclose relevant information regarding their finances as a result of their business operations. The 10-Q is generally an unaudited report." *SEC Form 10-Q Definition*, Investopedia, <https://www.investopedia.com/terms/1/10q.asp> (last visited August 15, 2022). Official information as to the purpose (and proper completion) of Form 10-Q can be discerned from the online version of Form 10-Q (and its accompanying instructions). *See Form 10-Q*, <https://www.sec.gov/files/form10-q.pdf> (last visited August 15, 2022).

H. July 26, 2017 8-K

This form, announcing preliminary financial and operating results for the second quarter of 2017, included an Adjusted EBITDA of \$435 million which was impacted by the Company's "bad debt" provision. (*Id.* at ¶ 123). Defendant CHS had used "catch-up" charges²¹ during this period which caused bad debt-to-net revenue to increase from 13.2% in the first quarter to 14.1% in the second quarter. (*Id.* at ¶ 125). Investors [*22] reacted negatively, and Defendant CHS's share price dropped by more than 14.5%, closing at \$7.23 per share on July 27, 2017, on unusually heavy trading volume. (*Id.* at ¶ 126). Plaintiffs allege that Defendant CHS limited this decline by not including the full extent of Defendant CHS's "bad debt" expense in its Adjusted EBITDA calculation, instead taking on the incremental "catch up" charge. (*Id.* at ¶ 127). Moreover, Plaintiffs allege that while the pre-announcement constituted a partial "materialization"²² of risk, Defendants continued to make statements (and omissions) that (under the Bad Debt Theory) Plaintiffs allege were materially false and/or misleading. (*Id.* at ¶ 127).

I. August 1, 2017 8-K

Defendant CHS announced its second quarter 2017 financial results in another 8-K, reporting its net operating revenues, adjusted EBITDA, and provision for bad debt. (*Id.* at ¶ 128). Invoking the Bad Debt Theory, Plaintiffs allege that these statements were materially false and/or misleading. (*Id.* at ¶ 129).

J. 2017 Q2 10-Q

The Company's second-quarter 2017 Form 10-Q affirmed the second quarter results and stated that, "[o]ur [Defendant CHS's] provision for bad debts decreased \$21 million to \$679 [*23] million, or 14.1% of operating revenues (before the provision for bad debts) for the three months ended June 30, 2017." (*Id.* at ¶ 130). It also stated, "[t]he Company collects substantially all of its third-party insured receivables." (*Id.* at ¶ 131). Plaintiffs allege that these statements were materially false and/or misleading, invoking the Bad Debt Theory and further alleging that it failed to disclose "that collection of substantially all receivables from third-party insured patients, including government insured

²¹ This was defined in the Complaint as "any amount recorded as a one-time charge" used to correct the misuse or oversight of facts which existed during prior periods. (Doc. No. 61 at ¶ 94).

²² It is unclear what Plaintiffs mean by "materialization" in this context. The Court finds the most likely interpretation of this term here to mean the pre-announcement revealed some of what Defendant CHS had allegedly failed to disclose regarding its financial status (as described in the Bad Debt Theory).

patients was not probable, and neither the Company nor the signatories so believed." (*Id.* at ¶ 132). This 10-Q also contained SOX certifications signed by Defendants Smith and Aaron, which Plaintiffs, invoking the SOX Theory, allege were misleading. (*Id.* at ¶ 133).

K. Q2 2017 Earnings Call

On August 2, 2017, Defendants held a conference call with investors and analysts ("Q2 2017 Earnings Call") during which Defendant Smith, speaking on behalf of Defendant CHS, stated:

Now, I'd like to provide an update on our divestiture plan. ***As you're aware, we have announced plans to shift our portfolio to a smaller group of hospitals that are better positioned in their respective markets [*24] with better demographics and volume growth, higher EBITDA margin and improved cash flow generation profile.*** This will also allow us to direct future investments and corporate resources to our most attractive markets in regional networks. [Emphasis added.]

(*Id.* at ¶ 134). Plaintiffs allege that this statement was materially false and misleading because Defendant CHS sold many of the Company's strongest hospitals, making the remaining portfolio of hospitals weaker, rather than stronger. (*Id.*)

Defendant Aaron, speaking on behalf of Defendant CHS, further stated during this call that "[a]s of June 30, 2017, our EBITDA cushion on our secured net leverage ratio is 15% and our EBITDA cushion on our interest coverage ratio is 26%." (*Id.* at ¶ 135). Plaintiffs allege that:

These statements were materially false and misleading because they were derived from artificially inflated Consolidated EBITDA figures, as a result of: (1) excluding evidence that the Company's actual ability to collect uninsured "self-pay" receivables, especially aged receivables; (2) excluding from "bad debt" calculations evidence that collection of amounts due from insured patients as co-pays or deductibles was not probable [*25] for large groups of patients and hospitals; (3) excluding impact of "anticipated denials" from third-party payors that it had not reflected in its "bad debt" calculations; (4) and excluding that collection of substantially all receivables from third-party insured patients, including government insured patients was not probable, as the Company had assumed for purposes of calculating bad debt.

(*Id.* at ¶ 135).²³ Plaintiffs also state that Defendants Aaron and

CHS, when speaking about one of the primary drivers of Defendant CHS's bad debts, stated that "[i]mprovement in AR days more than offset the changes in third-party settlements." (*Id.* at ¶ 136 (emphasis added)). Regarding this statement, Plaintiffs allege:

This statement was materially false and misleading because they failed to disclose to investors the understatement of bad debt due to: (1) excluding evidence that the Company's actual ability to collect uninsured "self-pay" receivables, especially aged receivables, was not probable; (2) excluding from its "bad debt" calculations evidence that collection of amounts due from insured patients as co-pays or deductibles was not probable for large groups of patients and hospitals; (3) excluding [*26] the impact of "anticipated denials" from third-party payors that it had not reflected in its "bad debt" calculations; (4) and excluding that collection of substantially all receivables from third-party insured patients, including government insured patients, was not probable, as the Company had assumed for purposes of calculating bad debt.

(*Id.*)

L. November 1, 2017 8-K

The 8-K document contained the Company's net operating revenues, adjusted EBITDA, and provision for bad debt for the third quarter of 2017. (*Id.* at ¶ 139). Plaintiffs allege that Defendant CHS continued to use "catch up" charges during the third quarter—causing the bad debt-to-net revenue ratio to increase to 15.4%—in an attempt to get rid of part of Defendant CHS's massive bad debt overhang before reporting audited financial results in accordance with ASC 606. (*Id.* at ¶¶ 140, 141). These "dismal" third quarter results and Defendant Aaron's admission during the Q3 2017 Earnings Call that the results were caused partly by "increased bad debt" led Defendant CHS's share price to fall 23.1% (\$1.36 per share) over two days. (*Id.* at ¶ 143). Invoking the Bad Debt Theory, Plaintiffs allege that Defendants continued to conceal [*27] damaging information which stymied this price decline and continued to make false and misleading statements (and omissions). (*Id.* at ¶ 144).

M. 2017 Q3 10-Q

"was not probable" to the end of the phrase "(1) excluding evidence that the Company's actual ability to collect uninsured "self-pay" receivables, especially aged receivables"; not only did Plaintiffs add such language to the end of that phrase where it appears elsewhere in the Complaint, but the addition of that phrase (or something just like it) would be necessary to make the point Plaintiffs clearly were trying to make here.

²³ It seems clear to the Court that something is missing from the point (1) here. Specifically, it seems that Plaintiffs must have intended to add,

In the Company's third-quarter 2017 Form 10-Q, Defendant CHS stated that "[o]ur net operating revenues for the nine months ended September 30, 2017 decreased \$1.7 billion Our provision for bad debts decreased \$131 million to \$2.0 billion, or 14.2% of operating revenues (before the provision for bad debts) for the nine months ended September 30, 2017." (*Id.* at ¶ 146). Defendants also stated, "[t]he Company [Defendant CHS] collects substantially all of its third-party insured receivables." (*Id.* at ¶ 147).

Plaintiffs allege that these statements were materially false and/or misleading. In so alleging, Plaintiffs rely on the Bad Debt Theory and the additional assertion that these statements failed to disclose "that collection of substantially all receivables from third-party insured patients, including government insured patients, was not probable and neither the Company nor the signatories so believed." (*Id.* at ¶ 148). This form also contained SOX certifications, signed by Defendants Smith and Aaron, which Plaintiffs (invoking [*28] the SOX Theory) allege were materially false and misleading. (*Id.* at ¶ 149).

N. Q3 2017 Earnings Call

Defendants held a conference call with investors and analysts on November 2, 2017 ("Q3 2017 Earnings Call"), during which Defendant Aaron, speaking on behalf of Defendant CHS, stated that "our EBITDA cushion on our secured net leverage ratio is 15% and our EBITDA cushion on our interest coverage ratio is 29%." (*Id.* at ¶ 150). Plaintiffs allege that these statements were materially false and misleading because:

[T]hey were derived from artificially inflated Consolidated EBITDA figures, as a result of: (1) excluding evidence that the Company's actual ability to collect uninsured "self-pay" receivables, especially aged receivables, was not probable; (2) excluding from "bad debt" calculations evidence that collection of amounts due from insured patients as co-pays or deductibles was not probable for large groups of patients and hospitals; (3) excluding the impact of "anticipated denials" from third-party payors that it had not reflected in its "bad debt" calculations; (4) and excluding that collection of substantially all receivables from third-party insured patients, including government [*29] insured patients, was not probable, as the Company had assumed for purposes of calculating bad debt.

(*Id.*). On the same call, Defendant Aaron also stated that "consolidated net revenue was below our expectations from a combination of lower-than-expected volumes, payer rates, along with increased bad debt." (*Id.* at ¶ 151).

O. 2017 Form 10-K

The 2017 Form 10-K stated that Defendant CHS had conducted an analysis to develop new accounting processes and methodologies to comply with the revenue recognition accounting standards in ASC 606. (*Id.* at ¶ 152). This analysis also led to a change in estimate for the fourth quarter and year ended²⁴ December 31, 2017, increasing contractual allowances and provision for bad debts by approximately \$591 million. (*Id.* at ¶¶ 152, 153).

On February 27, 2018, Defendant CHS announced its fourth quarter and full year 2017 financial results in an 8-K, which included the \$591 million charge—\$197 million for contractual allowances, \$394 million for the bad debt provision—. (*Id.* at ¶ 154). Analysts expressed skepticism about characterizing the \$591 million charge as an adjustment occasioned by ASC 606. (*Id.* at ¶¶ 155, 156).

On February 28, 2018, Defendants held a [*30] conference call with investors and analysts (the "Q4 2017 Earnings Call"), during which Defendant Aaron reiterated how Defendant CHS reached its \$591 million change in estimate after developing new accounting processes and methodologies to comply with the new standard (ASC 606). (*Id.* at ¶ 157). When asked by an analyst about the size of the change, Defendant Aaron stated:

So when you compare the size of the adjustments, it's going to depend on how filers would have historically set their reserves. We've had higher days. We kept our self-pay on our books. Internally, we pursued those and gone after those for collection. So moving to this new method, it is a more conservative method. We had to anticipate with the new standard, we felt things that might impact the collectability and make sure that the amounts we set up were more conservative. So that included for — if you take a look at third-party payments, anticipated denials using our history on the transactions to anticipate denials from third-party payers, any audits that may come out from third-party payers and also our self-pay.

*So we did run the model backwards, as I mentioned, and to several prior years to see the impact of that. [*31] And if you think about going from a standard where you were maybe less conservative to one that's more*

²⁴ A company's 10-K functions as both its annual financial report and its financial report for the fourth quarter. The reported financials reflect both the company's fourth quarter financial position and its overall financial position for the previous year. 10-K, Investopedia, <https://www.investopedia.com/terms/1/10-k.asp> (last visited August 15, 2022). This is why the 10-K is described as setting forth financial results "for the fourth quarter and year ended."

conservative, really when we look at ours, it did not have an impact. And if you think about it, it probably has an impact when the size of your balance sheet is growing through acquisitions and potentially receivables that come on board from a large acquisition. We've had a couple of very large ones. [Emphasis added.]

(*Id.* at ¶ 158). Defendant CHS's share price fell more than 17% (\$1.06 per share) due the \$591 million charge. (*Id.* at ¶¶ 166, 167).

Defendant Aaron also stated that ASC 606 did not affect the collectability of Defendant CHS's bad debt. (*Id.* at 159). Plaintiffs state that Defendant Aaron further suggested that had ASC 606 been adopted in 2016, it would have been used to clear bad debt then just as it did for 2017, which amounts to a concession that uncollected receivables were inflated throughout the Class Period. (*Id.* at ¶ 160). Additionally, although Defendant CHS claimed during the Class Period that it collected substantially all third-party receivables, Defendant Aaron acknowledged that Defendant CHS had no basis, during the Class Period, to claim it understood the [*32] collectability of third-party receivables. (*Id.* at ¶¶ 161, 162).

Defendants had some motivation to mischaracterize the \$591 million charge as a change in accounting because it was the only way Defendant CHS could avoid triggering a default on its debt covenants. (*Id.* at ¶¶ 163-65). Confidential witnesses (all former CHS employees) state that the \$591 million charge was a stealth restatement to correct errors in earlier financial statements. (*Id.* at ¶ 168). One of these confidential witnesses states that the \$591 million increase was the result of an error or change to the accounting around the goodwill and synergies that Defendant CHS thought it would receive from HMA. (*Id.* at ¶¶ 169, 170).

Plaintiffs allege that Defendant CHS has never offered a plausible explanation for the \$591 million write-down, which alone is more than 88% of Defendant CHS's bad debt provision for the previous quarter. (*Id.* at ¶ 172). Plaintiffs further allege that had Defendant CHS formally acknowledged its restatement, it would have been required to provide a full explanation of the error(s), the nature of any related correction, and its actual proximity to triggering default under loan covenants to investors. [*33] (*Id.* at ¶ 174).

Finally, Plaintiffs include additional allegations specific to Defendants' scienter. Plaintiffs note that Defendants acted with scienter by virtue of:

- (a) their receipt of information reflecting the Company's understatement of bad debt and overstatement of EBITDA; and/or
- (b) their receipt of information reflecting that lacked adequate internal and financial controls; and/or

- (c) their intentional or reckless issuance of materially false or misleading statements; and/or
- (d) their ultimate responsibility to ensure the accuracy of such statements and his reckless failure to do so.

(*Id.* at ¶ 175). Plaintiffs state that this shows that Defendant CHS and the Individual Defendants either knew or were deliberately reckless in disregarding the materially false or misleading nature of the information they disseminated to the public. (*Id.*) Plaintiffs also state that the Individual Defendants knew or were deliberately reckless in disregarding that the material misrepresentations and omissions contained in Defendant CHS's public statements would affect the integrity of the market for Defendant CHS's securities and would cause the price of those securities to be artificially inflated. [*34] (*Id.* at ¶ 176).

Correspondence with the SEC shows that Defendant CHS's executives were actively involved in the budgeting process and were aware of the true financial condition of the bad debts. (*Id.* at ¶¶ 177, 178). A confidential witness also stated that Defendant CHS's management pulled reports from the revenue cycle stream, confirming that the Individual Defendants had access to the information they excluded from "bad debt" calculations. (*Id.* at ¶ 179). Defendant CHS's revenue and bad debt were of core importance, and Defendant CHS and the Individual Defendants knew that acquiring payment for services performed was vital to the success of Defendant CHS. (*Id.* at ¶ 180). Plaintiffs allege that the Individual Defendants were likely aware that Defendant CHS's bad debt provision was understated, and that even if they were unaware, the Individual Defendants acted in a deliberately reckless manner to ignore adverse information. (*Id.* at ¶ 181). Defendant CHS and the Individual Defendants were also aware of the loan covenants as evidenced by the facts that Defendant CHS is a party to the agreements (and is charged with knowledge thereof) and that Individual Defendants had spoken to investors [*35] regarding the covenants and the related "EBITDA cushion." (*Id.* at ¶ 182). Defendant Cash is also a signatory on the 8-k filed on December 6, 2016, disclosing the December 5, 2016 amendment to the covenant ratios. (*Id.*) Therefore, the Defendants understood the covenants and were incentivized to postpone recognition of the bad debt expense until it could be characterized as a "change in accounting" and be exempted from the covenant calculation. (*Id.*)

The SEC was already investigating HMA for similar conduct. HMA, which Defendant CHS acquired prior to the Class Period, is²⁵ the subject of an ongoing SEC investigation

²⁵The allegation in the Amended Complaint of an ongoing investigation concerning HMA was, naturally, an allegation that the

concerning issues related to accounts receivable, billing write-downs, contractual adjustments, reserves for doubtful accounts, accounts receivable aging, and recording of revenue. (*Id.* at ¶ 183). Plaintiffs state that "[t]he fact that its largest acquisition was facing an SEC investigation at the time of Defendants' conduct supports an inference that Defendants were aware of the fraud since it necessarily brought the issues to their attention." (*Id.* at ¶ 184).

Finally, during the Class Period, the Individual Defendants were given far more compensation than they could obtain [*36] at other healthcare competitor-employers. (*Id.* at ¶ 185). The Individual Defendants' compensation was tied to Defendant CHS's Adjusted EBITDA which further incentivized the Individual Defendants to understate Defendant CHS's bad debts. (*Id.*)

The Complaint asserts two claims. Count One alleges violation(s) by all Defendants of [section 10\(b\)](#) of the Exchange Act (codified at [15 U.S.C. § 78j\(a\)](#)) and [Rule 10b-5](#) promulgated thereunder (codified at [17 C.F.R. § 240.10b-5](#)). (*Id.* at ¶¶ 197-207). Count Two sets forth a claim of so-called "control person" liability with respect to the Individual Defendants—*i.e.*, the theory that the Individual Defendants (even if not otherwise liable for the violations alleged in Count One) are, under [section 20\(a\)](#) of the Exchange Act (codified at [15 U.S.C. § 78t\(a\)](#)), liable for violations committed by CHS as alleged in Count One because they are so-called controlling persons of CHS. (*Id.* at ¶¶ 208-214). Plaintiffs' requested relief includes certification of the proposed plaintiffs' class, compensatory damages, and reasonable costs and expenses. (*Id.* at 64.).

LEGAL STANDARD

For purposes of a motion to dismiss under [Fed. R. Civ. P. 12\(b\)\(6\)](#), the Court must take all of the factual allegations in the complaint as true. [Ashcroft v. Iqbal](#), 556 U.S. 662, 678, 129 S. Ct. 1937, 173 L. Ed. 2d 868 (2009). To survive a motion to dismiss, a complaint must contain sufficient [*37] factual matter, accepted as true, to state a claim to relief that is plausible on its face. *Id.* A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged. *Id.* Threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice. *Id.* When there are well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement to relief. [Id.](#) at 1950. A legal

conclusion, including one couched as a factual allegation, need not be accepted as true on a motion to dismiss, nor are mere recitations of the elements of a cause of action sufficient. *Id.*; [Fritz v. Charter Township of Comstock](#), 592 F.3d 718, 722 (6th Cir. 2010), cited in [Abrig v. Hall](#), 295 F. Supp. 3d 874, 877 (M.D. Tenn. 2018). Moreover, factual allegations that are merely consistent with the defendant's liability do not satisfy the claimant's burden, as mere consistency does not establish plausibility of entitlement to relief even if it supports the possibility of relief. [Iqbal](#), 556 U.S. at 678.

In determining whether a complaint is sufficient under the standards of [Iqbal](#) and its predecessor and complementary case, [Bell Atlantic Corp. v. Twombly](#), 550 U.S. 544, 127 S. Ct. 1955, 167 L. Ed. 2d 929 (2007), it may be appropriate to "begin [the] [*38] analysis by identifying the allegations in the complaint that are not entitled to the assumption of truth." [Iqbal](#), 556 U.S. at 680. This can be crucial, as no such allegations count toward the plaintiff's goal of reaching plausibility of relief. To reiterate, such allegations include "bare assertions," formulaic recitation of the elements, and "conclusory" or "bold" allegations. [Id.](#) at 681. The question is whether the remaining allegations — factual allegations, *i.e.*, allegations of factual matter — plausibly suggest an entitlement to relief. *Id.* If not, the pleading fails to meet the standard of [Federal Rule of Civil Procedure 8](#) and thus must be dismissed pursuant to [Rule 12\(b\)\(6\)](#). [Id.](#) at 683.

As a general rule, matters outside the pleadings may not be considered in ruling on a motion to dismiss under [Rule 12\(b\)\(6\)](#) unless the motion is converted to one for summary judgment under [Rule 56](#). [Fed. R. Civ. P. 12\(d\)](#). When a document is referred to in the pleadings and is integral to the claims, it may be considered without converting a motion to dismiss into one for summary judgment. [Doe v. Ohio State Univ.](#), 219 F.Supp.3d 645, 652-53 (S.D. Ohio 2016); [Blanch v. Trans Union, LLC](#), 333 F. Supp. 3d 789, 791-92 (M.D. Tenn. 2018).

On a [Rule 12\(b\)\(6\)](#) motion to dismiss, "[t]he moving party has the burden of proving that no claim exists." [Total Benefits Planning Agency, Inc. v. Anthem Blue Cross and Blue Shield](#), 552 F.3d 430, 433 (6th Cir. 2008). That is not to say that the movant has some *evidentiary* burden; as should be clear from the discussion above, evidence (as opposed to *allegations* [*39] as construed in light of any allowable matters outside the pleadings) is not involved on a [Rule 12\(b\)\(6\)](#) motion. The movant's burden, rather, is a burden of *explanation*; since the movant is the one seeking dismissal, it is the one that bears the burden of explaining—with whatever degree of thoroughness is required under the circumstances—why dismissal is appropriate for failure to state a claim.

investigation was ongoing as of the time the Amended Complaint was filed.

Additional (heightened) pleading requirements also apply to Plaintiffs' claims by virtue of [Federal Rule of Civil Procedure 9\(b\)](#) and the Private Securities Litigation Reform Act ("PSLRA"), as discussed in more detail below.

DISCUSSION

Defendants assert that the Amended Complaint is flawed in several ways: 1) it fails to allege facts sufficient to establish that Defendants made misrepresentations; 2) it fails to allege facts sufficient to establish the element of scienter; 3) it fails as a matter of law because the company's estimates of future uncollectible revenue are inherently forward-looking and protected by an applicable safe harbor; and 4) because (according to Defendants) it fails to state a claim of securities fraud against the Company, the claims against the Individual Defendants also fail as a matter of law. (Doc. No. 66 at 9-11).²⁶ [*40] The Court will address each of these arguments in turn.

A. Overview of relevant law

[Section 10\(b\)](#) of the Act and [Rule 10b-5](#) prohibit fraudulent, material misstatements or omissions in connection with the sale or purchase of a security. [Grae v. Corrections Corp. of Am., No. 3:16-cv-2267, 2017 U.S. Dist. LEXIS 207475, 2017 WL 6442145, at * 13 \(M.D. Tenn. Dec. 18, 2017\)](#). In particular, to put the matter simply, in pertinent part [Section 10\(b\)](#) makes it illegal to employ, in connection with the purchase or sale of any security, any manipulative or deceptive device or contrivance in contravention of such rules and regulations promulgated by the SEC. [15 U.S.C. § 78j\(b\)](#). [Rule 10b-5](#) is just such a rule, and it is the primary one implicated in this case. [Rule 10b-5](#) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the

²⁶When citing herein to a page in a document filed by one of the parties, the Court endeavors to cite to the page number ("Page -- of --") added by the Clerk's Office as part of the pagination process associated with Electronic Case Filing if such page number differs from the page number originally provided by the author/filer of the document.

purchase [*41] or sale of any security.

[17 C.F.R. § 240.10b-5](#).²⁷

To state a claim under [Section 10\(b\)](#) and [Rule 10b-5\(b\)](#), a plaintiff must allege: "(1) a material misrepresentation or omission by the defendant;²⁸ (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation." [Jackson Cty. Employees' Ret. Sys. v. Ghosn, 510 F. Supp. 3d 583, 2020 WL 7711378, at *13 \(M.D. Tenn. 2020\)](#) (citing [In re Omnicare, Inc. Sec. Litig., 769 F.3d 455, 469 \(6th Cir. 2014\)](#) [hereinafter, "[Omnicare I](#)"]). Stated another way, "a plaintiff must allege, in connection with the purchase or sale of securities, the misstatement or omission of a material fact, made with scienter, upon which the plaintiff justifiably relied and which proximately caused the plaintiff's injury." *Id.*

Plaintiffs' securities fraud claims implicate the heightened pleading standards of [Federal Rule of Civil Procedure 9\(b\)](#), [Jackson Cty.](#), 510 F. Supp. 3d 583, 2020 WL 7711378, at *5, which requires that a party "must state with particularity the circumstances constituting fraud or mistake." [Fed. R. Civ. P. 9\(b\)](#). Accordingly, the Amended Complaint must "(1) specify the statements that Plaintiffs contend were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent." [Jackson Cty.](#), 510 F. Supp. 3d 583, 2020 WL 7711378, at *5 (citing [Dougherty v. Esperion Therapeutics, Inc., 905 F.3d 971, 978 \(6th Cir. 2018\)](#)). The Private Securities Litigation Reform Act ("PSLRA")—in particular, [*42] [15 U.S.C. § 78u-4\(b\)\(1\)](#) and [\(2\)](#), respectively—requires that a plaintiff's

²⁷It is clear that [subsection \(b\)](#) would have more precisely articulated its (surely) intended meaning had it provided: "To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make **any statements that were made**, in the light of the circumstances under which they were made, not misleading" By replacing the phrase "the statements made" with the bolded language proposed by the undersigned, the rule would have clarified that liability for omitting material facts can be based upon statements that are not themselves "untrue" (and do not themselves contain any untrue content); without this change, [subsection \(b\)](#) is clear enough, but this change would have made the point clearer still.

²⁸Successfully pleading an actionable material misrepresentation or omission requires a plaintiff to allege facts demonstrating two things: (1) that a defendant made a statement or omission that was false or misleading; and (2) that this statement or omission concerned a material fact." [Jackson Cty., 510 F. Supp. 3d 583, 2020 WL 7711378 at *14](#) (citing [Omnicare I, 769 F.3d at 470](#)).

complaint (1) specify each statement alleged to have been misleading along with the reason(s) why the statement is misleading and (2) state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind. *Id.*

Historically, the first two of the six elements have been notoriously difficult to articulate. As the Sixth Circuit noted a half-dozen years ago:

Our court has covered the standards for pleading these elements many times, and yet for all of our efforts and many pronouncements, the precise requirements for sufficiently pleading them, at least in this circuit, remain somewhat hazy and muddled. Therefore, before analyzing KBC's actual allegations, we will attempt to state the doctrine simply and in a straightforward manner in the hope of clearing away any confusion.

[Omnicare I, 769 F.3d at 469](#). The Court herein will attempt to do likewise, relying on [Omnicare I](#) (and whatever clarity it provided) and other extant cases.

B. Material misrepresentation or omission

The Sixth Circuit has explained:

A misrepresentation is an affirmative statement that is misleading or false. When an alleged misrepresentation concerns "hard information"—"typically [*43] historical information or other factual information that is objectively verifiable"—it is actionable if a plaintiff pleads facts showing that the statement concerned a material fact and that it was objectively false or misleading. [Murphy v. Sofamor Danek Grp., Inc. \(In re Sofamor Danek Grp., Inc.\)](#), 123 F.3d 394, 401 (6th Cir. 1997) (internal quotation marks omitted); see [City of Monroe Emps. Ret. Sys. v. Bridgestone Corp.](#), 399 F.3d 651, 669-70 (6th Cir. 2005). When an alleged misrepresentation concerns "soft information," which "includes predictions and matters of opinion," *id.*, a plaintiff must additionally plead facts showing that the statement was "made with knowledge of its falsity," [\[Indiana v. Omnicare\]](#), 583 F.3d at 945-46.

It is this latter type of alleged misrepresentation that is at issue here and that has given us and other courts such trouble because it adds a subjective inquiry to an otherwise objective element, thus conflating two elements of the six-element cause of action—an actionable misrepresentation and scienter. See, e.g., [Brown v. Credit Suisse First Bos. LLC \(In re Credit Suisse First Bos. Corp. Sec. Litig.\)](#), 431 F.3d 36, 48 (1st Cir. 2005) (recognizing that "the subjective aspect of the falsity requirement and the scienter requirement

essentially merge"), *overruled on other grounds by Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 127 S. Ct. 2499, 168 L.Ed.2d 179 (2007); [In re Salomon Analyst AT & T Litig.](#), 350 F.Supp.2d 455, 466 (S.D.N.Y. 2004) (recognizing same). Until now, we have ignored this merger of elements and analyzed whether a defendant had actual knowledge under both Elements One and Two. See, e.g., [\[Indiana v. Omnicare\]](#), 583 F.3d at 945-47 (analyzing knowledge of falsity under the material-misrepresentation [*44] requirement); [Zaluski](#), 527 F.3d at 573 (same); [City of Monroe](#), 399 F.3d at 670-76, 684-88 (analyzing knowledge of falsity under both requirements). In doing so, we have muddled the analytical framework, making it more difficult for lower courts and parties to evaluate whether a plaintiff has sufficiently pleaded a cause of action.

In the end, we must choose one way or the other to analyze a defendant's actual knowledge. Whether courts choose to evaluate this subjective component as part of their material-misrepresentation analysis or their scienter analysis makes little difference for the parties. Under either approach, Plaintiffs will need to allege particular facts demonstrating that defendants had actual knowledge that their statements concerning soft information were false or misleading at the time that they were made. But for the sake of clarity, it makes the most sense to adopt the First Circuit's approach and conceive of this additional requirement as raising the bar for alleging scienter. See [In re Credit Suisse](#), 431 F.3d at 48-49; see also Wendy Gerwick Couture, *Opinions Actionable as Securities Fraud*, 73 *L. L. Rev.* 381, 394-401 (2013). Doing so would allow courts to evaluate materiality and whether the statement was misleading or false—two objective inquiries—under the material-misrepresentation prong and then [*45] to save all subjective inquiries for the scienter analysis. In addition, whether someone made a statement with the knowledge that it was false is, at bottom, a question of someone's state of mind—the general subject of a scienter inquiry.

[Omnicare I, 769 F.3d at 470-71](#).

Defendants argue that Plaintiffs fail to plead with particularity facts sufficient to establish a material misrepresentation or omission. Plaintiffs identify the following paragraphs from the Amended Complaint as the ones setting forth the (affirmative) statements that underlie Plaintiffs' claims of material misrepresentations and omissions:²⁹ ¶¶ 100-101, 102-03, 104,

²⁹ Obviously, an affirmative statement can underlie a claim of *misrepresentation* because it can contain a misrepresentation. But one

105-06, 107-08, 109-10, 112-13, 115-16, 117, 118-19, 120, 123, 127, 128-29, 130-32, 133, 134, 135, 136, 139-40, 144, 145-48, 149, 150 (which are discussed in more detail in the Factual Background section, above). (Doc. No. 69 at 19). Defendants raise three (supposed) bases for challenging the sufficiency of Plaintiffs' assertion that their allegations of material misrepresentations and omissions are plausibly grounded on these statements: 1) Plaintiffs' supposed failure to sufficiently plead a lack of a reasonable basis for Defendant CHS's accounting estimates of uncollectible revenue, [*46] 2) Defendant CHS's supposed full disclosure of the risks related to uncollectible revenue, and 3) the statements supposedly amounting to mere (non-actionable) subjective statements of opinion, puffery, and characterizations.³⁰ (Doc. No. 66 at 23, 28).

1. Reasonable basis

Defendants argue that accounting estimates (such as reserves of uncollectible revenue) are evaluated under a standard of reasonableness and that the Complaint fails to plead facts sufficient for the Court to "infer that CHSI's accounting estimates of uncollectible revenue lacked any reasonable basis." (Doc. No. 66 at 23). Defendants cite Ninth Circuit authority for the proposition that "[a] company's determination of [] reserves, like other types of forecasts, is considered fraudulent only if plaintiffs can show that the company lacked a reasonable basis for the determination." (*Id.*).

Defendants also cite an unreported district court case in which the court held that:

[W]here a complaint alleges that defendants distorted certain data disclosed to the public by using unreasonable accounting practices, the complaint must state what the unreasonable accounting practices [*47] were and how those practices distorted the disclosed data. *In re Burlington*,

might reasonably ask how affirmative statements can underlie a claim of an *omission*. For purposes of [Rule 10b-5](#), the answer is clear: affirmative statements underlie a claim of an omission (of a material fact) to the extent that the omission of the material fact makes the statements misleading considering the circumstances under which they were made.

³⁰Though Defendants do not expressly assert that the omissions addressed throughout this section are immaterial, Defendants imply that their omissions were immaterial. To the extent that Defendants are making an argument regarding the materiality of statements, Defendants have not explained why the alleged misstatements or omissions "are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance." *Helwig v. Vencor, Inc.*, 251 F.3d 540, 563 (6th Cir. 2001), *abrogated on other grounds by Tellabs.*, 551 U.S. 308.

[114 F.3d at 1417-18](#). Statements of reserve amounts are "fraudulent only if . . . the responsible parties knew or should have known that [the amounts of reserve] were derived in a manner inconsistent with reasonable accounting practices." *Christidis v. Pa. Mortgage Trust*, 717 F.2d 96, 100 (3d Cir.1983). Accordingly, a complaint must plead with particularity "the manner in which, in establishing reserves for bad debts in the financial statements relied upon, the defendants knowingly departed from reasonable accounting practices." *Id.* To do so, the complaint must "include details about when and to what level the accounts receivable should have been written down, when and to what level the allowance should have been changed, why the allowance made by the corporation was unreasonable in light of the [bad debt] experienced, and how many accounts ultimately were uncollectible." *In re Loewen Group, Inc. Sec. Litig.*, Civ. A. No. 98-640, 2004 U.S. Dist. LEXIS 16601, 2004 WL 1853137, at *11 (E.D. Pa. Aug. 18, 2004). In the absence of such allegations, "neither the increase of allowance toward the end of

the class period nor the eventual financial ruin of [the defendant corporation] are proof that defendants committed any acts worse than mismanagement." 2004 U.S. Dist. LEXIS 16601, [WL] at *12.

Here, the Amended Complaint does identify with sufficient particularity which GAAP procedures were [*48] allegedly violated. However, the Amended Complaint does not state when and to what level bad debt should have been recognized, when and to what level bad debt reserves should have been changed, or how many accounts ultimately were uncollectible. *See id.* Similarly, the Amended Complaint does not identify the data, or source of data, that was used to arrive at its conclusions, the amount by which reserves were distorted, or how much revenue was improperly recognized. *See CHUBB*, 394 F.3d at 153. Accordingly, the Court finds that the Amended Complaint fails to plead facts which would support the inference that Defendants were engaging in accounting fraud with the particularity demanded by the PSLRA.

Freed v. Universal Health Servs., Inc., No. CIV.A.04-1233, 2005 U.S. Dist. LEXIS 7789, 2005 WL 1030195, at *9 (E.D. Pa. May 3, 2005). Defendants argue that like the plaintiffs in *Freed*, Plaintiffs "did not plead with any particularity facts sufficient to show that CHSI's estimates for uncollectible revenue lacked any reasonable basis at the time the estimates were made," "have not pled when the estimates should have been revised, or by how much," have not alleged "what facts were known or readily available to management during the Class Period to conclude that uncollectible revenue was underestimated," and "provide

no particularized support for their [*49] claim that financial statements for certain unspecified periods should be restated by an unspecified amount," thus failing to plead the "who, what, when, where and how" of the underlying events. (Doc. No. 66 at 26).

Plaintiffs respond that Freed is both unreported and out-of-circuit. They deem Freed an outlier and claim that it is based on a misinterpretation of In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410 (3d Cir. 1997) (hereinafter "In re Burlington"), which Plaintiffs assert (and the Court agrees) articulated not what was *necessary* to state a claim, but rather what was *sufficient* to state a claim. (Doc. No. 69 at 24 n.13). Plaintiffs assert that Defendants applied the wrong standard altogether, with "reasonableness" having no part of the calculus. Instead, Plaintiffs characterize the requisite standard as follows: "once a defendant speaks upon a subject he 'cannot omit material facts related to that issue so as to make [his] disclosure misleading.' Weiner v. Tivity Health, Inc., 365 F. Supp. 3d 900, 913 (M.D. Tenn. 2019). A speaker must provide "'the whole truth' . . . literal accuracy is not enough.' Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund, 575 U.S. 175, 192 (2015)." (*Id.* at 20). Here, unlike the plaintiffs in Freed, Plaintiffs do allege with sufficient particularity under the relevant pleading standards previously described that Defendant CHS "understated its provision for bad debts and [*50] overstated its operating revenue and Adjusted EBITDA." (Doc. No. 61 at 2).

Defendants also make several references in their briefing to the so-called "reasonable accountant standard." Under that standard (which would be more accurately dubbed the "not necessarily unreasonable accountant standard"), mere misapplications of accounting principles are insufficient to show the recklessness needed in a securities fraud case. S.E.C. v. Price Waterhouse, 797 F. Supp. 1217, 1240 (S.D.N.Y. 1992). Rather, plaintiffs must prove that "[t]he accounting practices were so deficient that the audit amounted to no audit at all or that the accounting judgments which were made were such that no reasonable accountant would have made the same decisions if confronted with the same facts." *Id.* (internal citations omitted).

Plaintiffs argue that this standard applies only to auditors (which do not include among their ranks any Defendants), and so this Court should not apply it to the instant case. Case law supports this position. *Compare id.* (applying the standard to an outside auditor), and *in re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1426 (9th Cir. 1994) (applying the standard to an outside auditor), with *in re Miller Indus., Inc.*, 120 F. Supp. 2d 1371, 1382 (N.D. Ga. 2000) (applying the standard to company-prepared financials). In the Sixth Circuit, this standard has been applied only to auditors, although [*51] the Sixth Circuit has not expressly prohibited giving it a wider scope. See La. Sch. Emps' Ret. Sys. v.

Ernst & Young, LLP, 622 F.3d 471, 479 (6th Cir. 2010) (applying the reasonable accountant standard to an outside auditor); Cosby v. KPMG, LLP, No. 3:16-CV-121-TAV-DCP, 2018 U.S. Dist. LEXIS 130244, 2018 WL 3723712, at *4 (E.D. Tenn. Aug. 2, 2018) (describing the reasonable accountant standard as the standard by which to judge an outside auditor). The Court thus declines to apply the "reasonable accountant standard" in the instant context.

But regardless of whether the reasonable accountant standard applies just to auditors or to all accountants (and, therefore, regardless of whether it will ultimately be applicable in the instant case), Plaintiffs are correct that courts treat the issue of whether a defendant has complied with relevant accounting standards as inappropriate to resolve on a motion to dismiss. See, e.g., In re Burlington, 114 F.3d at 1421 ("[I]t is a factual question whether [a defendant's] accounting practices were consistent with GAAP."); Wells Fargo Bank, N.A. v. Worldwide Shrimp Co., No. 17 CV 4723, 2019 U.S. Dist. LEXIS 150655, 2019 WL 4189480, at *5 (N.D. Ill. Sept. 4, 2019) ("[C]ompliance with GAAP is a fact-specific issue and cannot be resolved as part of a motion to dismiss."); SEC v. Cotton, No. SACV 06-0905 AG(ANX), 2006 U.S. Dist. LEXIS 98393, 2006 WL 6382128, at *6 (C.D. Cal. Dec. 21, 2006) (noting that it is not appropriate to resolve a dispute regarding the reasonableness of an accounting practice at the pleading stage); In re Triton Energy Ltd. Sec. Litig., No. 5:98-CIV-256, 2001 U.S. Dist. LEXIS 5920, 2001 WL 872019, at *8 (E.D. Tex. Mar. 30, 2001) ("Whether Defendants violated the applicable accounting standards is a question [*52] of fact."); Nappier v. Pricewaterhouse Coopers LLP, 227 F. Supp. 2d 263, 276 (D.N.J. 2002) (noting that whether an accounting practice complies with GAAP is a question of fact best resolved through expert testimony and therefore inappropriate for resolution on a motion to dismiss).

Instead, Plaintiffs need only meet the applicable pleading standards set forth in Iqbal and Twombly, Fed. R. Civ. P. 9(b), and the PSLRA, described by the Court above. The Court finds that Plaintiffs have done so. Without resolving factual issues as to the reasonableness of the accounting standards used by Defendants or whether the accounting principles used by Defendants comply with GAAP, Plaintiffs have plausibly alleged that Defendants distorted certain figures disclosed to the public and stated what the practices were and how they allegedly distorted the data. In re Burlington, 114 F.3d at 1410. At this stage, the Court cannot say—and, as discussed above, need not say—whether Defendants in fact complied with GAAP or whether the alleged misrepresentations can be explained in full (and justified) by a "change from one GAAP-compliant methodology for making accounting estimates to another GAAP-compliant methodology." (Doc. No. 66 at 27). In re Burlington, 114 F.3d at 1421.

The Court rejects Defendants' insistence that a "reasonable basis" standard applies when determining whether [*53] Plaintiffs have stated a claim for a material representation or omission based on forward-looking accounting estimates. Reasonableness is a question of fact to be decided by the jury, not by the Court on a motion to dismiss. The Court thus will not consider Defendants' proposed "reasonable basis" test when assessing whether Plaintiffs have adequately stated a claim for a material representation or omission.

2. Disclosed risk

Defendants include a brief argument for dismissal of Plaintiffs' 10(b) claim on the ground that (according to Defendants) "CHSI fully disclosed the risks related to uncollectible revenue." (Doc. No. 66 at 28). To support this argument, Defendants explain:

[Defendant CHS] provided fulsome, meaningful cautionary language and disclosed the risks related to potential future uncollectability of revenues. The Company identified its accounting policies for Third-Party Reimbursements and Allowance for Doubtful Accounts as Critical Accounting Policies. [Defendant CHS] informed investors that these estimates involved uncertainty and that actual results could differ from what was estimated. [Defendant CHS] also fully disclosed its methodology for calculating these estimates. [*54] The Company disclosed to investors that its adoption of ASC 606 could impact its financial statements.

In sum, [Defendant CHS] provided a reasonable, GAAP-compliant estimate for uncollectible revenue based on its historical experience for all periods, it fully disclosed its methodology for calculating these estimates, and it cautioned investors that actual results could differ. It provided expansive disclosure of its adoption of ASC 606 including the implementation of new processes and methodologies to comply with the new, historic change in GAAP. And [Defendant CHS] detailed its change in estimate in the fourth quarter 2017 based upon new information available with the implementation of those new processes and methodologies.

(*Id.* (footnotes omitted)).

Plaintiffs reply by arguing that "Defendants' naked warnings about 'risks and uncertainties' were insufficient to place investors on notice of the known risks inherent in their investments" because 1) "the supposed cautionary language Defendants cite was so generic that it would apply to any company that had any receivables" and 2) "the long list of potential generic risks contained in the Company's Annual

Reports (see Doc. No. 61-1 at [*55] 93-95) did not actually put investors on notice that these risks had already materialized." (Doc. No. 69 at 31-32).

As noted above, factual determinations are inappropriate on a motion to dismiss. Whether Defendants provided "fulsome, meaningful" cautionary language is clearly an issue in dispute between the parties, and is not fit for determination at this juncture. Because the issue of whether Defendants adequately disclosed risks related to uncollectable revenue is an issue of fact, the Court is not situated to dismiss Plaintiffs' well-pleaded 10(b) claim based on an argument that Defendants did indeed disclose the risks at issue here.

3. Opinion, puffery, and characterizations

Defendants assert that paragraphs 104, 109, 115, 118, 120, 131, 134, and 147 allege mere statements of opinion and are thus "non-actionable." (Doc. No. 66 at 28). The statements contained in these paragraphs are summarized as follows:

- Defendant Smith stated in the Q4 2016 Earnings Call that "we expect one result of our divestiture were [sic] to be a stronger, sustainable group of hospitals in markets where we can invest and grow." (Doc. No. 61 at ¶ 104).
- Defendant Cash, when speaking with an analyst and managing [*56] director of health care services at RBC Capital Markets, stated the following concerning Community Health's credit facility: "We're in good shape and we did it with — anybody who wants a little bit of cushion, we got a fair amount of debt and we've got a little bit of cushion for 2017. We're in good shape. At the end of December, we'll be in good shape in the quarters this year and then we should be in good shape going into 2018 on the covenants we have. And then there'd be some refinancing activities along the way." (Doc. No. 61 at ¶ 109).
- The 2017 Q1 10-Q stated in part, "We believe that we collect substantially all of our third-party insured receivables," while failing to disclose certain facts which Plaintiffs allege makes this statement materially false and/or misleading. (Doc. No. 61 at ¶¶ 115-116).
- Defendants stated on a Q1 2017 Earnings Call with investors and analysts that "[w]e're working to not only improve our debt-EBITDA ratio, but also working to reduce the overall amount of our debt[]," "[o]ur EBITDA cushion on the senior secured ratio was 11% and our EBITDA cushion on our interest coverage was 16%[]," "adjusted EBITDA of \$527 million was in line with our expectations[]," [*57] and, with respect to one of the

primary drivers of the Company's bad debt, that "the improvement in AR days more than offset third-party [settlements]]" (Doc. No. 61 at ¶ 118).

- Defendants stated, regarding Defendants' hospital divestitures "[o]ur current divestiture plan will also allow us to move to a portfolio of hospitals that are better positioned in our markets with better volume growth, higher EBITDA margin, improved cash flow[]" yet Plaintiffs state that the Company's divestitures "included many of the Company's strongest hospitals, and accordingly, the remaining portfolio of hospitals was weaker, not stronger." (Doc. No. 61 at ¶ 120).
- The 2017 Q2 10-Q stated in part that "[t]he Company collects substantially all of its third-party insured receivables . . ." (Doc. No. 61 at ¶ 131).
- During the Q2 2017 Earnings Call, Defendants stated, regarding Community Health's sell-off of hospitals, "As you're aware, we have announced plans to shift our portfolio to a smaller group of hospitals that are better positioned in their respective markets with better demographics and volume growth, higher EBITDA margin and improved cash flow generation profile." Yet, Plaintiffs state that "the [*58] Company's divestitures included many of the Company's strongest hospitals, and accordingly, the remaining portfolio of hospitals was weaker, not stronger." (Doc. No. 61 at ¶ 134).
- The "Management's Discussion and Analysis" section of Defendants' Form 10-Q for the third quarter of 2017 stated in part that "[t]he Company collects substantially all of its third-party insured receivables. (Doc. No. 61 at ¶ 147).

In *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, 575 U.S. 175, 135 S. Ct. 1318, 191 L. Ed. 2d 253 (2015) (hereinafter, "*Omnicare II*"),³¹ the Supreme Court distinguished statements of fact (which express certainty about a thing) from statements of opinion (which do not express certainty) in a securities fraud case. 575 U.S. at 182; see also *Zwick Partners, LP v. Quorum Health Corp.*, No. 3:16-cv-2475, 2018 U.S. Dist. LEXIS 97942, 2018 WL 2933406, at *5 (M.D. Tenn. Apr. 19, 2018). An opinion can successfully form the basis for an alleged misrepresentation in a securities fraud claim (that is, it is

"actionable") if the person stating the opinion does not actually hold the stated belief, or if the opinion contains a materially false embedded statement of fact, or if the opinion is paired with a sufficiently material omission that makes the statement misleading. *Id.* (discussing *Omnicare II*); see also *USM Holding, Inc. v. Simon*, No. 15-14251, 2017 U.S. Dist. LEXIS 146913, 2017 WL4005939, at *4 (E.D. Mich. Sept. 12, 2017).³² Whether a statement is "misleading" depends on the perspective of a reasonable investor. *Zwick Partners*, 2018 U.S. Dist. LEXIS 97942, 2018 WL 2933406, at *5 (citing *Omnicare II*, 575 U.S. at 186). In *Omnicare II*, the court explained that a reasonable investor expects [*59] not just that the company believes the opinion, but also that "it fairly aligns with the information in the company's possession at the time." *Id.* (citing *Omnicare II*, 575 U.S. at 189).

"The Sixth Circuit has made clear that even superficially broad statements of corporate self-praise must be evaluated in context to determine whether they convey more than just a generalized optimism." *Grae*, 2017 U.S. Dist. LEXIS 207475, 2017 WL 6442145, at *14 (citing *City of Monroe Emps. Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651, 671-72 (6th Cir. 2005)). A company's general boasts of quality are typically insufficient to establish liability under Section 10(b). See *St. Clair Cty.*, 2021 U.S. Dist. LEXIS 10346, 2021 WL 195370, at *6. The key is whether the statement at issue can be proven or disproven using standard tools of evidence. See *id.* Thus, vague statements not subject to verification by proof are generally deemed non-actionable puffery. But opinion or puffery, in particular contexts in which it is both factual and material, may be actionable. See *id.* "Material statements [that] contain the speaker's opinion are actionable under Section 10(b) of the Securities Exchange Act if the speaker does not believe the opinion and the opinion is not factually well-grounded." *Helvig v. Vencor, Inc.*, 251 F.3d 540, 562 (6th Cir. 2001) (quoting *Mayer v. Mylod*, 988 F.2d 635, 639 (6th Cir. 1993)). See also *City of Monroe*, 399 F.3d at 672 (citing *Casella v. Webb*, 883 F.2d 805, 808 (9th Cir. 1989)) ("What might be innocuous 'puffery' or mere statement of opinion standing alone may be actionable as an integral part of a representation of material fact when used to emphasize [*60] and induce reliance upon such a representation.") and *Scratchfield v. Paolo*, 274 F. Supp. 2d 163, 175-76 (D.R.I. 2003) (stressing that "a company's statements that it is 'premier,' 'dominant,' or 'leading' must not be assessed in a vacuum (*i.e.*, by plucking the statements out of their context to determine whether the words, taken *per se*, are

³¹ Although *Omnicare II* involved a registration statement that allegedly violated Section 11 of the Securities Act of 1933, other courts have found that the same standards for alleging the falsity of opinion statements apply to Section 10(b) and Rule 10b-5. See *Zwick Partners*, 2018 U.S. Dist. LEXIS 97942, 2018 WL 2933406, at * 5.

³² If the speaker omits material facts about the inquiry into or knowledge concerning the statement of opinion, and if those facts conflict with what a reasonable investor would take from the statement itself, then that omission is actionable. *USM Holdings*, 2017 U.S. Dist. LEXIS 146913, 2017 WL 4005939, at *4.

sufficiently 'vague' so as to constitute puffery.")).

First, some of the above statements are statements of fact, not of opinion. As pointed out by Plaintiffs, the statement contained in paragraphs 131 and 147 ("[t]he Company collects substantially all of its third-party insured receivables") is not an opinion, but rather an assertion of fact.³³

The Court finds that for the remaining "opinions," Plaintiffs have sufficiently alleged that Defendants omitted material factual information which would render the statements misleading to a reasonable investor under the [Omnicare II](#) standard. Plaintiffs describe these material omissions as follows:

Defendants' statements regarding the Company's financial results, including performance metrics that could trigger defaults on the Company's credit facilities, omitted that there were growing problems with its aged receivables from uninsured "self-pay" patients, debts related to co-pays [*61] and deductibles from insured patients, and disputed payments from third-party payors. [. . .] To avoid misleading investors by the plain inference of their statements, Defendants were required to disclose that they had collectibility [sic] problems with certain types of accounts. Such omitted facts would unquestionably have been material to investors because they "conflict with what a reasonable investor would take from the statement itself." [Omnicare](#), 575 U.S. at 189.

(Doc. No. 69 at 16-17).

Defendants also argue that these statements include expressions of "optimism, opinion, and subjective characterizations and analyses, and are understood by investors as mere 'puffery.'" (Doc. No. 66 at 28-29).

To arrive at the conclusion that the above-mentioned

³³ An argument could be made that the statement as a whole is an opinion inasmuch as the adverb "substantially" is subjective, meaning that the appropriateness of its use in a particular context is a matter of opinion rather than of fact. Ultimately, though, the Court would reject such an argument, believing that it is based on a view of what constitutes a fact that is too narrow—one that would enable speakers too often to deny, based merely on their inclusion of a subjective adjective or adverb, that they made a factual representation. On the other hand, the Court acknowledges that in some situations the use of an adjective or adverb absolutely turns what otherwise would be a statement of fact into a statement of opinion. But in the Court's view, this is not one of those contexts, in part because the notion of "substantially all"—which clearly signifies close to 100 percent, *i.e.*, 100 percent minus a rather immaterial percentage that stands as an outlier—is less subjective than the notion of "substantially" as used in so many other contexts.

statements are mere "puffery," Defendants improperly take each statement out of context. When viewed instead in its proper context, each statement is properly viewed as more than mere "puffery." For example, the alleged statement "[w]e're in good shape" was made in the context of Defendant Cash speaking with an RBC Capital Markets analyst about Defendants' credit facility, characterizing the Company in a way that misleads the listener by omitting the fact that the [*62] Company "would be in default or close to default even with the covenant changes if it recorded the full amount of its 'bad debt' expense." (Doc. No. 61 at 32). In that context, Defendant Cash's alleged statement regarding the financial status of the Company, made to a financial analyst, certainly would induce reasonable reliance on the health of the Company on the part of a reasonable investor. And, though the facts surrounding this point are disputed by the parties and are not subject to resolution on a motion to dismiss, Plaintiffs' version of the facts would support a reasonable inference that the speaker did not actually believe that the Company was in "good shape" as stated; likewise, the factual allegations in the Complaint (accepting them as true, as required) plausibly suggest that the statement was not well grounded.

Likewise, the statement "[w]e believe that we collect substantially all of our third-party insured receivables" was made in the 2017 Q1 10-Q, a report that Defendants knew investors would rely upon, in a paragraph which purports to explain how the Company "estimate[s] the allowance for doubtful accounts." (Doc. No. 61 at 34). This "opinion"³⁴ was specifically tethered [*63] to the Company's official statement regarding its financial status and the process by which the Company "estimate[s] the allowance for doubtful accounts." Plaintiffs have set forth sufficient factual matter to demonstrate both that the fact contained within this statement is false and that Defendants had no basis for stating this opinion. (Doc. No. 61 at 49).

The Court's conclusion here is supported by the supplemental authority cited by Plaintiffs. (Doc. No. 76). In [Bond v. Clover Health Investments, Corp. et. Al](#), 3:21-cv-00096, 587 F. Supp. 3d 641, 2022 U.S. Dist. LEXIS 34417 (M.D. Tenn. Feb. 28, 2022), the court found that even statements "resembl[ing], on some level, empty corporate self-praise" were sufficient to establish

³⁴ It is hard to say whether this statement is even properly characterized as an "opinion." Instead, it is probably most accurate to characterize this statement as an opinion statement that contains an embedded statement of fact—in which case, under [Omnicare II](#), it is actionable if the embedded fact is materially false. [Omnicare II](#), 575 U.S. at 176 ("In addition, opinion statements can give rise to false-statement liability under § 11 if they contain embedded statements of untrue facts.").

liability under [Section 10\(b\)](#) because the statements were "built around a core contention that was factual and definite in nature." (Doc. No. 76-1 at 40-41). Similarly, Plaintiffs have set forth sufficient factual matter demonstrating that Defendants' statements here, despite some of them resembling "opinions," are all either (a) tied to materially false factual contentions regarding the Company's financial estimates and financial results, or (b) paired with sufficiently material omissions that make the statements misleading, [*64] thus rendering them actionable under [Section 10\(b\)](#).

The Court is thus unconvinced that the above statements fall into the category of non-actionable opinion, puffery, or mere characterizations. Therefore, the Court finds that contrary to Defendants' argument, Plaintiffs here have sufficiently alleged statements that plausibly amount to misstatements and omissions and therefore are potentially actionable.

C. Alleging facts sufficient to establish element of scienter

"[T]he complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." [15 U.S.C. § 78u-4\(b\)\(2\)](#). This required state of mind, referred to as "scienter," has been defined as a mental state embracing intent to deceive, manipulate, or defraud. *Jackson Cty.*, 510 F. Supp. 3d 583, 2020 WL 7711378, at *18 (citing *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 48, 131 S. Ct. 1309, 179 L. Ed. 2d 398 (2011)). "In the securities fraud context, scienter includes a knowing and deliberate intent to manipulate, deceive, or defraud, and recklessness."³⁵ *Id.* (citing *Doshi v. Gen. Cable Corp.*, 823 F.3d 1032, 1039 (6th Cir. 2016)); see also *Dougherty v. Esperion Therapeutics, Inc.*, 905 F. 3d 971, 979 (6th Cir. 2018). Whether someone made a statement with the knowledge that it was false is, at bottom, a question of someone's state of mind, which is the general subject of a scienter inquiry. *Omnicare I*, 769 F.3d at 471.

The Supreme Court has set forth [*65] a framework for analyzing the scienter element as follows:

We establish the following prescriptions: First, faced with a [Rule 12\(b\)\(6\)](#) motion to dismiss a [§ 10\(b\)](#) action, courts must, as with any motion to dismiss for failure to plead a claim on which relief can be granted, accept all factual allegations in the complaint as true

Second, courts must consider the complaint in its entirety,

as well as other sources courts ordinarily examine when ruling on [Rule 12\(b\)\(6\)](#) motions to dismiss, in particular, documents incorporated into the complaint by reference, and matters of which a court may take judicial notice. The inquiry, as several Courts of Appeals have recognized, is whether all of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard.

Third, in determining whether the pleaded facts give rise to a "strong" inference of scienter, the court must take into account plausible opposing inferences

The strength of an inference cannot be decided in a vacuum. The inquiry is inherently comparative: How likely is it that one conclusion, as compared to others, follows from the underlying facts? To determine [*66] whether the plaintiff has alleged facts that give rise to the requisite "strong inference" of scienter, a court must consider plausible, nonculpable explanations for the defendant's conduct, as well as inferences favoring the plaintiff. The inference that the defendant acted with scienter need not be irrefutable, i.e., of the "smoking-gun" genre, or even the "most plausible of competing inferences."...Yet the inference of scienter must be more than merely "reasonable" or "permissible"—it must be cogent and compelling, thus strong in light of other explanations. A complaint will survive, we hold, only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.

Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 322-24, 127 S. Ct. 2499, 168 L. Ed. 2d 179 (2007) (citations omitted).

In *Matrixx*, the Court provided a post-*Tellabs* example of how to consider scienter pleadings "holistically" in [Section 10\(b\)](#) cases. See *Frank v. Dana Corp.*, 646 F.3d 954, 961 (6th Cir. 2011) ("*Dana II*") (citing *Matrixx*, 563 U.S. at 48). "Writing for the Court, Justice Sotomayor expertly addressed the allegations collectively, did so quickly, and, importantly, did not parse out the allegations for individual analysis." *Id.* "This is the only appropriate approach following *Tellabs*'s mandate to review scienter pleadings based on the [*67] collective view of the facts, not the facts individually." *Id.* ³⁶ (citing *Tellabs*, 551 U.S. at 322-23) ("The inquiry . . . is whether all of the facts alleged, taken

³⁵ Under the general PSLRA standard, a complaint may allege scienter based on "either knowing falsity or recklessness." *Moshell v. Sasol Ltd.*, 481 F. Supp. 3d 280, 289 (S.D.N.Y. 2020).

³⁶ The former method of reviewing each allegation individually before reviewing them holistically risks losing the forest for the trees. *Dana II*, 646 F.3d at 961. Furthermore, after *Tellabs*, conducting an individual review of myriad allegations is an unnecessary inefficiency. *Id.*

collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard.")).

As part of that analysis, the Sixth Circuit has noted recently, nine non-exhaustive factors ("the [Helwig](#) factors") should be considered: (1) insider trading at a suspicious time or in an unusual amount; (2) divergence between internal reports and external statements on the same subject; (3) closeness in time of an allegedly fraudulent statement or omission and the later disclosure of inconsistent information; (4) evidence of bribery by a top company official; (5) existence of ancillary lawsuit charging fraud by a company and the company's quick settlement of that suit; (6) disregard of the most current factual information before making statements; (7) disclosure of accounting information in such a way that its negative implications could only be understood by someone with a high degree of sophistication; (8) the personal interest of certain directors in not informing disinterested directors of an impending [*68] sale of stock; and (9) the self-interested motivation of defendants in the form of saving their salaries or jobs. [City of Taylor Gen. Emps. Ret. Sys. v. Astec Indus., Inc.](#), 29 F.4th 802, 813 (6th Cir. 2022) (citing [Helwig](#), 251 F.3d at 552).³⁷

³⁷ Plaintiffs argue that [Helwig](#) is altogether inapplicable, quoting *Dana I* for the proposition that "the standard adopted in [Helwig](#) is no longer good law." (Doc. No. 69 at 25). But *Dana I* does not render [Helwig](#) inapplicable in its entirety. Plaintiffs take this quotation from *Dana I* out of context; the quoted material from *Dana* is actually referring not to the applicability of the nine factors articulated in [Helwig](#), but rather to *Dana*'s holding that the "most plausible of competing inferences" standard from [Helwig](#) is no longer applicable. *Dana I*, 547 F.3d at 571. In fact, several cases cited by Plaintiffs do consider the nine factors (non-exhaustively, without analyzing each factor in isolation, as directed by [Tellabs](#)) when analyzing scienter. See, e.g., [In re Huffly Corp. Sec. Litig.](#), 577 F. Supp. 2d 968 at 998 (S.D. Ohio 2008) (recognizing the applicability of the second, third, sixth and eighth [Helwig](#) factors in the context of the holistic [Tellabs](#) analysis for scienter); [Weiner v. Tivity Health, Inc.](#), 365 F. Supp. 3d 900, 915 (M.D. Tenn. 2019) ("[T]he Court does not read *Franks II* as premitting consideration of the [Helwig](#) factors when determining whether the facts alleged, taken collectively, give rise to a strong inference of scienter that is at least as compelling as any opposing inference. Indeed, post-[Tellabs](#), some Sixth Circuit decisions have specifically addressed the [Helwig](#) factors in securities fraud cases."), *reconsideration denied*, No. 3:17-CV-01469, 2019 U.S. Dist. LEXIS 86237, 2019 WL 2211764 (M.D. Tenn. May 22, 2019). And as noted above, the Sixth Circuit recently stated that the nine [Helwig](#) factors are to be considered in the scienter analysis. [City of Taylor](#), 29 F.4th at 813 (6th Cir. 2022) ("As part of [the scienter analysis], we consult a non-exhaustive list of considerations known as the [Helwig](#) factors."). But Plaintiffs *are* correct that, as noted above, the scienter inquiry is done "holistically" based on a collective review of all the facts. *Id.*

Thus, the Court will address Plaintiffs' claims holistically, considering the [Helwig](#) factors, but it also will address the specific arguments in Defendants' Motion. Defendants make several primary arguments to support their position that there is a lack of pled scienter: 1) speculative motive and presumed access to information are not sufficient to raise scienter inference; 2) the size of a change of estimate does not establish scienter; 3) an SEC investigation resulting in no adverse findings does not raise an inference of scienter; 4) executives receiving salaries does not raise an inference of scienter; 5) Defendant Cash's retirement does not show scienter; 6) individual SOX certifications do not show scienter; and 7) confidential witness statements do not raise scienter inference. Plaintiffs respond that the Amended Complaint creates a strong inference of scienter because the following things demonstrate scienter: 1) Defendants' debt covenant manipulation; 2) company executives' active involvement [*69] with and awareness of Defendant CHS's core business; 3) the magnitude of the fraud; 4) post-class period admissions; 5) the Individual Defendants' review and approval of the company's accounting controls; and 6) Defendants' weak competing inference. (Doc. No. 69 at 36-44). The Court will first address each of Defendants' arguments:

1. *Speculative motive and presumed access to information support scienter*

Defendants argue that Plaintiffs' theory of scienter improperly rests on two speculative conclusions of fact: Specifically, according to Defendants, Plaintiffs (i) assume that because the Individual Defendants were high-ranking officers, they necessarily had access to certain financial information, and (ii) speculate that Defendants were motivated to wait to disclose accurate estimates until the fourth quarter of 2018³⁸ because the Company would violate its credit agreements if it disclosed the estimates during the Class Period. (Doc. No. 66 at 32-33).

a. **Motive**

According to the Sixth Circuit, an allegation that a party had a motive to commit securities fraud is insufficient by itself to establish a strong inference of scienter, but facts demonstrating motive can be part of the scienter [*70] analysis. See [In re Comshare Inc. Sec. Litig.](#), 183 F.3d 542, 549 (6th Cir. 1999) ("[W]e conclude that plaintiffs may plead scienter in [§ 10b or Rule 10b-5](#) cases by alleging facts giving rise to a strong inference of recklessness, but not by alleging facts merely establishing that a

³⁸ The Court understands Defendants to have made a typographical error in writing "2017" rather than "2018" when stating, "Defendants, as the story goes, somehow became convinced that the Company would violate its credit agreements if it disclosed accurate estimates during the Class Period, and so waited until the fourth quarter of 2017 to disclose the accurate estimate." (Doc. No. 66 at 33) (emphasis added). See Doc. No. 61 at ¶ 9.

defendant had the motive and opportunity to commit securities fraud."); [Darby v. Century Bus. Servs., Inc.](#), 96 F. App'x 277, 283 (6th Cir. 2004) ("Whether the facts can be said to establish motive, opportunity, or neither, we are directed only to consider whether they produce a strong inference that the defendant acted at least recklessly.... Accordingly, facts presenting motive and opportunity may be of enough weight to state a claim under the PSLRA, whereas pleading conclusory labels of motive and opportunity will not suffice.") (quoting [Helmig](#), 251 F.3d at 551); [Robert N. Clemens Tr. v. Morgan Stanley DW, Inc.](#), 485 F.3d 840, 852 (6th Cir. 2007) (holding that merely alleging motive and opportunity to commit securities fraud was insufficient).

Here, Plaintiffs pled a number of facts that present a plausible theory of motive that goes beyond mere conjecture or conclusory labeling:

The Complaint alleges that the Defendants manipulated Community Health's financials to ensure they did not trigger a default of their debt covenants. The Company, which had a far higher debt burden than its peers (¶31), had a credit facility that required Community Health to keep its [*71] "secured net leverage ratio" below a maximum level and its "interest coverage ratio" above a minimum level, both of which related to its consolidated EBIDTA, to avoid default. ¶45. However, a loophole in debt agreements specifically excluded from these calculations expenses classified as related to accounting principle changes. ¶50. Just prior to the Class Period, the Company was barely able to avoid triggering a default by renegotiating with its lenders to exceed the then-specified maximum secured net leverage ratio and minimum interest coverage ratio. ¶52. Thus, Defendants had a strong, unique motive to avoid recognizing the bad debt expense as incurred, instead taking advantage of the loophole by delaying recognition until their end-of-Class-Period shift to a new accounting method.

(Doc. No. 69 at 36).

Because Plaintiffs support their allegations of motive (to engage in securities fraud) with a strong set of alleged facts, the Court rejects Defendants' argument that Plaintiffs' assertion of motive is merely speculative. Maybe Defendants acted on such alleged motive, and maybe they did not; the Court is well aware that merely because someone had a motive does not mean that the person [*72] acted in accordance with that motive (and, for that matter, that merely because a plaintiff has plausibly alleged that a defendant had a motive does not mean that the plaintiff has plausibly alleged that the defendant acted in accordance with that motive, if such allegation were even required). But what matters for present purposes is that Plaintiffs have plausibly alleged that Defendants *had* such a motive. Plaintiffs' allegations

regarding Defendants' motive can thus be considered as evidence in the holistic [Tellabs](#) analysis of scienter.

b. Access to Information

Merely having access to information is not sufficient to establish a strong inference of scienter. *See e.g.*, [PR Diamonds, Inc. v. Chandler](#), 364 F.3d 671, 688, 91 Fed. Appx. 418 (6th Cir. 2004) ("[F]raudulent intent cannot be inferred merely from the Individual Defendants' positions in the Company and alleged access to information."), *abrogated on other grounds by* [Tellabs](#), 551 U.S. 308; [Loc. 295/Loc. 851 IBT Emp. Grp. Pension Tr. & Welfare Fund v. Fifth Third Bancorp.](#), 731 F. Supp. 2d 689, 726 (S.D. Ohio 2010) ("Scienter, however, cannot be inferred merely because of the defendants' positions in the company or the fact that they had access to the company's financial information.").

In the Sixth Circuit, "high-level executives can be presumed to be aware of matters central to their business's operation." [PR Diamonds](#), 364 F.3d at 688 (emphasizing that only knowledge of "central, day-to-day [*73] operational matters," however, may be presumed). Though the Court in [PR Diamonds](#) acknowledges the applicability of this so-called "core operations doctrine," the Sixth Circuit has not clearly stated whether this doctrine survived the PSLRA. But as the undersigned recently explained:

In [Stein v. U.S. Xpress Enterprises, Inc.](#), No. 1:19-cv-98, 2020 U.S. Dist. LEXIS 114686, 2020 WL 3584800 (E.D. Tenn. June 30, 2020), . . . the court noted that a majority of district courts appear to have concluded that the doctrine survived, albeit only as a supplementary consideration that may bolster other well-pleaded facts. 2020 U.S. Dist. LEXIS 114686, 2020 WL 3584800, at *39 (concluding that the core-operations theory, even assuming the doctrine survives, provided the plaintiff in that case no support). Although the "core-operations" inference generally will not establish a strong inference of scienter by itself, it can be one relevant part of a complaint supporting that inference. [In re Baxter Int'l Inc. Sec. Litig.](#), No. 19 C 7786, 2021 U.S. Dist. LEXIS 5158, 2021 WL 100457, at *13 (N.D. Ill. Jan. 12, 2021). Thus, the Court considers the "core-operations" allegations, albeit not as an independent means to show scienter, but rather as one possible indicator of scienter under a holistic examination.

[Indiana Pub. Ret. Sys. v. AAC Holdings, Inc.](#), No. 3:19-CV-00407, 2021 U.S. Dist. LEXIS 68415, 2021 WL 1316705, at *19 (M.D. Tenn. Apr. 8, 2021) (Richardson, J.). Here, too, the Court will treat "core-operations" allegations as relevant in the holistic [Tellabs](#) scienter analysis, without relying on the doctrine as an independent means of showing scienter.

Plaintiffs argue [*74] that Defendant CHS' collection of revenue, and the amount of CHS's "bad debt," were matters so central and critical to CHS' business operations that knowledge thereof can be imputed to the Individual Defendants, making it more likely that they acted with scienter. (Doc. No. 69 at 39). Plaintiffs provide additional alleged facts specific to Individual Defendants Aaron and Smith, who allegedly were directly involved in the calculation and assessment of the Company's finances. (*Id.* at 40). The Court is persuaded that these additional allegations are enough to support an inference of knowledge on the part of Defendants Aaron and Smith.

With respect to the other Individual Defendant (Larry Cash), Plaintiffs do not point in their Response to any additional alleged facts supporting knowledge and instead rely solely on the "core-operations" doctrine. Plaintiffs assert that "[b]ecause the management of receivables was core to its operations, investor sentiment, and avoiding debt default, it would be absurd to infer that its executives were not aware of the actual amount of bad debt" and thus, these Individuals "knew the truth when making inconsistent statements to investors." (*Id.* at 39). This [*75] assertion by Plaintiffs is not persuasive. While the core-operations doctrine allows the Court to presume knowledge, it does not by itself render "absurd" an inference of a lack of knowledge, which conceivably could be drawn from other applicable circumstances. In any event, the question is not whether an inference of lack of knowledge can be drawn; rather, it is whether, as Plaintiffs suggest, the core-operations doctrine by itself enables the Court to draw an inference of knowledge on the part of the Individual Defendants as to Defendant CHS' management of receivables.

The face of the Complaint provides sufficient factual matter regarding Defendant Cash's role and responsibilities at the Company such that the core-operations doctrine is relevant to the scienter inquiry as to this Individual Defendant. The Complaint alleges that Defendant Cash was the Chief Financial Officer from 1997 to 2017, and signed the Company's 2016 annual report and first quarter 2017 quarterly report. From this, it is reasonably inferable that Defendant Cash was particularly situated to be extremely familiar with the Company's financial operations, as well as and especially knowledgeable about the amount of [*76] the Company's revenue and receivables and the way in which these figures were calculated and portrayed to investors. Thus, the inference of knowledge under the core-operations doctrine is permissible as to Defendant Cash and will be considered by the Court as part of the overall scienter analysis.

2. The size of the change of estimate supports scienter

Defendants argue that because the size of a change in estimate does not raise an inference of scienter, the "0.6 percent increase

in total estimated uncollectible revenue on the income statement" at issue here (which "contributed to just a three percent year over year increase in the allowance for doubtful accounts") does not raise a strong inference of scienter. (Doc. No. 66 at 36-37). In their Response, Plaintiffs characterize the magnitude of alleged fraud differently, framing it as "massive and incredibly material to [CHS's] financial prospects," and noting that "the \$591 million charge alone [was] more than 88% of Community Health's bad debt provision for the previous quarter (§172), and the revelation that Community Health ramped 'bad debt' expense (for the third time in as many quarters) to more than \$1 billion in the quarter, amounting [*77] to a whopping 25% of revenues (§19) caused the Company's stock to decrease more than 17%, causing investors to lose tens of millions of dollars. §§12-13." (Doc. No. 69 at 40-41) (internal quotation marks omitted).

The Sixth Circuit distinguishes, for purposes of considering scienter, (a) the magnitude of a false financial statement (or a misapplication of accounting principles or a financial "misstatement") made by a company from (b) the magnitude of a misstatement made by an outside auditor. Regarding misstatements made by an outside auditor, the Sixth Circuit has held that the magnitude of an accounting error cannot give rise to an inference of scienter. See [Ley v. Visteon Corp.](#), 543 F.3d 801, 816 (6th Cir. 2008).³⁹

However, the Sixth Circuit has considered the magnitude of an error when determining the scienter of non-outside auditor defendants (primarily company officers). See [PR Diamonds](#), 364 F.3d 671, 684, 91 Fed. Appx. 418 (6th Cir. 2004) ("[S]ome courts have recognized that an inference of knowledge or recklessness may be drawn from allegations of [a company's] accounting violations that are so simple, basic, and pervasive in nature, and so great in magnitude, that they should have been obvious to a defendant."), *abrogated on other grounds by* [Tellabs](#), 551 U.S. 308; [Ley](#), 543 F.3d 801, 812 (6th Cir. 2008) (considering [*78] magnitude of defendant-company's accounting improprieties in the scienter analysis); [Doshi v. Gen.](#)

³⁹ See also [Fidel v. Farley](#), 392 F.3d 220, 231 (6th Cir. 2004), *abrogated on other grounds by* [Tellabs](#), 551 U.S. 308 (with respect to an outside auditor, "[w]e decline to follow the cases that hold that the magnitude of financial fraud contributes to an inference of scienter on the part of the defendant. Allowing an inference of scienter based on the magnitude of fraud 'would eviscerate the principle that accounting errors alone cannot justify a finding of scienter.' *In re SCB Computer Tech., Inc. Sec. Litig.*, 149 F.Supp.2d 334, 359 (W.D. Tenn. 2001); see also *In re Comshare*, 183 F.3d at 553 (holding that the failure to follow accounting standards 'is, by itself, insufficient to state a securities fraud claim'). It would also allow the court to engage in speculation and hindsight, both of which are counter to the PSLRA's mandates.").

[Cable Corp.](#), 823 F.3d 1032, 1042 (6th Cir. 2016) (considering the magnitude of defendant-company's financial misstatements for purposes of determining whether plaintiff's allegations created a strong inference of scienter); [Dana II](#), 646 F.3d at 960-61 (considering the magnitude of the defendant-company's false financial statements when finding that plaintiffs had adequately pleaded a strong inference of scienter); [In re FirstEnergy Corp. Sec. Litig.](#), 316 F. Supp. 2d 581, 598 (N.D. Ohio 2004) ("The fact that [non-outside auditor defendants'] accounting practices resulted in such enormous overstatements of revenue for several years further supports an inference of scienter."); [In re Huff Corp. Sec. Litig.](#), 577 F. Supp. 2d 968, 991 (S.D. Ohio 2008) (considering the magnitude of the company's misstatements when examining whether there is a strong inference of scienter against corporate executives in a securities fraud case).

Additionally, many courts (including the Sixth Circuit) have cited to the following out-of-circuit case for the proposition that the court may consider the magnitude of a misstatement for a non-outside auditor defendant in a scienter analysis:

To begin with, the fact that a restatement of financials occurred is not sufficient to raise a strong inference of scienter, for it is settled that "scienter requires [*79] more than a misapplication of accounting principles," and "[m]ere allegations that statements made in one report should have been made in earlier reports do not make out a claim of securities fraud." This general rule states the sensible and otherwise unremarkable proposition that the inferences that may be drawn for or against scienter from the mere fact that a company misapplied GAAP and accordingly had to restate its financials are in equipoise, and, therefore, that such allegations by themselves cannot give rise to a "strong inference" of scienter.

But this is not to say that a misapplication of accounting principles or a restatement of financials can never take on significant inferential weight in the scienter calculus; to the contrary, **when the number, size, timing, nature, frequency, and context of the misapplication or restatement are taken into account, the balance of the inferences to be drawn from such allegations may shift significantly in favor of scienter (or, conversely, in favor of a nonculpable state of mind)**. Nor does the rule stand for the proposition that scienter cannot be inferred at all from such allegations and that the allegations are, therefore, irrelevant [*80] to the issue of scienter. Such a proposition ignores the value of relevant circumstantial evidence as it relates to a defendant's state of mind. To put it differently, while it is true that it cannot be strongly inferred from bare allegations of a GAAP violation or a restatement of financials that a defendant

acted recklessly, consciously, or intentionally, it is not true that nothing can be inferred from those facts at all or that **"[s]pecific attributes of a GAAP violation may give rise to a stronger, or weaker, inference of scienter."** The mere fact that there was a restatement or a violation of GAAP, by itself, cannot give rise to a strong inference of scienter; the nature of such a restatement or violation, however, may ultimately do so.

[In re MicroStrategy, Inc. Sec. Litig.](#), 115 F. Supp. 2d 620, 634-35 (E.D. Va. 2000) (emphasis added).

The Sixth Circuit has shed some light on how "extreme" a misstatement must be in order to raise a scienter inference, finding a scienter inference appropriate only where the magnitude of the misstatement is such that it "should have been obvious" to the defendants. See [PR Diamonds](#), 364 F.3d at 686 ("It simply cannot be said that [the company's] accounting improprieties, by virtue of their type and size, 'should have been obvious,' [Comshare](#), 183 F.3d at 554, to the Individual Defendants. [*81] These are not 'in your face facts' that 'cry out' scienter."); [Konkol v. Diebold, Inc.](#), 590 F.3d 390, 400 (6th Cir. 2009) ("One cannot determine from the complaint whether the magnitude of Diebold's alleged accounting violations are the type of extreme 'in your face facts' that 'cry out' scienter. . . . The complaint does not specify the total amount of revenue that Diebold allegedly overstated. Nonetheless, Diebold is a multi-billion-dollar company and, as such, the amount of improperly recognized revenue would have to be significant in order to support a finding of scienter.").

The Court first notes that Plaintiffs attribute the fraudulent misstatements to Defendants rather than to outside auditors. Thus, as discussed above, the Sixth Circuit allows an inference of scienter to be drawn (and considered in the holistic [Tellabs](#) analysis of scienter) if the magnitude of the fraud is such that it should have been obvious to Defendants. As noted by Plaintiffs in their Response and by the Court above, the Complaint alleges that "the \$591 million charge alone [was] more than 88% of Community Health's bad debt provision for the previous quarter (¶172),' and the revelation 'that Community Health ramped "bad debt" expense (for the third time in as many quarters) [*82] to more than \$1 billion in the quarter, amounting to a whopping 25% of revenues (¶9)' caused the Company's stock to decrease more than 17%, causing investors to lose tens of millions of dollars. ¶¶12-13." (Doc. No. 69 at 40-41). These are the types of "in your face" (alleged) circumstances that are so extreme that they reasonably should have been obvious to Defendants. And as alleged by Plaintiffs, outside analysts even highlighted the magnitude of the overstatements, an (alleged) fact that adds to the plausibility of Plaintiffs' assertion that such magnitude was large. (Doc. No. 69 at 41). A scienter

inference based on the magnitude of the false financial statements is thus appropriate here, and will be considered as part of the larger scienter inquiry.

3. *The SEC investigation, which did not result in any adverse findings, does not support scienter*

Courts in this circuit as well as others have taken the view that the existence of an investigation by itself without adverse findings does not support an inference of scienter. See [Dana II](#), 649 F. Supp. 2d at 742 (determining that a pending SEC investigation "does not add to the scienter inference"); see also [Halford v. AtriCure, Inc.](#), No. 1:08CV867, 2010 U.S. Dist. LEXIS 144377, 2010 WL 8973625, at *15 (S.D. Ohio Mar. 29, 2010) (holding that the mere opening of an investigation by the DOJ, [*83] without finding of wrongdoing, "cannot support an inference of scienter"); see also [In re Ceridian Corp. Secs. Litig.](#), 542 F.3d 240, 249 (8th Cir. 2008) (holding that an SEC investigation with no adverse findings did not show scienter); see also [Cuzzarelli v. Inspire Pharms. Inc.](#), 549 F.3d 618, 628 n. 2 (4th Cir. 2008) (finding that an ongoing SEC investigation alone is "too speculative to add much, if anything, to an inference of scienter").

Defendants argue that here, "subpoenas issued by the SEC in 2013 (four years before the Class Period) to HMA (a company CHSI acquired)" do not create an inference of scienter, because there were no adverse findings by the SEC. (Doc. No. 66 at 38). The Court agrees. While the SEC investigation may have brought relevant issues to Defendants' attention, Plaintiffs allege no facts establishing that Defendants did in fact investigate any allegedly fraudulent conduct at HMA and gain knowledge of such alleged fraud. Thus, Plaintiffs' bare allegations regarding an inconclusive SEC investigation of one of Defendants' acquisition hospitals cannot be considered as probative of a scienter finding.

4. *Executives receiving salaries does provides little support for scienter*

Plaintiffs allege that another fact supporting scienter and Defendants' incentive to understate the Company's bad debts was that [*84] "Defendants were uniquely motivated to preserve artificial executive compensation not available at peer companies." (Doc. No. 61 at 55-56). Defendants argue in their motion that "Plaintiffs allege no particularized or unique facts related to individual salaries and bonuses to create an inference of scienter. Plaintiffs only allege that the Individual Defendants received salaries and bonuses." (Doc. No. 66 at 38).

Plaintiffs' argument here relates to the final [Helwig](#) factor: "the self-interested motivation of defendants in the form of saving their salaries or jobs." [Helwig](#), 251 F.3d at 552.

The Court previously has explained that:

In this Circuit "an executive's desire to protect his position within a company or increase his compensation" does not "comprise a motive for fraud," [PR Diamonds](#), 364 F.3d at 690, nor are allegations that Defendants would receive bonuses linked to company performance sufficient for an inference of scienter. [In re Kindred Healthcare](#), 299 F. Supp. 2d at 741. Yet, "self-interested motivation of defendants in the form of saving their salaries" can support scienter. [Bridgestone](#), 399 F.3d at 687 (quoting [Helwig v. Vencor, Inc.](#), 251 F.3d 540, 552 (6th Cir. 2001)). "A very difficult position" and "unusual pressures to perform," coupled with other factors, can provide an inference of improper motive. [Telxon](#), 133 F.Supp.2d at 1029. The Court concludes that if regular compensation is [*85] commensurate to the executive's service to the company, then Plaintiffs' allegations that the individual Defendants' had the ability to enhance their compensation by 100% of their regular compensation creates an inference of "unusual pressures to perform" *Id.* In addition, Defendants allegedly engaged in improper practices that allegedly enhanced their compensation.⁴⁰

[N. Port Firefighters' Pension-Loc. Option Plan v. Fushi Copperweld, Inc.](#), 929 F. Supp. 2d 740, 785 (M.D. Tenn. 2013) (footnote omitted) (finding support for inference of scienter where a defendant-company's executives had an "unusual pressure to perform" due to compensation system where regular compensation was commensurate to the defendant's service to the company). *But see* [PR Diamonds](#), 364 F.3d at 690 (stating that "an executive's desire to protect his position within a company or increase his compensation" does not comprise a motive for fraud from which a court could infer a knowing or reckless state of mind); [Kalnit v. Eichler](#), 264 F.3d 131, 140 (2d Cir. 2001) ("an allegation that defendants were motivated by a desire to maintain or increase executive compensation is insufficient [to support scienter] because such a desire can be imputed to all corporate officers.").

Plaintiffs have not alleged any facts that go beyond the executives' general motivation to maintain their level of compensation. Plaintiffs state [*86] only that "the Individual Defendants' incentive compensation was tied to Community Health's reported Adjusted EBITDA, which provided them

⁴⁰In the quoted language, the Court spoke in terms an "inference of improper motive" and an inference of "unusual pressures to perform," without specifically mentioning an inference of "scienter," which is the inference ultimately at issue in this context. The undersigned notes that the inferences of which the Court did speak can, in turn, support an inference of scienter.

further incentive to understate the Company's bad debts." (Doc. No. 61 at 56). Plaintiffs fail to explain how these individuals' compensation was specifically tethered in any way to Defendants' alleged fraud (nor do Plaintiffs respond to this argument in their Response). As discussed above, fraud must be pled with particularity, and the Court finds that a single statement that alleges, without any supporting factual matter, that the Individual Defendants' incentive compensation was "tied to" CHS's reported Adjusted EBITDA fails to meet the pleading standards of [Fed. R. Civ. P. 9\(b\)](#) and the PSLRA. Thus, Plaintiffs' bare assertion in the Complaint that Individual Defendants Smith, Cash, and Aaron desired to maintain an exorbitant salary provides little support for an inference of scienter.

5. Defendant Cash's retirement does not support scienter

Defendants argue that the retirement of Larry Cash does not raise a strong inference of scienter. Plaintiffs do not respond to this point, and they do not even assert in the Complaint that Defendant Cash's retirement raises an inference [*87] of scienter.⁴¹ The Court addresses this argument nonetheless (and presumes that to the extent that an inference of scienter were to be raised based on the retirement of Defendant Cash, it would be raised only as to Defendant Cash and not as to any other Individual Defendants).

Whatever its timing vis-à-vis relevant underlying events, the retirement of an executive does not typically create a strong inference of scienter. [In re BearingPoint, Inc. Sec. Litig.](#), 525 F. Supp. 2d 759, 777 (E.D. Va. 2007), *aff'd in part, rev'd in part and remanded sub nom. Matrix Cap. Mgmt. Fund, LP v. BearingPoint, Inc.*, 576 F.3d 172 (4th Cir. 2009) ("This Court recently has held that

⁴¹ Plaintiffs mention Defendant Cash's retirement (only) in the Background section of the Complaint, and state only the following:

The very next day, February 22, 2017, Community Health announced that one of its Directors and its longtime CFO, Defendant Cash, was resigning effective May 16, 2017. The retirement announcement did not specify why Cash was resigning, or whether the resignation was the result of any disagreement with the Company with respect to its financial and auditing policies, operations, or practices. *Id.* Cash's resignation coincided with the commencement of Defendants' scheme (detailed below) to conceal its revenue misstatements in the second, third, and fourth quarters of 2017 by holding out its revisions as a change in accounting principles, not a restatement of revenue.

(Doc. No. 61 at 10) (footnote omitted). While the Court understands that one could draw a number of conclusions based on the way in which Plaintiffs presented these alleged facts regarding the circumstances of Defendant Cash's retirement, the Court does not read this paragraph as Plaintiffs suggesting a finding of scienter based on Defendant Cash's retirement.

retirements and resignations [*88] of executives do not support a strong inference of scienter."). "Even when a resignation closely follows disclosure of improper accounting practices, the mere fact of the resignation and its proximity to the disclosure gives little support to an inference of scienter." [Dana I](#), 649 F. Supp. 2d at 741; *see also Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 1002 (9th Cir. 2009), as amended (Feb. 10, 2009) ("Although resignations, terminations, and other allegations of corporate reshuffling may in some circumstances be indicative of scienter, the resignations at issue here are not so numerous or suspicious as to raise such an inference. Where a resignation occurs slightly before or after the defendant corporation issues a restatement, a plaintiff must plead facts refuting the reasonable assumption that the resignation occurred as a result of restatement's issuance itself [rather than as a result of a culpable state of mind as to the events that led to the restatement] in order for a resignation to be strongly indicative of scienter.").⁴² The Court has previously explained:

In some situations, courts have found that resignations and related remedial, internal changes were "unusual" and, combined with other evidence, possibly indicative of fraud. [In re Sipex Corp. Sec. Litig.](#), No. C 05-00392 WHA, 2005 U.S. Dist. LEXIS 30854, 2005 WL 3096178, at *1 (N.D. Cal. Nov. 17, 2005) ("These circumstances, combined with [*89] the announcement of the impending restatement, establish a strong inference that the company itself believes that fraud led to materially misleading financials for the period in question"), *cited in In re Am. Serv. Grp., Inc.*, No. 3:06-0323, 2009 U.S. Dist. LEXIS 28237, 2009 WL 1348163, at *58 (M.D. Tenn. Mar. 31, 2009). As with the other alleged indicators of scienter, the Court will consider this factor—not alone, but in combination with other factors—in connection with the holistic [Tellabs](#) standard.

[Indiana Pub. Ret. Sys.](#), 2021 U.S. Dist. LEXIS 68415, 2021 WL 1316705, at *10.

Here, Plaintiffs have not alleged any particularly unusual facts surrounding the circumstances of Defendant Cash's retirement. Defendants articulate a reasonable rationale for the retirement decision, completely independent of any fraud allegations. (Doc. No. 66 at 39) ("[T]he sixty-eight-year-old Mr. Cash explained his decision to retire but continue to be a consultant, as he was looking forward to being a husband, dad, papa, and grandpa."). Thus, the Court finds that Defendant Cash's retirement gives no

⁴² Taking some interpretive license, the Court has added the bracketed language to make more explicit the entire point [Zucco Partners](#) was making.

support for a scienter finding.

6. *Individual SOX Certifications support scienter*

Plaintiffs allege in support of a scienter finding that "Individual Defendants signed certifications pursuant to the [Sarbanes-Oxley Act of 2002 \("SOX"\)](#) that affirmed that the Company's financial statements fairly presented [*90] all material aspects of its financial condition and results of operations, affirmed that the Company's disclosure controls and procedures were effective, and provided reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP. These certifications, which were issued in response to requirements under SOX legislation, provide further support for the inference that defendants were reckless in disregarding the falsity the Company's financial statements." (Doc. No. 69 at 42-43) (citation omitted). Defendants argue that the signed SOX Certifications do not strengthen the inference of scienter. (Doc. No. 66 at 31).

The Sixth Circuit has stated that a Sarbanes—Oxley certification is probative of scienter only if the person signing the certification was severely reckless in certifying the accuracy of the financial statements. [Ley](#), 543 F.3d at 812. See also [Indiana Pub. Ref. Sys.](#), 2021 U.S. Dist. LEXIS 68415, 2021 WL 1316705, at *9 (Richardson, J.) (allowing consideration of SOX certifications in its scienter analysis where the plaintiffs "alleged facts to suggest that Defendants had reason to know or should have suspected accounting irregularities or other 'red flags' at the time they signed the certificates"). [*91] One district court (in the Fifth Circuit) has explained that:

The Fifth Circuit addressed the relationship between SOX certifications and scienter in [Cent. Laborers' Pension Fund](#), 497 F.3d 546 (5th Cir. 2007); see also [Indiana Elec. Workers' Pension Trust Fund IBEW v. Shaw Group, Inc.](#), 537 F.3d 527, 532-33 (5th Cir. 2008)]. Relying on an Eleventh Circuit decision, the court "rejected a reading that would permit a strong inference of scienter from the certification alone." [Cent. Laborers' Pension Fund](#), 497 F.3d at 555. [. . .] [C]onsidering SOX certifications as part of the scienter analysis is proper only "if the person signing the certification had reason to know, or should have suspected, due to the presence of glaring accounting irregularities or other 'red flags,' that the financial statements contained material misstatements or omissions." [Cent. Laborers' Pension Fund](#), 497 F.3d 546 (internal quotation marks omitted); see also [Horizon Mgmt. Inc. v. H & R Block, Inc.](#), 580 F.3d 755, 765-66 (8th Cir. 2009); [Zucco Partners, LLC v. Digimar Corp.](#), 552 F.3d 981 (9th Cir. 2009).

[Daves v. Imperial Sugar Co.](#), 975 F. Supp. 2d 666, 693 (S.D. Tex. 2013); see also [Markman v. Whole Foods Mkt., Inc.](#), No. 1:15-CV-

[681-LY](#), 2016 U.S. Dist. LEXIS 188833, 2016 WL 10567194, at *12 (W.D. Tex. Aug. 19, 2016).

Here, while the Individual Defendants' signatures on the SOX certifications alone do not raise a scienter inference, the Amended Complaint alleges fraud implicating Defendants' internal accounting practices where Defendants "understated [their] provision for bad debts and overstated [their] operating revenue and Adjusted EBITDA" in order to "to avoid triggering defaults on the Company's credit facilities." (Doc. No. 61 at ¶ 2). Plaintiffs allege that the Individual Defendants signed the [*92] SOX certifications "in the face of clear, repeated accounting violations" such that a "strong inference of scienter" is supported. (Doc. No. 69 at 43). The Court agrees that the signed SOX certifications provide support for an inference of scienter because the Complaint sets forth with particularity factual matter demonstrating what the Court finds could be characterized as "red flags." In particular, Plaintiffs have alleged particularized facts supporting their allegations that Defendant CHS misstated their provision for bad debt and Adjusted EBITDA. Thus, Plaintiffs' allegations are sufficient for the Court to consider the specific SOX certifications in its holistic scienter analysis.

7. *Confidential witness statements support scienter*

Defendants argue that the alleged confidential witness statements described in Paragraphs 29, 39-44, 168-170 and 179-180 of the Amended Complaint⁴³ "add nothing of substance" and do not establish scienter. (Doc. No. 66 at 39-40). Defendants claim that these confidential witnesses did not actually communicate with the Individual Defendants or were not privy to the Individual Defendants' knowledge. (*Id.* at 40). Defendants also indicate that the statements [*93] are "nothing more than vague and general assertions that do not establish a prior material misstatement or an inference of knowledge or recklessness." (*Id.*). Plaintiffs respond that the Court should consider the confidential witness statements because the Amended Complaint specifies the title, division, and dates of employment for each, demonstrating that each confidential witness was in a position to have knowledge of their recollections. (Doc. No. 69 at 40 n.33).

⁴³The Court has chosen its terminology here carefully. These paragraphs do not set forth verbatim any "statement," of a confidential witness, and thus these paragraphs cannot be said to quote or even "include" any such statement. Rather, each of these paragraphs merely either paraphrases certain things a confidential witness allegedly stated, or otherwise makes clear the substance of something a confidential witness stated. So the most that can be said about these paragraphs' recounting of alleged statements of confidential witnesses is that they describe certain alleged statements of confidential witnesses.

The Court has previously analyzed confidential witness statements in ruling on a similar motion to dismiss:

Plaintiffs cite to statements from "confidential witnesses" concerning financial matters and operational concerns with the spin-off. Defendants argue such witnesses must be discounted. While courts often discount information provided by anonymous sources, plaintiffs may rely on confidential witnesses if they plead facts with sufficient particularity to support the probability that a person in the confidential witness' position would possess the information alleged. *Doshi v. Gen. Cable Corp.*, 823 F.3d 1032, 1037, n. 2 (6th Cir. 2016).

Confidential sources cannot be used to merely parrot conclusory allegations contained in the complaint, *Jackson v. Hayard Health, Inc.*, 2018 U.S. Dist. LEXIS 54738, 2018 WL 1621539 at * 9 (S.D. N.Y. March 30, 2018), but confidential witnesses may assist securities [*94] fraud plaintiffs so long as they are not vague and conclusory. *In re EveryWare Global, Inc. Sec. Litig.*, 175 F.Supp.3d 837, 852 (S.D. Ohio 2016). The complaint must allege that the confidential witnesses were in a position to establish the basis of personal knowledge of the alleged misconduct and they must establish that the defendants were aware of the misconduct. *Id.* Even confidential high level executives' statements will be insufficient absent some allegation that the witness communicated with the individual defendants or else that the witness was privy to the individual defendants' knowledge. *Glaser v. The2, Ltd.*, 772 F.Supp.2d 573, 589 (S.D. N.Y. 2011). Courts, however, will credit confidential source allegations, generally, in two situations. The first is when those sources' position and/or job responsibilities are described sufficiently to indicate a high likelihood that they actually knew facts underlying their allegations. *Id.* at 590. Second, when independent adequately pled factual allegations corroborate a confidential source's statements, the requirement of a description of the source's job is loosened. *Id.*

Zwick Partners, LP v. Quorum Health Corp., No. 3:16-CV-2475, 2018 U.S. Dist. LEXIS 97942, 2018 WL 2933406, at *5 (M.D. Tenn. Apr. 19, 2018); *Halford v. AtriCure, Inc.*, No. 1:08CV867, 2010 U.S. Dist. LEXIS 144377, 2010 WL 8973625, at *3 (S.D. Ohio Mar. 29, 2010) ("In considering the weight to be given to allegations from confidential witnesses under the PSLRA, this Court has adopted the reasoning and result reached by the Seventh Circuit in *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702 (7th Cir. 2008) ("Tellabs II") and *In re Amgen Inc. Securities Litigation*, 544 F. Supp. 2d 1009 (C.D. Cal. 2008). In doing so, this [*95] Court has explained: when deciding whether to consider the statements attributed to confidential or

anonymous witnesses in the Amended Complaint, as part of the calculus to be applied to determine whether the Plaintiffs have complied with the pleading requirements contained in the PSLRA, this Court will examine the descriptions of each of those individuals' jobs to ascertain whether any would have been in a position to have gained firsthand knowledge of the facts attributed to him or her, and the detail of the information each is reported to have provided." (internal citations and quotation marks omitted)).

The Amended Complaint describes statements from five confidential witnesses in paragraphs 29, 39-44, 168-70, and 179-80.⁴⁴ For each confidential witness, the Amended Complaint provides a detailed description of the job of the confidential witness, including the time period(s) and location(s) of employment, specific job titles, and, in some instances, supervisors. Many of the statements made by the confidential witnesses are (at least ostensibly) corroborated by other information alleged in the Amended Complaint. Plaintiffs provided sufficiently detailed allegations for each of these [*96] five confidential witnesses to plausibly suggest that each would have been in a position to gain first-hand knowledge of the facts reflected in their described statements. Therefore, though the Court recognizes that the described statements come from anonymous sources, the Court finds that these confidential witness statements—as described and to the extent relevant—can support an inference of scienter.⁴⁵

8. Conclusion

Plaintiffs have alleged factual matter plausibly suggesting that Defendants knew, or were reckless,⁴⁶ in "disregarding the

⁴⁴ Each such paragraph describes statements (or at least a statement) from only a single respective confidential informant.

⁴⁵ Plaintiffs do not allege that any particular statement made by any particular confidential witness contained in the Amended Complaint is probative of scienter (other than, in their Response, stating that Confidential Witness 5 confirmed that the Individual Defendants had access to necessary financial information). (Doc. No. 69 at 40). Defendants nonetheless argue that the statements from all confidential witnesses referenced in the Amended Complaint are irrelevant to the scienter analysis because they "do not establish a prior material misstatement or an inference of knowledge or recklessness." (Doc. No. 66 at 40). The Court will not endeavor to seek out and develop any particular arguments cutting in favor or against scienter based on the particular statements made by confidential witnesses; instead, the Court finds only that Plaintiffs have alleged sufficient information such that the Court will not discount confidential witness statements contained in the Amended Complaint by virtue of these statements originating from confidential sources.

⁴⁶ Scienter includes recklessness. *Forman v. Meridian Bioscience*,

materially false or misleading nature of the information they caused to be disseminated to the investing public" and that the Individual Defendants "also knew or were deliberately reckless in disregarding that the material misrepresentations and omissions contained in the Company's public statements would adversely affect the integrity of the market for the Company's securities and would cause the price of such securities to be artificially inflated" so as to constitute fraud. (Doc. No. 61 at ¶¶ 175-176). Plaintiffs' allegations of motive to engage in fraud, specific allegations as to Individual Defendants Aaron and Smith's direct involvement in financial [*97] calculations and assessments, Defendant Cash's role in the company (and its subsequent core-operations inference), the magnitude of the alleged fraud, and the relevant SOX certifications provide ample support for a scienter finding. Taken together, Plaintiffs have sufficiently alleged facts to show a strong inference of scienter as to Defendant CHS understating its provision for bad debts and overstating its operating revenue and Adjusted EBITDA.

The Court finds that, when the allegations are viewed holistically, Plaintiffs have sufficiently alleged facts giving rise to a strong inference of scienter as required to validly state the securities fraud claims asserted by Plaintiffs.

D. Safe harbor

The PSLRA contains a "safe-harbor provision" for a forward-looking statement,⁴⁷ whereby a defendant is liable for such a

Inc., 387 F. Supp. 3d 791, 794 (S.D. Ohio 2019). "Recklessness" is defined in this context as highly unreasonable conduct which is an extreme departure from the standards of ordinary care akin to conscious disregard. *Id.* Recklessness requires more than negligence or the mere notice and opportunity to commit fraud, but it is a lower standard than knowing misrepresentation or intent. *Id.*

⁴⁷ "Under the PSLRA, protected forward-looking statements include, among others: (1) projections of revenues or other financial items, (2) statements of plans and objectives for future operations, and (3) statements of the assumptions underlying the previous two categories." *Julianello v. K-V Pharm. Co.*, 791 F.3d 915, 921 (8th Cir. 2015) (citing 15 U.S.C. § 78u-5(i)(1)). The determinative factor of whether something is a forward-looking statement is whether the truth or falsity of a statement can only be determined after a statement is made. *See id.* ("In determining whether a statement is truly forward-looking, the determinative factor is not the tense of the statement; instead, the key is whether its 'truth or falsity is discernible only after it is made.'" (quoting *W. Wash. Laborers—Emp'rs Pension Trust v. Panera Bread Co.*, 697 F. Supp. 2d 1081, 1093 (E.D. Mo. 2010)); *Doughtery*, 905 F.3d at 983 (adopting the *Julianello* test for the Sixth Circuit). Statements of present or historical facts—those statements whose truth or falsity can be determined presently—are excluded from the safe harbor. *See Doughtery*, 905 F.3d at 983 (providing the example of "[t]ake for instance a man's statement to his friend, 'My girlfriend has agreed to marry me.' That is

statement only if: (i) it was material, (ii) the defendant had actual knowledge that it was false or misleading, and (iii) the defendant did not identify it as forward-looking or insulate it with meaningful cautionary language. *Weiner v. Tivity Health, Inc.*, 365 F. Supp. 3d 900, 910 (M.D. Tenn. 2019); *Doughtery v. Esperion Therapeutics, Inc.*, 905 F.3d 971, 983 (6th Cir. 2018) (holding that in a securities-fraud case, a defendant is not liable for a material forward looking statement if either: "(1) the statement is 'identified [*98] as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement,' or (2) 'the plaintiff fails to prove that the forward-looking statement . . . was made with actual knowledge . . . that the statement was false or misleading.'" (quoting 15 U.S.C. § 78u-5(c)(1)(A)-(B))). A company that chooses to speak, therefore, is protected against failed projections, provided that it identifies important factors that could cause actual results to differ materially from those in the forward-looking statements. *Weiner*, 365 F. Supp. 3d at 911. While a company need not list all factors, the cautionary statements must convey substantive information about factors that realistically could cause results to differ materially from those projected in the forward-looking statements. *Id.* (finding that the forward-looking statements at issue were provided in the context of cautionary statements that were boilerplate, not meaningful, and inconsistent with the historical facts).⁴⁸ Notably, forward-looking statements that are included in a financial statement prepared in accordance with GAAP are excluded from the safe-harbor provision. [*99] *In re Telxon Corp. Sec. Litig.*, 133 F. Supp. 2d 1010, 1032 (N.D. Ohio 2000) ("[T]he clear language of the PSLRA expressly excludes from the safe harbor statements that are 'included in a financial statement prepared in accordance with generally accepted accounting principles.'" (quoting 15 U.S.C. § 78u-5(b)(2)(A))).

Defendants contend that the statements mentioned in

not a forward-looking statement. Rather, it is a backward-looking statement concerning a future event. When the man spoke to his friend, it was objectively discernable whether his girlfriend had accepted his proposal—either she had, or she had not."); *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 569 (S.D.N.Y. 2011) ("[T]he safe harbor does not protect statements which are misleading about historical and present facts at the time they are made, and whose misleading nature can be verified at the time they are made, simply because the statements are couched as predictions of future events."), *aff'd sub nom. In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223 (2d Cir. 2016).

⁴⁸ General cautionary language does not render the omission of specific adverse historical facts immaterial and, moreover, the disclaimer must be meaningful and tailored to the risks the business faces. *Winslow v. BancorpSouth, Inc.*, No. 3:10-00463, 2011 U.S. Dist. LEXIS 45559, 2011 WL 7090820, at *16 (M.D. Tenn. Apr. 26, 2011).

paragraphs 100, 102, 105, 107, 109, 112, 115, 117, 118, 130, 133, 136, 145, 146, 149 and 150 of the Amended Complaint (Doc. No. 61) are forward-looking.⁴⁹ Of these paragraphs, the Court finds that paragraphs 100, 105, 112, 115, 130, 145, and 146 all refer to statements that are contained within financial statements prepared in accordance with GAAP and are therefore excluded from the safe-harbor provision. *See* [15 U.S.C. § 78u-5\(b\)\(2\)\(A\)](#); *In re Telxon Corp. Sec. Litig.*, 133 F. Supp. 2d at 1032. Paragraphs 107, 117, 133, and 149 refer to the SOX certifications wherein Defendants "affirmed that the [Defendant CHS's] financial statements fairly presented all material aspects of its financial condition and results of operations, and that the [Defendant CHS's] disclosure controls and procedures were effective, and provided reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP." (Doc. No. 61 at 31). **[*100]** Plaintiffs contend that these statements were materially false and misleading by invoking the SOX Theory.⁵⁰ The truth or falsity of the affirmations in the SOX certifications—that the statements fairly presented Defendant CHS's financial situation and that the disclosure controls and procedures were effective—could have been determined when the certifications were signed. As such, these paragraphs are also not forward-looking statements. *See* [Julianello](#), 791 F.3d at 921; [Doughtery](#), 905 F.3d at 983.

The remaining paragraphs (102, 109, 118, 136 and 150), which refer to statements made during quarterly earnings calls and a

⁴⁹ Defendants never identify specific paragraphs which contain allegedly forward-looking statements. Rather, they generally state that the reserve for uncollectible revenue is an estimate and is therefore forward-looking. (Doc. No. 66 at 41). In an earlier portion of Defendants' memorandum in support of their motion to dismiss, they list the paragraphs above as containing Plaintiffs' allegations of false or materially misleading statements and state that all of Plaintiffs' allegations concern the reserve for uncollectible revenue. (*Id.* at 22). The Court, therefore, will assume that Defendants were referring to these same paragraphs when claiming that they were forward-looking statements.

⁵⁰ Under the SOX Theory, Plaintiffs state that:

Defendants failed to disclose to investors: (1) that the Company's financial statements did not fairly present its financial condition, particularly with respect to its "bad debt" exposure that the Company excluded from its "bad debt" calculations revenue receivable from "self-pay" patients, especially aged receivables, for which collection was not probable; and (2) that the Company's disclosure controls and procedures were not effective, and did not provide reasonable assurance regarding the reliability of financial reporting, particularly with respect to the assessment and reporting of "bad debt."

(Doc. No. 61 at 31).

conference, primarily **[*101]** involve Defendant CHS's then-current and previous EBITDA cushion. Plaintiffs allege that these statements were materially false and misleading because (according to Plaintiffs) they excluded relevant information and data from their bad-debt calculations (which artificially inflated EBITDA). These statements (and the alleged omissions therefrom) relate to matters of present or historical fact, inasmuch as one could determine, at the time that the statements were spoken, whether relevant evidence was excluded. And "the safe harbor does not protect statements which are misleading about historical and present facts at the time they are made, and whose misleading nature can be verified at the time they are made, simply because the statements are couched as predictions of future events." *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 569 (S.D.N.Y. 2011), *aff'd sub nom. In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223 (2d Cir. 2016). Therefore, the safe-harbor provision does not apply to these statements.

The Court thus finds that the safe-harbor provision does not shield Defendants from liability for any statements underlying Plaintiffs' claims.

E. [Section 20\(a\)](#) claim — control person liability

In Count Two, Plaintiffs assert a theory of so-called control person liability under [Section 20\(a\)](#).⁵¹ As background, Count One sets forth the theory that **[*102]** with respect to the alleged violations set forth therein, each of the Individual Defendants is primarily liable, together with the other Individual Defendants and CHS, based on their personal participation (including the required actus reus and mens rea) in these violations. Count Two sets forth an additional (secondary) basis for the Individual Defendants' liability, *i.e.*, the control-person theory, whereby so-called controlling persons may be held jointly and severally liable under [Section 20\(a\)](#) for securities fraud to the same extent as the entity of which they are "controlling." Plaintiffs contend that each of the Individual Defendants has control person liability for the actionable violations of CHS alleged in Count One and thus are jointly and severally liable with CHS for such actionable violations.

Disputing that the Individual Defendants are subject to control person liability, Defendants contend that "[w]ithout a primary

⁵¹ [Section 20\(a\)](#) provides that "[e]very person who . . . controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person." [15 U.S.C. § 78t\(a\)](#). The "controlling person" must be an actual participant and in control of the specific activity at issue. *Jackson Cty.*, 510 F. Supp. 3d 583, 2020 WL 7711378, at *20.

violation by CHSI or the Individual Defendants of the securities laws, there can be no secondary violation by the Individual Defendants as controlling persons under [Section 20\(a\)](#)." (Doc. No. 66 at 42). The Court rejects this argument, as Plaintiffs have adequately alleged a primary [*103] violation of [Section 10\(b\)](#). Defendants make no other argument as to Count Two. Defendants' motion to dismiss Plaintiffs' [Section 20\(a\)](#) claim will thus be denied.

CONCLUSION

For the reasons discussed above, Defendants' Motion (Doc. No. 65) will be denied.

An appropriate order will be entered.

/s/ Eli Richardson

ELI RICHARDSON

UNITED STATES DISTRICT JUDGE

ORDER

For the reasons set forth in the accompanying memorandum opinion, Defendants' Motion to Dismiss (Doc. No. 65) is **DENIED**.

IT IS SO ORDERED.

/s/ Eli Richardson

ELI RICHARDSON

UNITED STATES DISTRICT JUDGE

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EXHIBIT 26



Luma v. Dib Funding, Inc.

United States District Court for the District of Maryland

January 19, 2022, Decided; January 19, 2022, Filed

Civil No. ELH-20-2504

Reporter

2022 U.S. Dist. LEXIS 10528 *; 2022 WL 181156

HONSON LUMA, Plaintiff, v. DIB FUNDING, INC., et al.,
Defendants.

Prior History: [Luma v. Dib Funding Inc., 2021 U.S. Dist. LEXIS 3356, 2021 WL 75135 \(D. Md., Jan. 7, 2021\)](#)

Counsel: [*1] Honson Luma, Plaintiff, Pro se, Baltimore, MD.

Judges: Ellen L. Hollander, United States District Judge.

Opinion by: Ellen L. Hollander

Opinion

MEMORANDUM OPINION

The self-represented plaintiff, Honson Luma, filed a "Complaint And Appeal From Trademark Trial And Appeal Board." ECF 1 (the "Complaint"). He identified Dib Funding, Inc. ("Dib" or "DFI") and Sunshine Capital, Inc. ("Sunshine") as the "Defendant." *Id.* The Complaint arises from Dib's petition to cancel Luma's registration of the mark "DIBCOIN," on the ground that he is not the owner of the registered mark, as required by [15 U.S.C. § 1051\(a\)](#).

Pursuant to [15 U.S.C. § 1071\(b\)](#), Luma seeks reversal of the decision rendered on July 2, 2020, by the Trademark Trial and Appeal Board ("TTAB" or the "Board"), a component of the United States Patent Trademark Office ("USPTO"). *See Dib Funding, Inc. v. Luma* (the "TTAB Decision").¹ According to plaintiff, the TTAB improperly granted Dib "cancellation of Plaintiff's 'Dibcoin Mark (Reg. No. 5396033)," based on "weak documentation and testimony alleging that Plaintiff was not first to use the mark in commerce." ECF 1 at 1. Luma asserts: "Additional evidence was later obtained and submitted into the

record, but it was deemed late and not considered." *Id.* In Luma's [*2] view, a review of the evidence makes plain that "Plaintiff was the first to use the Dibcoin Mark in commerce and is therefore the owner of the Dibcoin Mark." *Id.* Therefore, he asks the Court to vacate the TTAB Decision. *Id.* at 10-11.

I. Procedural Background

By Memorandum (ECF 11) and Order (ECF 12) of March 2, 2021, the Court granted plaintiff's request (ECF 10) for leave to serve defendants by publication. On April 15, 2021, plaintiff docketed proof of service reflecting that "Defendant" was served on April 4, 2021, by publication of a summons and copy of the Complaint in a newspaper with circulation in defendants' locality, and by registered mail. ECF 13, ECF 13-1; ECF 13-2; ECF 13-3.² If service was accomplished, then, pursuant to [Fed. R. Civ. P. 12\(a\)\(1\)\(A\)](#), defendants' answer was due by April 26, 2021.

The Court received a letter from Adam Petty on April 26, 2021. ECF 14. He identified himself as the "CEO and majority owner of DIB Funding, Inc." *Id.* Further, he advised that "a business associate" informed him of this suit on April 22, 2021, and he "then discovered" that Dib's response was due on April 26, 2021. *Id.* Accordingly, Petty asked the Court for "additional time to secure legal representation and for [*3] said legal representation to have time to review the case." *Id.* By Order of April 27, 2021 (ECF 15), I granted defendants until May 28, 2021, to secure counsel.

Petty sent a fax to Chambers on May 28, 2021 (docketed June 2, 2021), in which he indicated that he was in the process of selecting an attorney, but that he required "more time to secure" counsel. ECF 19. In an Order of June 2, 2021, I granted another

¹ Plaintiff did not provide the Court with a copy of the TTAB decision. I have attached a copy of the TTAB decision as an Appendix to this Memorandum.

² Plaintiff's submission is imprecise. He states that the Order for Substitute Service "was mailed to Defendant on March 24, 2021." But, there are two defendants; in referring to a single defendant, plaintiff fails to specify the party he means. And, he states that the address of "the Defendants was unknown, and the Defendant could not be located." ECF 13 at 1. The exhibits do not shed light on the confusion.

extension—this time until June 25, 2021. ECF 20. However, no lawyer entered an appearance for either defendant by that date.

Thereafter, on June 29, 2021, plaintiff moved for Clerk's Entry of Default for want of answer or other defense. ECF 21. The following day, the Clerk entered default against defendants (ECF 22) and provided notice of the same. ECF 23.

Then, on June 30, 2021, via fax (docketed July 1, 2021), Petty filed a motion "To Intervene As Of Right Or, In The Alternative, Permissively As Co-Defendant." ECF 24 (the "Intervention Motion"). He identified himself as "a resident of Michigan," as well as "President, CEO and majority stockholder" of DFI. *Id.* at 2. Petty also claimed that he holds a lien on all assets of DFI, including the trademark DIBCOIN. *Id.* at 3. Plaintiff [*4] opposes the Intervention Motion. ECF 30.

In addition, Petty filed "Defendant's [sic] Motion To Dismiss For Lack Of Personal Jurisdiction, Or Alternatively, Motion to Transfer Venue To The Western District of Michigan" (the "Motion to Dismiss"). ECF 25. In the Motion to Dismiss, Petty identified himself as the defendant. *Id.* at 1. He also stated that Sunshine was domiciled in Nevada, but is now "defunct," and asserted that Dib owns a majority of Sunshine. *Id.* Further, he claimed that Dib is a Michigan corporation. *Id.* And, he stated that Petty resides in Michigan, while Luma is a resident of Maryland. *Id.* As an alternative to dismissal, Petty seeks transfer of the case to the Western District of Michigan. ECF 25 at 5. Plaintiff opposes the Motion to Dismiss. ECF 28.

Notably, Petty is not a named defendant in this suit. And, as discussed, *infra*, he cannot appear on behalf of a corporation. See [Rowland v. Calif. Men's Colony](#), 506 U.S. 194, 201-02, 113 S. Ct. 716, 121 L. Ed. 2d 656 (1993) ("It has been the law for the better part of two centuries . . . that a corporation may appear in the federal courts only through licensed counsel."); see also [Local Rule 101.1\(a\)](#) ("All parties other than individuals must be represented by counsel").

Plaintiff subsequently filed a "Request For Clerk's Entry Of Default [*5] Judgment [sic] Against Sunshine Capital Inc. And Dib Funding Inc." ECF 27 (the "Default Judgment Motion"). The Default Judgment Motion is supported by six exhibits, docketed at ECF 27-1 through ECF 27-6. Petty responded with a "Motion to Deny Default Judgement [sic] Against Defendants and Motion for Summary Judgement [sic] Against Plaintiff" (ECF 31, the "S.J. Motion"). It is supported by several exhibits. Plaintiff opposes the S.J. Motion. ECF 34.

Petty also filed a "Request to Abate Default Motion" (ECF 32, the "Abatement Motion"). And, Luma filed a response in opposition. ECF 33.

No hearing is necessary to resolve these motions. See [Local Rule 105.6](#). For the reasons that follow, I shall deny the Intervention Motion (ECF 24). I shall also deny the Motion to Dismiss (ECF 25); the Default Judgment Motion (ECF 27); the S.J. Motion (ECF 31); and the Abatement Motion (ECF 32), without prejudice.

II. Factual Background

The resolution of the pending motions does not turn on the specific allegations underlying the instant dispute. However, to contextualize the issues, it is helpful to provide a brief factual backdrop.³

According to the Complaint, Luma "is an individual who resides and conducts business [*6] relative to the cryptocurrency Dibcoin in the State of Maryland and particularly in the city of Baltimore, Maryland." ECF 1, ¶ 1. He asserts that he was the "owner . . . on the Principal Register of the mark DIBCOIN . . ." TTAB Decision at 1 (emphasis omitted).

Dib was "formed in 2015 for the purpose of 'acquiring third-party companies through the use of crypto-currency.'" *Id.* at 6 (citation omitted).⁴ And, Sunshine was a "majority-owned,

³The Court may take judicial notice of "matters of public record" and other information that, under [Federal Rule of Evidence 201](#), constitute "adjudicative facts." [Goldfarb v. Mayor & City Council of Balt.](#), 791 F.3d 500, 508 (4th Cir. 2015); see [Fed. R. Evid. 201\(b\)](#). Therefore, for the purpose of this Memorandum, I have drawn on facts as described in the TTAB Decision. See [Schultz v. Braga](#), 290 F. Supp. 2d 637, 651 n. 8 (D. Md. 2003) (taking judicial notice of dockets in state proceedings). However, if the Court is tasked with reaching the merits, it may not defer to the Board's factual findings. See [Swatch AG v. Beehive Wholesale, LLC](#), 739 F.3d 150, 155-56 (4th Cir. 2014) (outlining district court's standard of review of TTAB decision).

⁴The Court may take "judicial notice of factual information found on the world wide web." [O'Toole v. Northrop Grumman Corp.](#), 499 F.3d 1218, 1225 (10th Cir. 2007). However, "these facts [must be] construed in the light most favorable" to the non-movant. [Clatterbuck v. City of Charlottesville](#), 708 F.3d 549, 557 (4th Cir. 2013), abrogated on other grounds by [Reed v. Town v. Gilbert](#), 576 U.S. 155, 165-67, 135 S. Ct. 2218, 192 L. Ed. 2d 236 (2015), as recognized in [Cabaly v. Larosa](#), 796 F.3d 399, 405 (4th Cir. 2015).

Cryptocurrency is a "medium of exchange that is digital, encrypted and decentralized." Kate Ashford & John Schmidt, *What is Cryptocurrency?*, FORBES, <https://www.forbes.com/advisor/investing/what-is-cryptocurrency/> (last updated Jan. 3, 2022). And, unlike conventional currencies, "there is no central authority that manages and maintains the value of cryptocurrency." *Id.* Further, ownership of cryptocurrency

publicly-traded company of [Dib]," but "is now defunct." *Id.* (citation omitted). Petty is identified as the CEO of both corporations. *Id.*

On July 28, 2016, Luma "contracted" with Sunshine to "provide 'general management services' . . . for a period of one year," in exchange for "one million shares of Sunshine Capital Stock." ECF 1, ¶¶ 60-61, 63; *see* ECF 27-1 at 5-9 (the "Compensation Agreement").⁵ And, in August 2016, Luma was appointed Vice President of Dib and Sunshine. TTAB Decision at 6. However, Luma avers that defendants did not pay him the "shares of stock as agreed in the written contract." ECF 1, ¶ 79.

Cision PR Newswire issued a press release on September 16, 2016, announcing that Dib had created [*7] the cryptocurrency DIBCOIN, "to be Used by Sunshine Capital, Inc. for Asset Acquisitions," and described DIBCOIN as "being a Sunshine product to 'purchase assets and other corporations without diluting the shareholders of Sunshine.'" TTAB Decision at 7 (citation omitted). "[A] second press release was issued" on March 27, 2017, claiming that DIBCOIN "Ha[d] Been Approved To Trade On the Livecoin Exchange." *Id.* (internal quotation marks omitted). However, approximately two weeks later, on April 12, 2017, "pursuant to an order from the U.S. Securities and Exchange Commission, Sunshine was suspended from trading in securities in the company." *Id.* (citation omitted). "At some point in time, presumably after the suspension, Sunshine dissolved." *Id.* (citation omitted).

On July 7, 2017, Luma resigned from his position with Dib and Sunshine. *Id.* at 8. Thirteen days later, on July 20, 2017, Luma filed an application with the USPTO to register a trademark on DIBCOIN, claiming "that he first used the mark in connection with the identified services on July 5, 2016." *Id.* The resulting registration was issued on February 6, 2018. *Id.* at 1 n.1. Specifically, Luma claimed ownership of use of [*8] the DIBCOIN mark in the provision of the following services, *id.* at 2:

Financial services, namely, providing a virtual currency for use by members of an on-line community via a global computer network; Financial services, namely providing

oftentimes "comes in the form of transactions that are verified and recorded on a blockchain." *Id.* A blockchain is a "distributed ledger enforced by a disparate network of computers." Jake Frankenfield, *Cryptocurrency*, INVESTOPEDIA, <https://www.investopedia.com/terms/c/cryptocurrency.asp> (last visited Jan. 2, 2021).

⁵The Compensation Agreement indicated that Luma would be provided 333,333 shares of Sunshine Capital stock upon execution of the contract; 333,333 shares on July 28, 2017, and the remaining 333,334 shares "due on the 28th day of 2018." ECF 27-1 at 6.

electronic transfer of a virtual currency for use by members of an on-line community via a global computer network in International Class 36.

On an unspecified date, Dib filed a petition with the TTAB seeking cancellation of Luma's registration of the DIBCOIN mark, "on the ground that [Luma] was not the owner of the registered mark at the time of filing the underlying application," as required by federal law. *Id.* In support of its petition, Dib argued that Luma "knew at the time he filed [the application that] his statement that he believes that the applicant is the owner of the trademark/service mark sought to be registered was false." TTAB Decision at 2 (alteration in TTAB Decision) (citation and internal quotation marks omitted).⁶

During a "trial period," the parties submitted various exhibits and declarations for the TTAB's consideration. *Id.* at 3. However, Dib "raised objections in its trial briefs to [Luma's] filing, on two different occasions, [*9] of two declarations and various other materials outside his assigned trial period." *Id.* at 4 (citation omitted). Further, according to the TTAB, Luma "made 11 different submissions with the Board well after his assigned trial period and subsequent to the filing of the parties' trial briefs." *Id.* (citation omitted).

The Board issued its decision on July 2, 2020. *Id.* at 1. First, it declined to consider any materials that Luma submitted outside of his assigned trial period, on the ground that they were "manifestly untimely." *Id.* at 5. The TTAB explained: "Evidence not obtained and filed in compliance with the rules of practice governing inter parties proceedings before the Board will not be considered by the Board." *Id.* (citing, *inter alia*, [Rule 2.123\(k\)](#); [37 C.F.R. § 2.123\(k\)](#)).

As to the merits, the TTAB found that Dib had "demonstrated by a preponderance of the evidence that [Luma] was not the owner of the DIBCOIN mark on July 20, 2017, when [he] filed the use-based application that matured into the subject registration." TTAB Decision at 12. Further, it said that Luma's "efforts and involvement with the DIBCOIN cryptocurrency coin, and related technology and services associated therewith, were done at the behest [*10] and on behalf of [Dib] in his position as [Dib's] Vice President." *Id.* The Board also observed: "The evidence shows that the DIBCOIN cryptocurrency was first created and promoted at the time when [Luma] began working for [Dib]—in July 2016." *Id.* And, the TTAB pointed out that, under the Compensation Agreement, it was

⁶Dib "also asserted likelihood of confusion and fraud as grounds for cancellation but did not pursue these grounds at trial or argue them in its trial brief." *Id.* at 2 n.2 Therefore, the TTAB dismissed those claims as waived. *Id.*

"abundantly clear" that Luma had agreed to work "on behalf of Sunshine" and to "use his best efforts to promote the interests of [Sunshine]."[] TTAB Decision at 12 (alteration in TTAB Decision) (citation omitted).

Moreover, the Board determined that Dib had "demonstrated that it, and its related company Sunshine, were actually the entities using the mark throughout the relevant time period leading up to the filing of [Luma's] application." *Id.* at 16. Further, it observed that plaintiff did not present any evidence to show that Dib or Sunshine "ever relinquished ownership or control of the mark to [Luma] or anyone else." *Id.* Therefore, the TTAB concluded that Luma "was not the owner [of the Dibcoin mark] at the time of filing," and thus "the application that matured into [Luma's] registration was void ab initio." *Id.* On this basis, the Board granted Dib's petition and [*11] cancelled Luma's registration of the DIBCOIN mark. *Id.*

Plaintiff timely appealed the TTAB's decision to this Court, pursuant to [15 U.S.C. § 1071\(b\)](#). *See* ECF 1. This provision specifies, in part, that a "party to a cancellation proceeding . . . who is dissatisfied with the decision of the . . . [Board]," may pursue a "remedy by a civil action if commenced within such time after such decision, not less than sixty days . . ." [15 U.S.C. §§ 1071\(a\), \(b\)](#). Further, it indicates that the presiding court "may adjudge that an applicant is entitled to a registration upon the application involved, that a registration involved should be canceled, or other such matter as the issues in the proceeding require, as the facts in the case may appear." *Id.* [§ 1071\(b\)\(1\)](#).⁷

⁷As indicated, the parties do not reside in the same state. *See* ECF 1, ¶¶ 1-2; ECF 15 at 1. Such circumstances implicate [15 U.S.C. § 1071\(b\)\(4\)](#). This provision specifies, in pertinent part: "Where . . . there are adverse parties residing in a plurality of districts not embraced within the same State . . . the United States District Court for the Eastern District of Virginia shall have jurisdiction . . ." Some courts have construed this provision as limiting jurisdiction over appeals to the single jurisdiction named in the statute. *See, e.g., Del-Viking Productions, Inc. v. Estate of Johnson*, Civ. A. No. 93-1831, 1994 U.S. Dist. LEXIS 19400, 1994 WL 413752, at *1 (W.D. Pa. Feb.10, 1994); *Flying Tigers Oil Co. Inc. v. Flying Tigers Line, Inc.*, 118 F.R.D. 263 (D.D.C. 1988).

However, other courts have adopted a contrary view. Some have regarded the jurisdiction referenced in the statute as a "supplemental forum," *see Vosk Intern. Co. v. Zao Gruppya Predpriyatij Ost*, C11-1488RSL, 2012 U.S. Dist. LEXIS 42137, 2012 WL 1033535, at *2 (W.D. Wash. Mar. 27, 2012), or the forum of "last resort . . . if they cannot otherwise join all necessary parties in another federal district court." *Shell Research Ltd. v. Matthewson*, Civ. A. No. 89-0160, 1990 WL 198646, at *1 (D.D.C. Nov. 21, 1990); *see also Pollo Campestre, SA de C.V. v. Campero, Inc.*, LOG-18-217, 2018 U.S. Dist. LEXIS 234439, 2018 WL 10436602, at *2 (E.D. Va. Dec. 21, 2018).

Luma argues that the Board erred in refusing to consider the evidence submitted outside of his assigned trial period, because he did not discover the relevant evidence until "[]ate into the proceedings." ECF 1, ¶ 6. In addition, plaintiff contends that these materials were not earlier available to him "due to viruses and malicious software implanted by a hack of the Plaintiff's computer, wherein emails and documents were stolen and or [sic] contaminated." *Id.* [*12]

And, Luma claims that this evidence makes amply clear that he was owner of the DIBCOIN mark at the time he submitted his application to the Board. In particular, plaintiff highlights that this evidence shows that on July 18, 2016, he sold 800,000 DIBCOIN, out of a total of 300 million, to the sole owner of Dib and Sunshine in exchange for 100,000 shares of Sunshine stock. *See id.* ¶¶ 10-11, 27-28; *see also* ECF 27-4. Further, plaintiff contends that the sale occurred prior to his employment by defendants. *See* ECF 1, ¶¶ 29, 30. And, Luma alleges that, following DIBCOIN's suspension from the Livecoin exchange, he "continued to facilitate trading and other operations of the Dibcoin network despite Dib Funding [sic] desertion of the operation." *Id.* ¶ 87.

In sum, Luma maintains that this evidence showed that, contrary to the TTAB's decision, he was the first to use the DIBCOIN mark in commerce and he is "the rightful owner of the Dibcoin Mark . . ." *Id.* ¶ 91. Consequently, he seeks an Order "vacating and setting aside the decision" of the TTAB. *Id.* at 10. Further, he asks the Court to adjudge "the Compensation Agreement of July 28, 2016 and [sic] void and non-binding"; find that "Plaintiff [*13] had a right to take corporate opportunities for himself"; and determine "that Plaintiff owes

In *Vosk*, the court observed that the statute "did not unambiguously" establish whether [§ 1071\(b\)\(4\)](#) precluded review of a suit similar to plaintiff's. After an examination of the statute's legislative history, the court concluded that although "the statute speaks in terms of jurisdiction, it really refers to venue." [2012 U.S. Dist. LEXIS 42137, \[WL\] at *3](#). Further, the court found that the purpose of the provision was "not to limit venue, but to aid plaintiffs by providing a supplemental forum for plaintiffs who would otherwise be left without one . . ." [2012 U.S. Dist. LEXIS 42137, \[WL\] at *4](#) (internal quotation marks omitted); *accord Bally Gaming, Inc. v. Kappos*, 789 F. Supp. 2d 41, 43-44 (D.D.C. 2011) (reaching the same conclusion as to an analogous venue provision found in [35 U.S.C. § 146](#)); *Standard Oil Co. v. Montecatini Edison S.p.A.*, 342 F. Supp. 125, 131-33 (D. Del. 1972) (explaining that [35 U.S.C. § 146](#) "simply provided a supplemental forum . . . to a plaintiff in an interference suit when he could not otherwise obtain service of process upon all indispensable defendants in other fora under the general personal jurisdiction and venue statutes").

In view of the foregoing, I conclude that [§ 1071\(b\)\(4\)](#) does not deprive the court of subject matter jurisdiction.

no duty to Dib Funding, Inc., or any of its affiliates." *Id.* at 10-11.

III. Intervention Motion

Petty has moved to intervene pursuant to [Fed. R. Civ. P. 24](#), ECF 24. As stated, he is the "President, CEO, and majority stockholder" of Dib. *Id.* at 2. And, he asserts that DIBCOIN is the intellectual property of Dib. *Id.* at 3. Further, Petty indicates that he entered a loan agreement with Dib, by which he acquired "a lien on all the assets of DFI which include the trademark DIBCOIN." *Id.*

In support of the Intervention Motion, Petty notes that he personally paid the legal fees to litigate the case before the TTAB, which took two and a half years. *Id.* He seems to imply that he cannot afford to retain corporate counsel. *Id.* He now seeks to intervene in his personal capacity to "protect the interests of DFI stakeholders as well as his own interest" *Id.*

Motions to intervene are governed by [Fed. R. Civ. P. 24](#). It provides, in relevant part:

(a) Intervention of Right. On timely motion, the court must permit anyone to intervene who:

(1) is given an unconditional right to intervene by a federal statute; or

(2) claims an interest relating to **[*14]** the property or transaction that is the subject of the action, and is so situated that disposing of the action may as a practical matter impair or impede the movant's ability to protect its interest, unless existing parties adequately represent that interest.

(b) Permissive Intervention.

(1) *In General.* On timely motion, the court may permit anyone to intervene who:

(A) is given a conditional right to intervene by a federal statute; or

(B) has a claim or defense that shares with the main action a common question of law or fact.

* * *

(2) *Delay or Prejudice.* In exercising its discretion, the court must consider whether the intervention will unduly delay or prejudice the adjudication of the

original parties' rights.

[Section 1071\(b\)\(4\) of 15 U.S.C.](#) may also be relevant, although Petty does not cite it. The provision states, in part, that "any party in interest *may* become a party to the action." (Emphasis added). Of import here, "a party in interest," for the purposes of trademark law, "does not have to demonstrate proprietary interests in the mark; it must only demonstrate a direct and personal stake in the outcome" [Pro-Football, Inc. v. Blackhorse](#), 62 F. Supp. 3d 498, 507 (E.D. Va. 2014) (citing [Jewelers Vigilance Comm., Inc. v. Ullenberg Corp.](#), 823 F.2d 490, 493 (Fed. Cir. 1987) and [Ritchie v. Simpson](#), 170 F.3d 1092, 1095 (Fed. Cir. 1999)); see [U.S.C. § 1064](#) (outlining that a petitioner for cancellation of a trademark must demonstrate **[*15]** that it has a real interest in the outcome, and reasonably believes that the mark has caused or will cause damage).

In [Stuart v. Huff](#), 706 F.3d 345 (4th Cir. 2013), the Fourth Circuit explained the standard for intervention of right under [Rule 24\(a\)\(2\)](#). It said, *id.* at 349-50 (quoting [Teague v. Bakker](#), 931 F.2d 259, 260-61 (4th Cir. 1991)):

[A] district court must permit intervention as a matter of right if the movant can demonstrate "(1) an interest in the subject matter of the action; (2) that the protection of this interest would be impaired because of the action; and (3) that the applicant's interest is not adequately represented by existing parties to the litigation."

In addition to the three factors articulated in [Stuart](#), "timeliness is [also] a 'cardinal consideration' of whether to permit intervention" [Houston Gen. Ins. Co. v. Moore](#), 193 F.3d 838, 839 (4th Cir. 1999) (citation omitted). When assessing the timeliness of a motion to intervene, the court "is obliged to assess three factors: first, how far the underlying suit has progressed; second, the prejudice any resulting delay might cause the parties; and third, why the movant was tardy in filing its motion." [Alt v. U.S. EPA](#), 758 F.3d 588, 591 (4th Cir. 2014). "The determination of timeliness is committed to the sound discretion of the trial court and will not be disturbed on appeal absent an abuse of that discretion." *Id.*

In order to intervene as of right, **[*16]** a movant's interest in the action must be "significantly protectable" and a movant must "stand to gain or lose by the direct legal operation." [Teague](#), 931 F.2d at 261 (quoting [Donaldson v. United States](#), 400 U.S. 517, 531, 91 S. Ct. 534, 27 L. Ed. 2d 580 (1971)). With respect to the adequacy requirement of [Rule 24\(a\)\(2\)](#), "the Fourth Circuit has indicated that an intervenor's burden of showing inadequacy of representation is 'minimal.'" [First Penn-Pac. Life Ins. Co. v. William R. Evans, Chartered](#), 200 F.R.D. 532, 536 (D. Md. 2001) (quoting [Commonwealth of Virginia v. Westinghouse Elec. Corp.](#), 542 F.2d 214,

216 (4th Cir. 1976); alterations added). But, "[w]hen the party seeking intervention has the same ultimate objective as a party to the suit, a presumption arises that its interests are adequately represented, against which the [movant] must demonstrate adversity of interest, collusion, or nonfeasance." *Virginia v. Westinghouse Elec. Corp.*, 542 F.2d 214, 216 (4th Cir. 1976) (alteration added); see also *Stuart*, 706 F.3d at 350.

When the existing party has a legal obligation to represent the interests of the intervenor, then the intervenor has the "onerous" burden of making a "compelling showing of inadequate representation." See *In re Richman*, 104 F.3d 654, 660 (4th Cir. 1997) (quoting *In re Thompson*, 965 F.2d 1136, 1142 (1st Cir. 1992)) (emphasis in *In re Thompson*). Indeed, "courts now presume that the principal is adequately represented by its surety because they both have the 'same ultimate objective,' i.e., to avoid liability on the payment bond." *Atl. Refinishing & Restoration, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 272 F.R.D. 26, 30 (D.D.C. 2010).

Even if [Rule 24\(a\)\(2\)](#) does not mandate intervention, a party may be entitled to permissive intervention under [Rule 24\(b\)](#). See *Stuart*, 706 F.3d at 349. The decision [*17] to grant or deny permissive intervention "lies within the sound discretion of the trial court." *Smith v. Pennington*, 352 F.3d 884, 892 (4th Cir. 2003) (quoting *Hill v. Western Elec. Co. Inc.*, 672 F.2d 381, 386 (4th Cir. 1982)); see also *McHenry v. C.I.R.*, 677 F.3d 214, 219 (4th Cir. 2012).

In *Shanghai Meihao Elec., Inc. v. Leviton Mfg. Co.*, 223 F.R.D. 386 (D. Md. 2004), then-District Judge Andre Davis distilled, from "the text of [Rule 24\(b\)](#) itself [and] case law interpreting the rule," four conditions with respect to permissive intervention. They are as follows, *id.* at 387 (citations omitted; first alteration added, second alteration in *Shanghai Meihao Elec., Inc.*):

- (1) that [the intervenor's] motion is "timely";
- (2) that its "claim or defense and the main action have a question of law or fact in common" . . . ;
- (3) that there exists an independent ground of subject matter jurisdiction; and,
- (4) that "intervention will [not] unduly delay or prejudice the adjudication of the rights of the original parties."

As indicated, Petty is "President, CEO, and a majority stockholder" of DFI. ECF 24 at 2. He also claims that he acquired a lien on DFI's assets, including the DIBCOIN mark. *Id.* at 3. Under [§ 1071\(b\)\(4\)](#), "any party in interest may become a party to the action." (Emphasis added). "Read naturally, the word 'any' has an expansive meaning . . ." *Ali v. Fed. Bureau of Prisons*, 552 U.S. 214, 219, 128 S. Ct. 831, 169 L. Ed. 2d 680 (2008); see *United States v. Gonzales*, 520 U.S. 1, 5, 117 S. Ct. 1032, 137 L. Ed. 2d 132 (1997); *Alexander v. Carrington Mortg. Servs.*,

[23 F.4th 370](#), 2022 U.S. App. LEXIS 1549, 2022 WL 164018, at *5 (4th Cir. Jan. 19, 2022).

Petty appears to have an interest in the subject matter of the suit. Apart from his claim that he acquired an important asset of DFI, [*18] the Clerk has entered default against DFI (see ECF 22), and Luma has since asked for a default judgment against the defendants, which, to date, is unopposed. See ECF 27.⁸

However, [§ 1071\(b\)\(4\)](#) also uses the word "may": "[A]ny party in interest *may* become a party to the action." (Emphasis added). The word "may" is consistent with a permissive right to become a party, but not a compulsory right.

The task of interpreting a statute begins with the text. *Murphy v. Smith*, U.S. , 138 S. Ct. 784, 787, 200 L. Ed. 2d 75 (2018) ("As always, we start with the specific statutory language in dispute."). To ascertain a statute's meaning, "the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." *Gundy v. United States*, U.S. , 139 S. Ct. 2116, 2126, 204 L. Ed. 2d 522 (2019) (quoting *Nat'l Ass'n of Home Builders v. Defs. of Wildlife*, 551 U.S. 644, 666, 127 S. Ct. 2518, 168 L. Ed. 2d 467 (2007)). Terms that are not defined are "interpreted as taking their ordinary, contemporary, common meaning." *Sandifer v. U.S. Steel Corp.*, 571 U.S. 220, 227, 134 S. Ct. 870, 187 L. Ed. 2d 729 (2014) (citation omitted); accord *United States v. George*, 946 F.3d 643, 645 (4th Cir. 2020).

It is well settled that "the word 'may' . . . implies discretion . . ." *Kingdomware Technologies, Inc. v. United States*, 579 U.S. 162, 171-72, 136 S. Ct. 1969, 195 L. Ed. 2d 334 (2016). Thus, the statute's use of the word "may" indicates that a district court retains discretion in determining whether the intervention of a party in interest would be appropriate in a particular case.

The conclusion is bolstered by the construction of the provision as a whole. In 15 U.S.C. [§ 1071\(b\)\(2\)](#), it states that [*19] the Director of the USPTO "shall have the right to intervene" in suits brought under [§ 1071\(b\)\(1\)](#) (emphasis added). And, as the Supreme Court has explained, "the word 'shall' usually creates a mandate," indicating that "the district court has some nondiscretionary duty to perform." *Murphy*, 138 S. Ct. at 787 (citing *Lexecon Inc. v. Milberg Weiss Bershard Hynes & Lerach*, 523 U.S. 26, 35, 118 S. Ct. 956, 140 L. Ed. 2d 62 (1998) ("[T]he mandatory 'shall' . . . normally creates an obligation impervious to judicial discretion."); see *Maine Community Health Options v. United States*, U.S. , 140 S. Ct. 1308, 1320, 206 L. Ed. 2d 764 (2020) ("The first sign that [a] statute imposed an obligation is

⁸ It goes without saying that the Court always benefits when it is able to hear the views of opposing sides.

its mandatory language: 'shall.'").

Congress's use of the words "may" and "shall" in "adjacent portions of the statute reinforces the conclusion that it knowingly selected" the word "may" in drafting [§ 1071\(b\)\(4\)](#). See [South Carolina v. United States](#), 907 F.3d 742, 756 (4th Cir. 2018). Therefore, I am persuaded that [§ 1071\(b\)\(4\)](#) provides one who is a "party in interest" with a permissive right of intervention, rather than an unconditional right, within the meaning of [Fed. R. Civ. P. 24\(a\)\(1\)](#).

Luma asks the Court to vacate an order of the TTAB, which canceled Luma's registration of the DIBCOIN mark. ECF 1 at 10. As noted, Petty is an officer of DFI as well as a majority stockholder of DFI (ECF 24 at 2), and he claims to have acquired a lien on DFI's assets, including the DIBCOIN mark. *Id.* at 3. Thus, Petty allegedly has a "direct personal stake" in the subject [*20] matter of the suit, and would qualify as a party in interest within the meaning of [15 U.S.C. § 1071\(b\)\(4\)](#). But, in the exercise of this Court's discretion, Petty has not offered the Court a persuasive reason to allow his intervention.

In my view, Petty's request is no more than a thinly veiled attempt to circumvent the well established principle that in federal court a corporation may not appear without counsel. See [Rowland](#), 506 U.S. at 201-02 (stating that "a corporation may appear in the federal courts only through licensed counsel"); [In re Tamojira, Inc.](#), 20 F. App'x 133, 133-34 (4th Cir. 2001) ("Although [28 U.S.C. § 1654](#) permits parties to conduct their own litigation, it is well settled that a corporation that must be represented by an attorney in federal court."); see also [28 U.S.C. § 1654](#) ("In all courts of the United States the parties may plead and conduct their own cases personally or by counsel as, by the rules of such courts, respectively, are permitted to manage and conduct causes therein."); [Local Rule 101.1\(a\)](#) ("All parties other than individuals must be represented by counsel"). Indeed, the Court previously informed Petty of this requirement in its Order of April 27, 2021. See ECF 15 (citing [Rowland](#), 506 U.S. at 201, and [Local Rule 101\(a\)](#)).⁹

Although "an exception to this rule exists in cases in which a corporation fails to assert an available defense to an action against [*21] it . . . that exception is itself limited to cases in which the corporation's failure to defend is due to the

negligence, bad faith, collusion, or fraud of the corporation's officers." [Jacobs v. Patent Enforcement Fund, Inc.](#), 230 F.3d 565, 568-69 (2d Cir. 2000) (citing [Price v. Gurney](#), 324 U.S. 100, 105, 65 S. Ct. 513, 89 L. Ed. 776 (1945)). Such circumstances are not present in this case.

Many courts have declined to countenance the exploitation of [Rule 24](#) by corporate officers and shareholders. See, e.g., [M2 Technology, Inc. v. M2 Software, Inc.](#), 589 F. App'x 671, 675 (5th Cir. 2014) (per curiam) (explaining that a corporation's sole shareholder could not intervene in a trademark infringement suit on behalf of the corporation because doing so would "effectively nullify the well-established rule that in federal court, corporations must be represented by counsel"); [Motionless Keyboard Co. v. Microsoft Corp.](#), 184 F. App'x 967, 968-69 (Fed. Cir. 2006) (per curiam) (describing the motion to intervene in a suit against the corporation by the corporation's controlling shareholder "as an attempted end run around [section 1654](#)"); [Jacobs](#), 230 F.3d at 568-69 (finding that the corporation's president, sole officer and director could not intervene in a suit involving the corporation because the connection between the corporation and the officer was "so intimate" that the officer's intervention was "in effect an effort to enable [the corporation] to appear without counsel").

In [United States v. High Country Broadcasting Co.](#), 3 F.3d 1244, 1245 (9th Cir. 1993) (per curiam), the Ninth Circuit expounded on the reasoning that undergirds [*22] these decisions. There, the president and sole shareholder of a corporation, who was not an attorney, attempted to represent the corporation in proceedings before a district court. *Id.* The court ordered the corporation to retain counsel, but the corporation failed to do so. *Id.* As a result, the district court entered a default judgment against it. *Id.* Thereafter, the president moved to intervene in the suit, which the district court denied. *Id.* On appeal, the Ninth Circuit affirmed the lower court's resolution of the case. *Id.* It explained, *id.*:

In an ordinary case we might have our doubts whether [the corporation] could adequately represent [the president's] interests. But here [the president's] application to intervene pro se was nothing more than an end run around [section 1654](#). As [the corporation's] President, statutory agent and only shareholder, [the president] was singularly to blame for [the corporation's] failure to retain counsel. As an intervenor, [the president] sought . . . to represent [the corporation] pro se. To allow a sole shareholder with interests identical to the corporation's to intervene under such circumstances, rather than hire corporate counsel, would eviscerate [section 1654](#). We decline [*23] to read [Rule 24](#) as condoning such a result. See [Fed. R. Civ. P. 1](#) (court shall interpret rules to "secure the just, speedy, and

⁹As the Supreme Court explained, "the lower courts have uniformly held that [28 U.S.C. § 1654](#), providing that 'parties may plead and conduct their own cases personally or by counsel,' does not allow corporations, partnerships, or associations to appear in federal court otherwise than through a licensed attorney." [Rowland](#), 506 U.S. at 202 (citations omitted).

inexpensive determination of every action"); [Marquis Theatre Corp. v. Condado Mini Cinema](#), 846 F.2d 86, 89 (1st Cir.1988) (Rule 1 prevents party from flouting spirit of rules, even if party fits within their literal meaning).

[HomeBingo Network, Inc. v. Cadillac Jack, Inc.](#), 05-0701-WS-B, 2006 U.S. Dist. LEXIS 87502, 2006 WL 3469515 (S.D. Ala. Nov. 29, 2006), is also instructive. There, the proposed intervenor purportedly had an interest in the subject matter of the suit separate from the relationship he shared with the plaintiff corporation. In that patent infringement action, the plaintiff corporation "transferred . . . its patent infringement rights and interests against the named defendants" to the corporation's founder and general manager, who then moved to intervene in the suit. 2006 U.S. Dist. LEXIS 87502, [WL] at *1. The court denied the motion, stating, in relevant part: "The obvious inference raised by this sequence of events is that [plaintiff] assigned its patent infringement rights to [the proposed intervenor] in order to circumvent the requirement that [plaintiff] be represented in this action by counsel." 2006 U.S. Dist. LEXIS 87502, [WL] at *3.

Based on the assertions presented to the Court, it appears that Petty, an officer and majority stockholder of DFI, effectively owns DFI and controls its operations. ECF 24 at 2. Indeed, he claims that he had the authority [*24] to hire legal counsel to represent DFI in proceedings before the TTAB. *Id.* at 3. Further, he endeavored to secure counsel to represent Dib in this Court, although he has, to date, failed to do so. *See* ECF 14; ECF 19. In short, it is evident that Petty's connection with Dib is "so intimate" that his "intervention, even though formally on his own behalf, is in effect an effort to enable [Dib] to appear without counsel, undermining the longstanding rule that a corporation may appear in federal court only through its lawyer." [Jacobs](#), 230 F.3d at 569.

Against this backdrop, it becomes apparent that, to the extent that Petty's lien provides him with a financial interest in the DIBCOIN mark, distinguishable from DFI's own, it is a distinction without a difference. Rather, it seems that Petty, in effect, entered into a loan agreement with himself and, as a result, acquired a lien on what is, functionally, his own asset. To allow his intervention in this context would open the door to future manipulation from corporate officers and shareholders, seeking to enable the appearance of a corporation in federal court without incurring the cost of hiring duly licensed counsel.

Therefore, I decline to permit Petty to intervene [*25] in this suit as a matter of right pursuant to [Rule 24\(a\)](#), or permissively under [Rule 24\(b\)](#), or to otherwise join the suit as a party in interest under [15 U.S.C. § 1071\(b\)\(4\)](#). It follows that Petty's remaining motions must also be denied, without prejudice: the

Motion to Dismiss, the S.J. Motion, and the Abatement Motion.¹⁰

IV. Default Judgment Motion

As mentioned, Luma asks the Clerk to enter default judgment against defendants pursuant to [Fed. R. Civ. P. 55\(b\)\(1\)](#). ECF 27. [Rule 55\(b\)\(1\)](#) rule provides that the Clerk must enter a default judgment if the plaintiff's claim is "for a sum certain or a sum that can be made certain by computation." [Fed. R. Civ. P. 55\(b\)\(1\)](#). Plaintiff suggests that relief under [Rule 55\(b\)\(1\)](#) is appropriate here because he has asked the Court to award him a "sum certain," in so much as he requested an award of the costs associated with effecting service on defendants. ECF 27 at 1; *see* ECF 27-6.

But, plaintiff also seeks an Order vacating the decision of the TTAB and granting him further declaratory relief. ECF 1 at 10-11. Such remedies do not qualify as a sum certain, and thus the Clerk lacks the authority necessary to grant the Default Judgment Motion. *See Nevada General Ins. Co. v. Anaya*, 326 F.R.D. 685, 690 (D.N.M. 2018) (explaining that because the "Court Clerk may enter a default judgment only [for a sum certain] the Court Clerk is not authorized [*26] . . . to enter a default judgment in a declaratory judgment action"); [W. World Ins. Co. v. Czech](#), 275 F.R.D. 59, 62 (D. Mass. 2011) ("Because Western World seeks a declaratory judgment that it owes no duty to defend or indemnify Williams, plaintiff's claim is not for a 'sum certain' within the meaning of [Fed. R. Civ. P. 55\(b\)\(1\)](#) and thus the Clerk was not authorized to enter the Default Judgment"); [Northland Ins. Co. v. Cailu Title Corp.](#), 204 F.R.D. 327, 329 (W.D. Mich. 2000) ("This is an action for declaratory relief; no sum certain has been requested. Under the circumstances, Northland's request that the Clerk enter a default judgment in any form may not be granted.").

Notably, the United States Court of Appeals for the Fourth Circuit has a "strong policy favoring the disposition of cases on the merits . . ." [Rangarajan v. Johns Hopkins Univ.](#), 917 F.3d 218, 229 (4th Cir. 2019) (discussing [United States v. Shaffer Equip. Co.](#), 11 F.3d 450, 462 (4th Cir. 1993)), *cert. denied*, 139 S. Ct. 2762, 204 L. Ed. 2d 1137 (2019); *see Projects Mgmt. Co. v. Dynacorp Int'l LLC*, 734 F.3d 366, 376 (4th Cir. 2013). However, the policy is not absolute. Rather, default judgment "is appropriate when the adversary process has been halted because of an essentially unresponsive party." [Garnier-Thiebaut, Inc. v. Castello 1935 Inc.](#), SDT-17-3632, 2019 U.S. Dist. LEXIS 210474, 2019 WL

¹⁰The Court would certainly entertain a renewed motion to dismiss for lack of personal jurisdiction, if such a motion were filed by a duly licensed attorney on behalf of the corporate defendants.

6696694, at *1 (D. Md. Dec. 6, 2019) (Thacker, J.) (quoting *Int'l Painters & Allied Trades Indus. Pension Fund v. Cap. Restoration & Painting Co.*, 919 F. Supp. 2d 680, 684 (D. Md. 2013); see *SEC v. Lawbaugh*, 359 F. Supp. 2d 418, 421 (D. Md. 2005).

In any event, upon the entry of default against a party, the court must determine whether the undisputed factual allegations constitute a viable cause of action. *Ryan v. Homecomings Financial Network*, 253 F.3d 778, 780-81 (4th Cir. 2001); see also 10A Wright, Miller & Kane, *Federal Practice and Procedure* § 2688 (3d ed. 2010 Supp.) ("[L]iability is not deemed established simply [*27] because of the default . . . and the court, in its discretion, may require some proof of the facts that must be established in order to determine liability.").

Accordingly, to obtain a default judgment in this context, Luma must put forward facts that establish, as a matter of federal law, that he is entitled to ownership of the registered DIBCOIN mark. Relevant here, under 15 U.S.C. 1051(a), "only the owner of a mark is entitled to apply for registration." *In re Wella A.G.*, 787 F.2d 1549, 1554 (Fed. Cir. 1986) (emphasis omitted). Likewise, "only the owner of the mark is entitled to maintain an existing registration." *Id.* at 1554 n.1 (citations omitted). And, in order to determine the ownership of a mark, courts consider whether the applicant has the ability to "control[] the nature and quality of the goods sold under the mark . . ." *Id.* at 1554 (citing J. McCarthy, *Trademarks and Unfair Competition*, § 18.14, at 830 (2d ed. 1984)).

In this case, beyond Luma's bare assertions, he has not offered any evidence to the Court that tends to show that plaintiff owned the DIBCOIN mark on July 20, 2017, the date on which he filed his application with the TTAB. To be sure, plaintiff appended several exhibits to the Default Judgment Motion. But, these exhibits do not, in and of themselves, [*28] establish that Luma is entitled to the relief he seeks from the Court.

The exhibits include copies of emails that Luma exchanged with DFI officials reflecting the date on which he agreed to work for DFI and Sunshine, as well as the associated Compensation Agreement, executed on July 28, 2016 (ECF 27-1);¹¹ a portion of Luma's responses to DFI's requests for admission, presumably prepared in connection with proceedings before the TTAB (ECF 27-2); an overview of a computer network called "Coinprism" that Luma allegedly used to create DIBCOIN (ECF 27-3; see ECF 1, ¶¶ 13, 20-24; ECF 27 at 3); a copy of a certificate for 100,000 shares of Sunshine stock that was issued to plaintiff on July 18, 2016 (ECF 27-4); drafts of various business proposals involving DIBCOIN that Luma exchanged

with DFI officials between July 8, 2016 and July 24, 2016 (ECF 27-5); and receipts reflecting the expenses that Luma incurred in effecting service on defendants (ECF 27-6).

Critically, these exhibits do not evidence the circumstances in which DIBCOIN was created and the roles of plaintiff or defendants in that process. Moreover, the exhibits do not show that Luma had the capacity to "control[] the nature and quality [*29] of the goods sold under" the DIBCOIN mark at the time he applied to register it with the TTAB in July 2017. *In re Wella A.G.*, 787 F.2d at 1554. Consequently, in my view, the proffered evidence is inadequate to justify awarding Luma a default judgment.

Even if I were satisfied that Luma had presented sufficient evidence to obtain a default judgment, granting such a remedy at this juncture would be premature because it is apparent that Petty, for himself and/or Dib, has made clear his desire to oppose the suit, although he has yet to do so through a proper vehicle. As the "President, CEO, and majority stockholder" of DFI (ECF 24 at 1), Petty is responsible for securing corporate counsel to represent DFI. See ECF 14; ECF 19. After Petty failed to do so, he moved to intervene in this suit in his personal capacity. ECF 24. Petty also filed two motions in opposition to the Default Judgment Motion. See ECF 32; ECF 33. But, it may be that he was awaiting a ruling on the motion to intervene before resorting to obtaining a lawyer for defendants.

As noted, Petty may not effectuate an "end run around" the rule requiring corporations to retain counsel to appear in federal court. *Motionless Keyboard Co.*, 184 F. App'x at 968. However, until now, Petty did not know that the Court [*30] would not permit him to intervene to contest the Complaint on behalf of Dib or himself.

Accordingly, in light of Petty's pro se status and the Fourth Circuit's "strong policy that cases be decided on their merits," *Shaffer Equip. Co.*, 11 F.3d at 453, I am persuaded that defendants should be afforded one final opportunity to appear before the Court through proper representation and to respond to plaintiff's suit. Thus, I shall deny the Default Judgment Motion, without prejudice.

V. Conclusion

For the aforementioned reasons, I shall deny the Intervention Motion (ECF 24); the Motion to Dismiss (ECF 25); the S.J. Motion (ECF 31); and the Abatement Motion (ECF 32). And, I shall deny the Default Judgment Motion (ECF 27), without prejudice.

¹¹ The Compensation Agreement appears to include a typo that reflects that it was executed on April 28, 2016. ECF 27-1 at 5.

As a final note, this suit was initiated pursuant to [15 U.S.C. § 1071\(b\)](#). See ECF 1, ¶ 3. When a complaint is filed under this provision, the Clerk of the Court is required to provide notice of the filing to the Director of the USPTO (the "Director"), who has the right to intervene in the suit. See [15 U.S.C. § 1071\(b\)\(2\)](#). The docket does not reflect that such notice was provided.

Therefore, I shall order the Clerk to serve a copy of the Complaint, as well as a copy of the Docket sheet, this Memorandum, and the accompanying Order, [*31] on Drew Hirshfeld, the acting Director of the USPTO.

An Order follows.

Date: January 19, 2022

/s/

Ellen L. Hollander

United States District Judge

ORDER

For the reasons set forth in the accompanying Memorandum Opinion, it is this 19th day of January, 2022, by the United States District Court for the District of Maryland, **ORDERED**:

1. The Intervention Motion (ECF 24) is DENIED;
2. The Motion to Dismiss (ECF 25); the Default Judgment Motion (ECF 27); the S.J. Motion (ECF 31); and the Abatement Motion (ECF 32) are DENIED, without prejudice;
3. Defendants are directed to respond to the Complaint, through counsel, within 30 days of the date of docketing of this Order;
4. In accordance with [15 U.S.C. § 1071\(b\)\(2\)](#) and [37 C.F.R. § 104.2](#), the Clerk SHALL MAIL a copy of the Complaint (ECF 1), the Docket sheet, this Order, and the preceding Memorandum to Drew Hirshfeld, acting Director of the USPTO, at Office of the General Counsel, United States Patent and Trademark Office, P.O. Box 1450, Alexandria, VA 22313-1450; and
5. The CLERK shall mail a copy of the Memorandum and Order to Adam Petty at 11656 Edgeton Avenue, Rockford, MI 49341.

/s/

Ellen Lipton Hollander

United States District Judge

This Opinion is Not a Precedent of the TTAB

Mailed: July 2, [*32] 2020

UNITED STATES PATENT AND TRADEMARK OFFICE

Trademark Trial and Appeal Board

DIB Funding, Inc. v. Honson Luma

Cancellation No. 92068284

(Registration No. 5396033)

James R. Hastings of COLLEN IP, for DIB Funding, Inc.

Honson Luma, pro se.

Before Mermelstein, Wellington, and Larkin, Administrative Trademark Judges.

Opinion by Wellington, Administrative Trademark Judge:

Honson Luma ("Respondent" or "Luma"), is the owner of Registration No. 5396033 on the Principal Register of the mark **DIBCOIN** in standard characters for the following services:¹

Financial services, namely, providing a virtual currency for use by members of an on-line community via a global computer network; Financial services, namely, providing electronic transfer of a virtual currency for use by members of an on-line community via a global computer network in International Class 36.

DIB Funding, Inc. ("Petitioner") seeks to cancel the registration on the ground that Respondent was not the owner of the registered mark at the time of filing the underlying application, as required under [Trademark Act Section 1\(a\)](#), [15 U.S.C. § 1051\(a\)](#).² Petitioner alleges that "Respondent knew at the time

¹The registration issued on February 6, 2018, based on an application filed on July 20, 2017, wherein Respondent claimed first use of the mark in connection with the services on July 5, 2016.

²1 TTABVue (Petition for Cancellation). Petitioner also asserted likelihood of confusion and fraud as grounds for cancellation but did not pursue these grounds at trial or argue them in its trial brief. Accordingly, these claims are deemed waived and not given further consideration. See [Alcatraz Media Inc. v. Chesapeake Marine Tours Inc.](#), 107 USPQ2d 1750, 1752 n.6 (TTAB 2013), *aff'd*, 565 F. Appx. 900 (Fed. Cir. 2014); [Joel Gott Wines LLC v. Rehoboth Von Gott Inc.](#), 107 USPQ2d

he filed [the application that] his statement that 'he believes that the applicant is the [*33] owner of the trademark/service mark sought to be registered' was false."³ Specifically, Petitioner alleges that Respondent is "a former officer of Petitioner, [and] has acknowledged that DIBCOIN is an asset of [Petitioner]."⁴ Petitioner pleads that it is the rightful owner of the registered mark and has filed an application to register the mark for "crypto currency coins," and that said application has been refused based on Respondent's registration.⁵

In his Answer, Respondent makes certain admissions, including that "DIBCOIN is an open source Bitcoin 2.0 protocol embedded on top of the bitcoin blockchain,"⁶ but otherwise denies the salient allegations in the Petition for Cancellation.

The parties have fully briefed this cancellation proceeding.

I. The Record — Evidentiary Objections and Late Submissions

The record includes the pleadings and, by operation of [Trademark Rule 2.122](#), [37 C.F.R. § 2.122](#), the involved registration file.

During its trial period, Petitioner submitted the testimony declaration, with accompanying exhibits, of Adam Petty, Petitioner's President and CEO.⁷ Petitioner also filed a notice of reliance on the following materials: Respondent's responses to Petitioner's discovery requests, including [*34] interrogatories, requests for admissions and requests for production of documents; Internet printouts from websites, including articles and press releases involving use of the term DIBCOIN; and a printout from the Office's electronic database for Petitioner's pleaded application.⁸

Respondent, during his trial period, filed a copy of his testimony

by declaration, with accompanying exhibits.⁹ Respondent also filed a notice of reliance on the following materials: various email communications; a "DIBCOIN ledger"; a "Blockchain Timetable"; Petitioner's responses to Respondent's requests for production of documents; an "Ambisafe Service Agreement"; and various Internet printouts, including articles, involving the cryptocurrency DIBCOIN.

During its rebuttal trial period, Petitioner filed the rebuttal testimony declaration of Adam Petty.¹⁰

Petitioner's Objections and Respondent's Untimely Submissions

Petitioner has raised objections in its trial briefs to Respondent's filing, on two different occasions, of two declarations and various other materials outside his assigned trial period.¹¹ Respondent did not address the objections or otherwise explain why his submissions should be considered properly made [*35] of record despite being filed outside his trial period.

Additionally, Respondent made 11 different submissions with the Board well after his assigned trial period and subsequent to the filing of the parties' trial briefs.¹² Indeed, Respondent filed these papers subsequent to the Board's designating this proceeding as "submitted for final decision" (29 TTABVUE). Respondent's filings, some captioned as "supplemental notice of reliance," presumably contain evidentiary materials that Respondent would like the Board to consider.

In general, a party's assigned trial period is the time when it may take testimony and introduce other evidence. See [Trademark Rule 2.121](#), [37 C.F.R. § 2.121](#). See also, in general, TRADEMARK TRIAL AND APPEAL BOARD MANUAL OF PROCEDURE (TBMP) § 700 et seq. (2020) (Trial Procedure and Introduction of Evidence). Evidence not obtained and filed in compliance with the rules of practice governing inter partes proceedings before the Board will not be considered by the Board. [Rule 2.123\(k\)](#), [37 C.F.R. § 2.123\(k\)](#). See also [Maytag Co. v. Luskis's, Inc.](#), 228 USPQ 747, 748 (TTAB 1986); [Binney & Smith Inc. v. Magic Marker Ind., Inc.](#), 222 USPQ 1003, 1009 n.18 (TTAB 1984); and TBMP § 706.

[1424](#), [1426 n.3 \(TTAB 2013\)](#) (opposer's pleaded descriptiveness claim not argued in brief deemed waived); [Knight Textile Corp. v. Jones Im. Co.](#), [75 USPQ2d 1313](#), [1314 n.4 \(TTAB 2005\)](#) (pleaded dilution ground not pursued in brief deemed waived).

³ 1 TTABVUE 6 (¶ 18).

⁴ *Id.* at 4 (¶ 9).

⁵ *Id.* at 7 (¶¶ 26-28).

⁶ 4 TTABVUE (Answer ¶ 8).

⁷ 13 TTABVUE.

⁸ 12 TTABVUE.

⁹ 18 TTABVUE.

¹⁰ 20 TTABVUE.

¹¹ 23 TTABVUE 18 (Petitioner's objection); 21-22 TTABVUE (Respondent's declarations); 28 TTABVUE 7 (Petitioner's objection); 24-26 TTABVUE (Respondent's filings)

¹² 30-40 TTABVUE.

Inasmuch as Respondent's objected-to submissions were filed outside his trial period and are not otherwise properly of record, Petitioner's objections are sustained and the objected-to materials are given no further consideration in [*36] this proceeding.¹³ Respondent's additional filings are also manifestly untimely and we give them no further consideration. *Id.*

II. Background

This proceeding involves rights to registration of a mark involving cryptocurrency. Cryptocurrency is a digital asset designed to work as a medium of exchange wherein individual coin ownership records are stored in a digital ledger or computerized database using strong cryptography to secure transaction record entries, to control the creation of additional digital coin records, and to verify the transfer of coin ownership.¹⁴ Many cryptocurrencies use decentralized computer networks based on blockchain technology (a distributed ledger enforced by the disparate computer network).¹⁵ Cryptocurrencies are generally not issued by any central governmental authority.¹⁶

The parties agree that DIBCOIN is "an open source Bitcoin 2.0 protocol embedded on top of the bitcoin blockchain."¹⁷

Petitioner is a company formed in 2015 for the purpose of "acquiring third-party companies through the use of cryptocurrency."¹⁸,¹ Petitioner's majority owner and Petitioner share the same name ("DIB Funding, Inc."); Petitioner is incorporated in Delaware and its majority owner [*37] in Michigan.¹⁹ Petitioner's majority owner assigned Petitioner the "DIBCOIN intellectual property assets," according to Adam Petty, CEO for both corporations.²⁰

In or around August, 2016, Respondent was appointed Vice

President of Petitioner and Sunshine Capital, Inc. ("Sunshine"); the latter company was a majority-owned, publicly-traded company of Petitioner at the time and is now defunct.²¹ Respondent signed a "compensation agreement" with Sunshine (identified as a "DIB Funding Company") wherein he was tasked with "provid[ing] general management services."²²

On September 16, 2016, Cision PR Newswire issued a press release titled "DIB Funding, Inc. Has Created the First Cryptocurrency, 'DIBCOIN,' to be Used by Sunshine Capital, Inc. for Asset Acquisitions," which describes the DIBCOIN as being a Sunshine product to "purchase assets and other corporations without diluting the shareholders of Sunshine."²³ On March 27, 2017, a second press release was issued, titled "Sunshine Capital, Inc. Announces That DIBCOIN Has Been Approved To Trade On the Livecoin Exchange." The second press release includes the following language:

"We are about to make history," stated Adam Petty, President and CEO [*38] of Sunshine Capital, Inc. "Once DIBCOIN starts trading on the Live Coin Exchange, it automatically gives Sunshine Capital, Inc. a massive amount of liquid assets. Having DIBCOIN trading on the Livecoin exchanged is the first step in implementing our business plan."

"In months, we have done something that takes other companies years to achieve!" exclaimed Honson Luma, Vice President of Sunshine Capital, Inc. "What the investment world needs to understand is that for every penny DIBCOIN trades at, it gives our Company approximately \$40 Million Dollars in liquid assets. So a single penny should increase Sunshine Capital, Inc.'s book value approximately \$2.35 a share."

On April 12, 2017, pursuant to an order from the U.S. Securities and Exchange Commission, Sunshine was suspended from trading in securities in the company.²⁴ At some point in time, presumably after the suspension, Sunshine dissolved.²⁵

On July 7, 2017, Respondent resigned from his position with Petitioner and Sunshine.²⁶ Approximately two weeks later, on

¹³ To be clear, 21-22 and 24-26 TTABVUE are not of record.

¹⁴ We take judicial notice definitions of "cryptocurrency" provided by Investopedia (www.investopedia.com), an online investment encyclopedia, and Merriam-Webster online dictionary (www.merriam-webster.com).

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ See Note 6.

¹⁸ 13 TTABVUE (Petty Dec. ¶¶ 3 and 5).

¹⁹ *Id.*

²⁰ *Id.*, ¶¶ 5-6.

²¹ *Id.*, ¶¶ 7-8 and Ex. A (press release); also 18 TTABVUE (Luma Dec. Ex. 1).

²² 18 TTABVUE (Luma Ex. 2).

²³ Petty Dec. Exs. K-L.

²⁴ 18 TTABVUE (Luma Dec. ¶ 25 and Ex. 9).

²⁵ 20 TTABVUE (Petty Rebuttal Dec. ¶ 5).

²⁶ *Id.*, Luma Dec. ¶ 27.

July 20, 2017, Respondent filed the application that matured into the subject registration and claimed that he first used the mark in connection with the identified services on July [*39] 5, 2016.

The evidence does not clearly indicate when the DIBCOIN mark was first used in connection with cryptocurrency products and services. However, based on the testimony and issued press releases, discussed *supra*, there is no dispute that a DIBCOIN-branded cryptocurrency, and related technology, was operational prior to Respondent's resignation in July 2017.

As to the genesis of a DIBCOIN-branded cryptocurrency or related technology, Respondent avers that "in early 2016" he and two previously-associated officers of Petitioner and Sunshine "formed a loose partnership to help the company enter the cryptocurrency space."²⁷ However, Respondent does not state how he, as an individual, first began to use DIBCOIN in connection with cryptocurrency. Nevertheless, according to Respondent, he had a "gentlemen's agreement (separate from [Sunshine and Petitioner]," whereby he "could retain ownership and control over my Legacy Wallet and my intellectual property . . . [and] ownership, control and disposition of the coin I created."²⁸

Petitioner, on the other hand, claims it coined the term DIBCOIN. Petitioner's President and CEO avers that DIB "stands for 'Do It Big,'" and "was derived by the [*40] incorporators of DIB Funding, Inc. [Petitioner] in October of 2015 when DIB Funding, Inc. was formed."²⁹ He further states that therefore "[t]he mark 'DIBCOIN' was created by [Petitioner] as the name of its cryptocurrency" and this "all occurred prior to Luma being involved with [Petitioner], or its publicly traded company, [Sunshine]."³⁰ Petitioner asserts that Respondent Luma was hired to "create crypto currencies for both [Sunshine and Petitioner] and get the crypto currencies listed on public exchanges."³¹ Petitioner also asserts that the "relevant public associates the DIBCOIN mark with Petitioner," pointing to the press releases and an agreement with a third party cryptocurrency exchange accepting DIBCOIN as a depository item.³²

²⁷ 18 TTABVUE (Luma Dec. ¶ 4).

²⁸ *Id.* (Luma Dec. ¶ 14).

²⁹ 20 TTABVUE (Petty Dec. ¶ 4).

³⁰ *Id.*

³¹ 23 TTABVUE 11, citing to Petty Dec. ¶ 7 (13 TTABVUE).

³² *Id.* at 12; Petty Dec. ¶ 23 and Ex. AH.

III. Petitioner's Standing

Standing is a threshold issue that a plaintiff must prove in every inter partes case. See *Empresa Cubana Del Tabaco v. Gen. Cigar Co.*, 753 F.3d 1270, 111 USPQ2d 1058, 1062 (Fed. Cir. 2014). "The facts regarding standing ... are part of [a plaintiff's] case and must be affirmatively proved. Accordingly, [plaintiff] is not entitled to standing solely because of the allegations in its petition." *Lipton Indus., Inc. v. Ralston Purina Co.*, 670 F.2d 1024, 213 USPQ 185, 189 (CCPA 1982). Our primary reviewing court has enunciated a liberal threshold for determining standing: a plaintiff must demonstrate that it has a [*41] "real interest" in a proceeding beyond that of a mere intermeddler, and "a reasonable basis for his belief of damage." *Empresa Cubana*, 111 USPQ2d at 1062 (quotation omitted). A "real interest" is a "direct and personal stake" in the outcome of the proceeding. *Ritchie v. Simpson*, 170 F.3d 1092, 50 USPQ2d 1023, 1026 (Fed. Cir. 1999).

Petitioner's standing in this proceeding is clearly established through the testimony, with exhibits, of Petitioner's principal and Respondent himself. Essentially, the evidence shows that the parties were in business together in connection with a cryptocurrency under the mark DIBCOIN. Specifically, Petitioner's principal avers that Petitioner was incorporated with the express purpose of entering the cryptocurrency business and lays claim to the DIBCOIN mark. Respondent acknowledges that he signed a compensation agreement with Petitioner to assist Petitioner in its business endeavors.

Petitioner's application to register the same mark for cryptocurrency was also refused registration based on the involved registration and suspended pending the outcome of this proceeding.³³ *Lipton Indus.*, 213 USPQ at 189; see also *King Candy Co. v. Eunice King's Kitchen, Inc.*, 496 F.2d 1400, 182 USPQ 108, 110 (CCPA 1974); *L'Oreal S.A. v. Marcon*, 102 USPQ2d 1434, 1436 n.7 (TTAB 2012).

The aforementioned amply demonstrates that Petitioner has standing as plaintiff, and that it is not a mere intermeddler, and has a reasonable basis for its belief of damage in [*42] connection with Respondent's continued registration of the DIBCOIN mark. *Ritchie v. Simpson*, 50 USPQ2d at 1025-26.

IV. Petitioner's Non-Ownership Claim

Under [Trademark Act Section 1\(a\)](#), 15 U.S.C. § 1051(a), only the

³³ *Id.*, Petty Dec. ¶¶ 34-36; Ex. AH.

owner may apply to register a mark. Whoever controls the nature and quality of goods or services sold under a mark is the owner of that mark. See *In re Wella A.G.*, 787 F.2d 1549, 229 USPQ 274, 278 (Fed. Cir. 1986). Under Trademark Act Section 5, 15 U.S.C. § 1055,

Where a registered mark or a mark sought to be registered is or may be used legitimately by related companies, such use shall inure to the benefit of the registrant or applicant for registration, and such use shall not affect the validity of such mark or of its registration, provided such mark is not used in such manner as to deceive the public.

"The term 'related company' means any person whose use of a mark is controlled by the owner of the mark with respect to the nature and quality of the goods or services on or in connection with which the mark is used." Trademark Act Section 45, 15 U.S.C. § 1127.

As plaintiff in this proceeding, Petitioner must prove its claim by a preponderance of the evidence. See *Bose Corp. v. QSC Audio Prods. Inc.*, 293 F.3d 1367, 63 USPQ2d 1303, 1305 (Fed. Cir. 2002); *Sanyo Watch Co. v. Sanyo Elec. Co.*, 691 F.2d 1019, 215 USPQ 833, 834 (Fed. Cir. 1982) ("As the opposer in this proceeding, appellant bears the burden of proof which encompasses not only the ultimate burden of persuasion, but also the burden of going forward with sufficient proof of the material allegations of the Notice [*43] of Opposition, which, if not countered, negates appellee's right to a registration.").

We find that Petitioner has demonstrated by a preponderance of the evidence that Respondent was not the owner of the DIBCOIN mark on July 20, 2017, when Respondent filed the use-based application that matured into the subject registration. The evidence shows that Respondent's efforts and involvement with the DIBCOIN cryptocurrency coin, and related technology and services associated therewith, were done at the behest and on behalf of Petitioner in his position as Petitioner's Vice President.

The evidence shows that the DIBCOIN cryptocurrency was first created and promoted at the time when Respondent began working for Petitioner — in July 2016. The "compensation agreement" that Respondent signed with Sunshine also makes abundantly clear that Respondent was working on behalf of Sunshine and he agreed that he "shall use his best efforts to promote the interests of [Sunshine]."³⁴ The agreement further provided that "upon termination of this Agreement, the Vice President, shall, upon request forthwith return to [Sunshine] any and all materials whatsoever" regarding the business of

Sunshine.³⁵

During Respondent's [*44] tenure as Vice President for Sunshine and Petitioner up to his resignation in July 2017, Respondent was holding himself out as Sunshine's and Petitioner's representative and the DIBCOIN cryptocurrency was being held out to the public as a product of Petitioner, not Respondent. In email correspondence dated on and around September 26, 2016, from Respondent to a third-party, Respondent identifies himself as "Vice president of [Petitioner and Sunshine]" and states that "we created DIBCOIN the currency for the two companies."³⁶ Respondent goes on to state in the email that "DIBCOIN has something backing it: [Petitioner] which own [sic] [Sunshine] which is a public company and if [Sunshine's ticker symbol] is worth \$1 or 5 billion dollars it is more than what is backing Bitcoin."³⁷ The email is signed "Honson Luma, Vice President . . . Sunshine Capital, Inc. (SCNP) . . . DIB Funding, Inc."³⁸ As illustrated by the press releases that were issued in 2016 and 2017 (discussed *supra*, "Background"), the DIBCOIN cryptocurrency is described as a product of Petitioner.

Respondent, in his brief, makes various factual assertions in support of his contention that he was the creator and only owner of [*45] the mark DIBCOIN in connection with cryptocurrency. However, many of these assertions are either unsupported or contradicted by the evidence of record. Specifically, Respondent states that "DIBCOIN was created and used in commerce long before [Petitioner hired Luma in July or August 2017]."³⁹ Respondent, however, has not produced any evidence to substantiate his claim regarding creation of the mark or testified how he was using it prior to entering into the contract with Petitioner. Indeed, noticeably absent from his testimonial declaration is any specific averment as to Respondent's creating the DIBCOIN cryptocurrency on his own behalf and using the mark to identify himself as the source for any DIBCOIN cryptocurrency or associated technology services. Respondent's assertion that he "sold and distributed the [cryptocurrency] coins under [the DIBCOIN mark]" is contrary to the email correspondence of record wherein Respondent seeks to have the cryptocurrency listed on exchanges while acting in his capacity as Vice President for Sunshine and Petitioner. Although Respondent, in later email

³⁵ *Id.* at 15.

³⁶ 13 TTABVUE 27 (Petty Dec. Ex. F).

³⁷ *Id.*

³⁸ *Id.* at 28.

³⁹ 27 TTABVUE 17.

³⁴ 18 TTABVUE 14 (Luma Dec. Ex. 2).

correspondence, added the moniker "& Creator of DIBCOIN" immediately after his title, this still appeared [*46] above the names and contact information for Sunshine and Petitioner.⁴⁰ In other words, a third-party receiving this type of solicitation or correspondence would perceive Respondent as still acting on behalf of Petitioner and the mark DIBCOIN as being the property of the company(ies) whom Respondent was representing, not Respondent individually.

The mindset of the relevant public is expressed in email correspondence dated September 5, 2017 from counsel for Cryptopia, a third-party currency exchange operator, and addressed to both Respondent and Petitioner.⁴¹ In responding to a request for Cryptopia to delist the DIBCOIN cryptocurrency and reacting to the ongoing dispute between Respondent and Petitioner, Cryptopia's counsel states:⁴²

[E]ven though our initial contact about listing DIBC [the trading symbol for DIBCOIN] was with Mr. Luma [Respondent], we have always believed that Mr. Luma was acting in his capacity as Vice-President of [Petitioner] and not Mr. Luma in his personal capacity. . . We therefore reject [Respondent's] proposition that our contract was with Mr. Luma, as opposed to [Petitioner]. It follows that we are unable to completely disregard [Petitioner's President] Mr. Petty's [*47] position, especially when he spoke in the capacity as the President of [Petitioner].

Respondent also argues that he was the one who "exercised control over the nature and quality of goods on which mark appeared . . . communicated with the various exchanges continually with respect to enhancing the product, adding more exchanges, promotional activities, coin swaps and resumptions of pauses in trading . . . [and] responded to hacks of the system."⁴³ Again, there is no evidence of record to support Respondent's claims that even if he was driving force behind the DIBCOIN cryptocurrency, he was actively performing these duties on his own behalf and that the relevant purchasers of the cryptocurrency regarded Respondent as acting in his individual capacity and as owner of the DIBCOIN mark, versus acting on behalf of his employers Sunshine and Petitioner.

Respondent argues in his brief that he "paid for advertising and

promotion of the trademarked [sic] initially."⁴⁴ Once more, there is no evidence showing that Respondent incurred expenses on his own for advertising cryptocurrency goods or services prior to the filing of the application on July 20, 2017, let alone that such advertising or promotion [*48] pointed to Respondent as the owner of the mark.

We further note that Respondent even acknowledges that Petitioner and Sunshine "sponsored promotions for use of their distribution of [the DIBCOIN cryptocurrency] coin"; however, Respondent contends that Petitioner's "promotion was as manufacturer, and not a distributor."⁴⁵ Regardless of how Respondent characterizes his relationship with Petitioner, there is no evidence indicating how Petitioner's promotion of the DIBCOIN mark in connection with cryptocurrency would inure to Respondent's personal benefit as putative owner of the mark.

Ultimately, the preponderance of the evidence shows that, at the time of filing his application that matured into the subject registration, Respondent was not the owner of the DIBCOIN mark in connection with the services listed in the registration. Petitioner has demonstrated that it, and its related company, Sunshine, were actually the entities using the mark throughout the relevant time period leading up to the filing of Respondent's application. The evidence does not show that Petitioner or Sunshine ever relinquished ownership or control of the mark to Respondent or anyone else. Because Respondent was [*49] not the owner at the time of filing, he was not eligible to apply to register the mark under [Section 1\(a\), 15 U.S.C. § 1051\(a\)](#), the application that matured into Respondent's registration was void ab initio, and the registration is thus void and is cancelled on this ground.

Decision: The petition to cancel Respondent's registration is granted on the ground that Respondent was not the owner of the mark at the time of filing the application that matured into the subject registration. Registration No. 5396033 will be cancelled in due course.

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⁴⁰ 13 TTABVUE; Petty Dec. Ex. G.

⁴¹ *Id.* at 319-323; Petty Dec. Ex. AI.

⁴² *Id.* at 320.

⁴³ 27 TTABVUE 30.

⁴⁴ *Id.*

⁴⁵ 27 TTABVUE 18.

EXHIBIT 27

Mich. Ass'n of Home Builders v. City of Troy

Court of Appeals of Michigan

October 16, 2024, Decided

No. 365166

Reporter

2024 Mich. App. LEXIS 8354 *; 2024 LX 277185; 2024 WL 4508609

MICHIGAN ASSOCIATION OF HOME BUILDERS, Plaintiff-Appellant/Cross-Appellee, and ASSOCIATED BUILDERS AND CONTRACTORS OF MICHIGAN and MICHIGAN PLUMBING AND MECHANICAL CONTRACTORS ASSOCIATION, Plaintiffs, v CITY OF TROY, Defendant-Appellee/Cross-Appellant.

Notice: THIS IS AN UNPUBLISHED OPINION. IN ACCORDANCE WITH MICHIGAN COURT OF APPEALS RULES, UNPUBLISHED OPINIONS ARE NOT PRECEDENTIALLY BINDING UNDER THE RULES OF STARE DECISIS.

Subsequent History: Motion granted by [Mich. Ass'n of Home Builders v. City of Troy, 2025 Mich. LEXIS 26, 2025 WL 52040 \(Jan. 8, 2025\)](#)

Leave to appeal denied by [Mich. Ass'n of Home Builders v. City of Troy, 2025 Mich. LEXIS 1993, 2025 WL 3032629 \(Oct. 29, 2025\)](#)

Prior History: [*1] Oakland Circuit Court. LC No. 2010-115620-CZ.

[Mich. Ass'n of Home Builders v. City of Troy, 2014 Mich. App. LEXIS 432 \(Mich. Ct. App., Mar. 13, 2014\)](#)

Counsel: For MICHIGAN ASSOCIATION OF HOME BUILDERS, Plaintiff - Appellant - Cross-Appellee: MELISSA A HAGEN.

For CITY OF TROY, Defendant - Appellee - Cross-Appellant: ALLAN T MOTZNY, LORI GRIGG BLUHM.

Judges: Before: LETICA, P.J., and BOONSTRA and MARIANI, JJ.

Opinion

PER CURIAM.

Following a bench trial, plaintiff Michigan Association of Home Builders (MAHB) appeals as of right the judgment in favor of MAHB on its claim under the [Stille-DeRossett-Hale Single State Construction Code Act \(CCA\), MCL 125.1501 et seq.](#), and in favor of defendant on MAHB's claim under the [Headlee Amendment, Const 1963, art 9, § 31](#), in this action challenging defendant's Building Department fees.¹ The trial court granted MAHB's request for declaratory and injunctive relief regarding the calculation of defendant's direct and indirect (or overhead) costs incurred in providing services for which the Building Department fees are imposed. Defendant has filed a cross-appeal from the same judgment. We reverse the judgment in favor of defendant on the Headlee Amendment claim and remand for entry of judgment in favor of MAHB on that claim. In all other respects, we affirm.

I. FACTUAL AND PROCEDURAL HISTORY

This case was filed in 2010 and has been the subject of two prior appeals, both of which resulted in the issuance of a Michigan [*2] Supreme Court opinion. See [Mich Ass'n of Home Builders v Troy, 504 Mich 204; 934 NW2d 713 \(2019\) \(MAHB IV\)](#); [Mich Ass'n of Home Builders v Troy, 497 Mich 281; 871 NW2d 1 \(2015\) \(MAHB II\)](#). In [MAHB IV, 504 Mich at 208-211](#), our Supreme Court summarized the underlying factual and procedural history:

Since 2003, [defendant's] Building Department allegedly had been operating with a yearly deficit which, in the aggregate, amounted to \$6,707,216 in 2011. In July 2010, [defendant] privatized the Building Department by entering into a contract with SAFEbuilt Michigan, Inc. (SAFEbuilt), under which SAFEbuilt assumed the duties of the Building Department. Under the terms of the contract, SAFEbuilt would receive 80% of the building inspection fees, and

¹The Building Department fees will sometimes be referred to as building inspection fees, building permit fees, building fees, or fees, all meaning the same thing.

[defendant] would retain the remaining 20% of the fees. The contract also provided that if the fees totaled more than \$1,000,000 for any fiscal year, then SAFEbuilt would only receive 75% of the fees and [defendant] would retain 25% of the fees. [Defendant] has retained over \$250,000 in fees every year since 2011, indicating that the fees totaled more than \$1,000,000 in each of those years. While the Building Department operated at a \$47,354 deficit in 2011, [defendant] retained \$269,483 in fees in 2012, \$488,922 in 2013, and \$325,512 in 2014. Over these three years, [defendant] retained \$1,083,917 in fees, and by 2016, [*3] [defendant] had retained \$2,326,061. [*Id.* at 208-209.]

In December 2010, plaintiffs, MAHB, Associated Builders and Contractors of Michigan (ABCM), and Michigan Plumbing and Mechanical Contractors Association (MPMCA), commenced this action by filing a three-count verified complaint against defendant. [*Id.* at 209.]

Plaintiffs alleged violations of the CCA and the [Headlee Amendment](#), [[Const 1963, art 9, § 31](#)] and they sought declaratory and injunctive relief. They claimed that the building inspection fees generated under [defendant's] contract with SAFEbuilt produced "significant monthly surpluses" that [defendant] used to augment its general fund. Plaintiffs alleged that this practice violates [MCL 125.1522\(1\)](#) [of the CCA], which 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. They also claimed that [defendant's] fee practice is unconstitutional under the Headlee Amendment, which prohibits taxation by local units of government without voter approval. [*Id.*]

"[T]he trial court granted summary disposition to [defendant], ruling that the court did not have jurisdiction over plaintiffs' lawsuit because plaintiffs [*4] had failed to exhaust their administrative remedies under [MCL 125.1509b](#) before filing their complaint." [MAHB IV, 504 Mich at 210](#). This Court affirmed the trial court's decision. [*Id.*, citing [Mich Ass'n of Home Builders v Troy, unpublished per curiam opinion of the Court of Appeals, issued March 13, 2014 \(Docket No. 313688\) \(MAHB I\), 2014 Mich. App. LEXIS 432, rev'd 497 Mich 281; 871 N.W.2d 1 \(2015\)](#)]. Plaintiffs applied for leave to appeal in our Supreme Court, and, after hearing oral argument on whether to grant the application or take other preemptory action, our Supreme Court "reversed the lower courts' decisions and held that the administrative procedure referred to in [MCL 125.1509b](#) did not apply." [MAHB IV, 504 Mich at 210](#), citing [MAHB II, 497 Mich at 288](#). Our Supreme Court remanded the case to the trial court for further proceedings. [MAHB IV, 504 Mich at 210](#),

citing [MAHB II, 497 Mich at 283](#).

After additional discovery on remand, the parties filed competing motions for summary disposition. [MAHB IV, 504 Mich at 210](#). The trial court granted summary disposition to defendant. [*Id.* The court reasoned that defendant's "practice of depositing the fees it had retained into the general fund does not violate [MCL 125.1522\(1\)](#) because that money repaid loans from the general fund that were used to operate the Building Department in times of shortfalls." [*Id.* A majority of this Court affirmed the trial court's decision. [*Id.*, citing [Mich Ass'n of Home Builders v Troy \(After Remand\), unpublished per curiam opinion of the Court of Appeals, issued September 28, 2017 \(Docket No. 331708\) \(MAHB III\), 2017 Mich. App. LEXIS 1521, rev'd 504 Mich 204, 934 N.W.2d 713 \(2019\)](#)]. Judge Jansen dissented and would have reversed the trial court's decision because she did not agree with the majority that defendant's practice comported [*5] with [MCL 125.1522\(1\)](#). [MAHB III, unpub op at 1](#) (JANSEN, J., dissenting).

Plaintiffs applied for leave to appeal in our Supreme Court. [MAHB IV, 504 Mich at 211](#). Ultimately, our Supreme Court reversed this Court's decision and remanded the case to the trial court for further proceedings. [*Id.* at 207-208, 229.]

Our Supreme Court concluded that defendant's "use of building inspection fees for the purpose of satisfying a historical deficit violates the second restriction in [MCL 125.1522\(1\)](#)," i.e., that "the amount of the fee 'shall' be reasonably related to the cost of providing the service." [*Id.* at 216, quoting [MCL 125.1522\(1\)](#)]. And, defendant's "discretion under [MCL 125.1522\(1\)](#) is not unfettered; it is subject to a reasonableness component that ensures payments are related to the costs for building inspection services performed or overhead, not the overall operation of the Building Department." [MAHB IV, 504 Mich at 219](#). Therefore, "[MCL 125.1522\(1\)](#) does not envision a 'surplus' baked consistently into the fees." [*Id.* However, "exactitude is not required, and occasional and incidental surplus would not run afoul of [MCL 125.1522\(1\)](#)." [*Id.* at 219 n 36.]

Our Supreme Court stated that there was evidence that defendant "did not intend that the fees charged bear a reasonable relation to the cost of the services performed." [*Id.* at 219. Under defendant's contract with SAFEbuilt, defendant "retains at least 20% of the [*6] revenue from the building fees but allegedly retains only 8% of that amount to absorb the Building Department's indirect costs." [*Id.* According to defendant, "it uses an 8% estimate, which is derived from a study, for indirect costs." [*Id.* at 219 n 37.]

Our Supreme Court noted that "[e]ven the Court of Appeals majority" in [MAHB III](#) acknowledged that the reasonableness

of a fee would be suspect if it consistently generated revenue that exceeded the cost of the service. *Id.* at 220. The [MAHB III](#) majority concluded that such excessiveness or unreasonableness had not been demonstrated, but our Supreme Court disagreed. *Id.* Rather, our Supreme Court agreed with Judge Jansen's dissent in [MAHB III](#) that defendant

"used its [B]uilding [D]epartment fees to raise \$269,483 in surplus funds in 2012, \$488,922 in 2013, and \$325,512 in 2014, for a total of \$1,083,917 deposited directly into [defendant's] general fund over the course of only three years. This 'surplus' is not negligible. Common sense indicates that it is not incidental." [*Id.*, quoting [MAHB III](#), unpub op at 2 (JANSEN, J., dissenting).]

Our Supreme Court nonetheless recognized that defendant had "presented some evidence of direct and indirect costs that may be related to the services performed and [*7] overhead." [MAHB IV](#), 504 Mich at 220. Our Supreme Court concluded that defendant was

entirely justified in retaining revenue to cover the direct and indirect costs of the services it provides. [MCL 125.1522\(1\)](#) expressly allows [defendant] to establish fees that cover overhead, i.e., indirect costs. But, because there is conflicting evidence in regard to the amount of indirect costs incurred by the Building Department, we remand to the trial court for further proceedings. [*Id.* at 221.]

Although plaintiffs lacked a private cause of action for money damages, a claimed violation of [MCL 125.1522\(1\)](#) could proceed by seeking declaratory and equitable relief. *Id.* at 225-226. That is, "plaintiffs may seek declaratory and injunctive relief to redress present and future violations of [MCL 125.1522\(1\)](#)." *Id.* at 208.

Next, with respect to plaintiffs' Headlee Amendment claim, our Supreme Court explained that "[s]tanding to pursue violations of the Headlee Amendment is given to all taxpayers in the state." *Id.* at 226; see also [Const 1963, art 9, § 32](#) (granting standing to "[a]ny taxpayer of the state" to bring a Headlee Amendment claim). Our Supreme Court concluded that plaintiffs had thus far "failed to provide any record evidence that plaintiffs (or their members for that matter) are taxpayers in the city of Troy and have actually paid [*8] the fees beyond the allegations in the complaint and counsel's representation at oral argument that plaintiffs sometimes pay homeowners' building inspection fees." *Id.* at 229. Our Supreme Court was thus unable to determine at that point whether plaintiffs had established standing. *Id.* Our Supreme Court further stated:

Because we cannot reach the conclusion on this record

that plaintiffs are taxpayers, we do not address the unripe constitutional question whether the challenged fees violate the [Headlee Amendment, Const 1963, art 9, § 31](#). Nonetheless, some of plaintiffs' individual members may be able to establish that they are indeed taxpayers. Thus, we remand to allow plaintiffs to establish representational standing to maintain a claim under the Headlee Amendment. [*Id.* at 229 n 58.]

"On remand, the trial court shall allow plaintiffs' members an opportunity to establish representational standing on plaintiffs' behalf." *Id.* at 208.

Following further discovery on remand, plaintiffs moved for summary disposition pursuant to [MCR 2.116\(C\)\(10\)](#) on both the CCA and [Headlee Amendment](#) claims. In response, defendant requested summary disposition in its favor. In a May 25, 2021 opinion and order, the trial court ruled in favor of MAHB with respect to its standing to pursue a Headlee Amendment claim.² In all [*9] other respects, the trial court ruled that neither party was entitled to summary disposition.

The case proceeded to a two-day bench trial held in August 2022. On February 2, 2023, the trial court issued an opinion granting judgment to MAHB on the CCA claim and judgment to defendant on the Headlee Amendment claim. Despite the earlier summary disposition ruling that MAHB had standing to pursue its Headlee Amendment claim, the trial court's opinion concluded that MAHB lacked standing.³ The court nonetheless stated that, if MAHB had standing to pursue the Headlee Amendment claim, the court would have found that defendant violated the Headlee Amendment. From this judgment, the parties appeal.

II. MAHB'S APPEAL

On appeal, MAHB presents multiple arguments challenging the trial court's bench-trial determination that MAHB lacked standing to pursue its Headlee Amendment claim. MAHB argues that: summary disposition had already been granted in favor of MAHB on the standing issue; defendant did not timely raise the issue of standing and thus waived the issue; MAHB had standing because its members paid the Building Department fees that constituted improper taxes; there was no legal significance to, [*10] or factual basis for, the notion that the fees paid by MAHB's members were passed on to the members' customers; and MAHB's members were not required to be

²The trial court ruled that ABCM and MPMCA lacked standing, and those plaintiffs are no longer involved in the case.

³By the time of the bench trial, the case had an assigned judge different from the judge who decided the summary disposition motion.

qualified electors of the city of Troy in order to have standing for the purpose of a Headlee Amendment claim. We are not convinced by MAHB's argument that defendant waived the issue of standing. We agree with MAHB's remaining arguments regarding standing.

This Court "review[s] a trial court's findings of fact in a bench trial for clear error and its conclusions of law de novo." [Chelsea Investment Group, LLC v Chelsea](#), 288 Mich App 239, 250; 792 NW2d 781 (2010) (citation omitted). Clear error exists if there is no evidentiary support for a finding or if this Court has a definite and firm conviction that a mistake has occurred. *Id.* at 251. "The trial court's findings are given great deference because it is in a better position to examine the facts." *Id.* "Whether a party has standing is a question of law that is reviewed de novo." [MAHB IV](#), 504 Mich at 212.

The interpretation or application of a constitutional provision is reviewed de novo as a question of law. [In re Petition of Muskegon Co Treasurer for Foreclosure](#), Mich App , ; NW3d (2023) (Docket No. 363764); slip op at 3-4, 2023 Mich. App. LEXIS 7760 (citations omitted), lv pending. "A primary rule in interpreting a constitutional provision such as the Headlee Amendment is the rule of common understanding." [MAHB IV](#), 504 Mich at 213 (quotation marks, brackets, and [*11] citation omitted). "A constitution is made for the people and by the people. *The interpretation that should be given it is that which reasonable minds, the great mass of people themselves, would give it.*" *Id.* (quotation marks and citation omitted). The appellate court "typically discerns the common understanding of constitutional text by applying each term's plain meaning at the time of ratification." [Wayne Co v Hathcock](#), 471 Mich 445, 468-469; 684 NW2d 765 (2004).

Review of this issue also entails consideration of the trial court's summary disposition ruling regarding standing. A trial court's decision on a motion for summary disposition is reviewed de novo. [El-Khalil v Oakwood Healthcare, Inc](#), 504 Mich 152, 159; 934 NW2d 665 (2019).

A motion under [MCR 2.116\(C\)\(10\)](#) . . . tests the *factual sufficiency* of a claim. When considering such a motion, a trial court must consider all evidence submitted by the parties in the light most favorable to the party opposing the motion. A motion under [MCR 2.116\(C\)\(10\)](#) may only be granted when there is no genuine issue of material fact. A genuine issue of material fact exists when the record leaves open an issue upon which reasonable minds might differ. *[Id.* at 160 (quotation marks and citations omitted).]

This Court's review of a ruling on a motion for summary disposition is limited to the evidence that had been presented to

the [*12] trial court at the time the motion was decided. [Innovative Adult Foster Care, Inc v Ragin](#), 285 Mich App 466, 475-476; 776 NW2d 398 (2009).

In [Lansing Sch Ed Ass'n v Lansing Bd of Ed](#), 487 Mich 349, 372; 792 NW2d 686 (2010), our Supreme Court explained standing principles:

We hold that Michigan standing jurisprudence should be restored to a limited, prudential doctrine that is consistent with Michigan's longstanding historical approach to standing. Under this approach, a litigant has standing whenever there is a legal cause of action. Further, whenever a litigant meets the requirements of [MCR 2.605](#), it is sufficient to establish standing to seek a declaratory judgment. Where a cause of action is not provided at law, then a court should, in its discretion, determine whether a litigant has standing. A litigant may have standing in this context if the litigant has a special injury or right, or substantial interest, that will be detrimentally affected in a manner different from the citizenry at large or if the statutory scheme implies that the Legislature intended to confer standing on the litigant.

"[U]nder Michigan law, an organization has standing to advocate for the interests of its members if the members themselves have a sufficient interest." *Id.* at 373 n 21. "[S]tanding is a limited, prudential doctrine, the purpose of which is to assess whether a litigant's interest in the [*13] issue is sufficient to ensure sincere and vigorous advocacy." [League of Women Voters of Mich v Secretary of State](#), 506 Mich 561, 590; 957 NW2d 731 (2020) (quotation marks and citations omitted). The outset of the case is generally the relevant time period in assessing standing. *Id.*

"Traditionally, a private citizen has no standing to vindicate a public wrong or enforce a public right if he or she has not been injured in a manner that is different from the public at large." [MAHB IV](#), 504 Mich at 226. Hence, "under general standing principles, a taxpayer has no standing to challenge the expenditure of public funds if the threatened injury to him or her is no different than that to taxpayers generally." *Id.* However, "[s]tanding to pursue violations of the Headlee Amendment is given to all taxpayers in the state." *Id.* [Const 1963, art 9, § 32](#) provides:

Any taxpayer of the state shall have standing to bring suit in the Michigan State Court of Appeals⁴ to enforce the

⁴ A Headlee Amendment claim may also be brought in the circuit court, as occurred in the instant case. [Wayne Co Chief Executive v Governor](#), 230

provisions of [Sections 25 through 31](#), inclusive, of this Article and, if the suit is sustained, shall receive from the applicable unit of government his costs incurred in maintaining such suit.

Our Supreme Court has explained:

In enacting the Headlee amendment the voters were concerned with ensuring control of local funding and taxation by the people most affected, the local taxpayers. The [*14] Headlee Amendment is the voters' effort to link funding, taxes, and control. Specifically relevant to the case at bar, we [have] held that [§ 32](#) is an explicit grant of standing to taxpayers to bring suits under the Headlee Amendment. [*MAHB IV*, 504 Mich at 227 (quotation marks, brackets, ellipsis, and citation omitted).]

In [MAHB IV](#), 504 Mich at 229, our Supreme Court noted that plaintiffs in the present case had "failed to provide any record evidence that plaintiffs (or their members for that matter) are taxpayers in the city of Troy and have actually paid the fees beyond the allegations in the complaint and counsel's representation at oral argument that plaintiffs sometimes pay homeowners' building inspection fees." Our Supreme Court was thus unable to conclude at that point that plaintiffs had established standing. *Id.* The Court stated that "some of plaintiffs' individual members may be able to establish that they are indeed taxpayers." *Id.* at 229 n 58. The Court therefore remanded the case to the trial court "to allow plaintiffs to establish representational standing to maintain a claim under the Headlee Amendment." *Id.*

On remand, plaintiffs moved for summary disposition under [MCR 2.116\(C\)\(10\)](#). Plaintiffs argued that they possessed standing to pursue their Headlee [*15] Amendment claim because their members were taxpayers in the city of Troy and had paid fees to defendant's Building Department for building permits and inspection services. Plaintiffs attached affidavits to support this argument. Lee Schwartz's affidavit averred that he was an executive vice president for MAHB. He identified three members of MAHB who were "tax paying entities" and paid Building Department fees to defendant in 2010, the year this lawsuit was filed.

On May 25, 2021, the trial court issued an opinion and order holding, in relevant part, that MAHB had standing to pursue a Headlee Amendment claim. The trial court noted that Schwartz's affidavit attested that three specific members of MAHB paid defendant's building fees in 2010, the year this lawsuit was filed, which was the pertinent time period for standing purposes. The trial court rejected defendant's "pass-

through" argument, i.e., that MAHB lacked standing because its members were reimbursed by their customers for the fees. Defendant's argument was premised on a comment by Chief Justice Young during oral argument before our Supreme Court in 2015, but our Supreme Court never adopted that position, and no authority supported [*16] it. The trial court stated that such a framework was absurd because it would, for example, deprive a landlord of standing to sue over property tax matters merely because the landlord received rent from tenants to cover the cost of the property taxes. In light of the documentation that MAHB's members paid the building fees, MAHB had standing to pursue a Headlee Amendment claim. Defendant should not be able to accept the fees from MAHB's members but remain insulated from legal challenge. MAHB "established that it paid the Building Department fees and, in the absence of any authority to the contrary, this [c]ourt holds that [MAHB] therefore has standing to pursue a Headlee Amendment claim."

Despite the trial court's ruling on the standing issue at the summary disposition stage, defendant again raised the standing issue in defendant's trial brief and posttrial brief. In its February 2, 2023 bench-trial opinion,⁵ the trial court noted that MAHB did not present any additional evidence on the standing issue at trial. According to the trial court, defendant's building official, Salim Omar Huerta, testified that a building contractor may initially pay the fee but that the fee is passed on to [*17] the homeowner. The court stated that the May 25, 2021 summary disposition ruling did not foreclose further consideration of the issue of standing. The court asserted that standing may be raised at any time and that the burden to establish standing increases over the course of the proceeding. The court held that because defendant continued to raise the issue of standing, MAHB was required to present evidence at trial on the issue. Moreover, MAHB was obligated to present evidence at trial that it was a qualified elector and taxpayer in the city of Troy. The court found that MAHB adduced no evidence at trial that its "members have paid [B]uilding [D]epartment fees throughout the pendency of this action." The trial court was also "troubled" by what it characterized as Huerta's testimony that "the homebuilders pay the building fees but ultimately these fees are passed on to homeowners. Therefore, the real injury is to the homeowners and not [MAHB] who is merely the 'middleman' for the fees." The court thus concluded that MAHB "did not establish that its members were taxpayers in the [c]ity of Troy who were injured by [defendant's] building fees."

"[S]tanding is not a jurisdictional issue, [*18] and should be raised by one of the parties in order to be put in issue."

[Mich App 258, 270; 583 NW2d 512 \(1998\)](#).

⁵ As noted earlier, the judge who decided the summary disposition motion was not the judge who issued the bench-trial opinion.

[Associated Builders & Contractors of Mich v State Treasurer](#), [Mich App](#) , ; [NW3d](#) (2024) (Docket No. 369314); slip op at 8, 2024 Mich. App. LEXIS 1783, lv pending. This Court has thus rejected the argument "that the issue of standing may be raised for the first time on appeal because it pertains to jurisdiction." *Id.*, quoting [In re Pollack Trust](#), [309 Mich App 125, 154; 867 NW2d 884](#) (2015). A defendant's failure to raise the issue of standing in the first responsive pleading or a motion filed before that pleading results in the waiver of the issue. [Glen Lake-Crystal River Watershed Riparians v Glen Lake Ass'n](#), [264 Mich App 523, 528; 695 NW2d 508](#) (2004).

We are not convinced by MAHB's argument that defendant waived the standing issue. MAHB says that defendant did not raise the issue of standing and that the issue was first raised by Chief Justice Young during the oral argument before our Supreme Court in 2015. It is true that defendant did not assert lack of standing in its list of affirmative defenses filed with its answer on January 12, 2011. However, defendant's answer denied an allegation of the complaint that was pertinent to standing. In ¶ 6 of their complaint, plaintiffs alleged that they and their members were injured and that they either absorbed the costs of the building fees or were forced to pass the costs along to their customers, putting plaintiffs and their members at a competitive disadvantage. In its answer, [*19] defendant responded to that allegation by stating that "[d]efendant denies the allegation that [p]laintiffs are harmed by [defendant]." Although not an explicit reference to standing, this part of the answer could be viewed as implicating the issue of standing. Moreover, the first document that defendant filed in this case was a December 17, 2010 brief responding to plaintiffs' motion for a preliminary injunction and order to show cause. In that brief, defendant asserted, "No emergency exists and it is very unlikely that the [p]laintiffs will [have] success on the merits, if in fact they even have standing to present this matter to the [c]ourt." Although this was not a direct assertion that plaintiffs lacked standing, this statement suggested that standing was an issue. Overall, we are not convinced that defendant waived the issue of standing.

Also, our Supreme Court in *MAHB IV* remanded the case to the trial court for a resolution of the standing issue. Our Supreme Court stated that, on remand, plaintiffs would be allowed to establish standing. [MAHB IV](#), [504 Mich at 229 n 58](#). Our Supreme Court made no reference to consideration of whether the standing issue had been waived. That is, our Supreme Court indicated that [*20] the trial court's task on remand was to determine whether plaintiffs had standing, not whether defendant waived the standing issue. "It is the duty of the lower court or tribunal, on remand, to comply strictly with the mandate of the appellate court." [Glenn v TPI Petroleum, Inc](#), [305 Mich App 698, 706; 854 NW2d 509](#) (2014) (quotation

marks and citations omitted). The trial court was thus required to resolve the issue of standing on its own merits rather than deem the issue waived.

In its May 25, 2021 summary disposition opinion and order, the trial court thoroughly analyzed the standing issue and concluded that MAHB "has standing to pursue a Headlee Amendment claim." In support of its motion, MAHB presented Schwartz's affidavit, which attested that three specific members of MAHB paid defendant's building fees in 2010, the year this lawsuit was filed. This affidavit further indicated that many more members paid the fees in subsequent years, up to the time the summary disposition motion was filed, although, as noted, the outset of the case is generally the relevant time period in assessing standing. [League of Women Voters](#), [506 Mich at 590](#). Defendant presented no evidence contesting the averments in Schwartz's affidavit. Therefore, the evidence provided at the summary disposition stage established [*21] beyond dispute that MAHB's members paid the fees that were alleged to constitute unlawful taxes under the Headlee Amendment. MAHB thus possessed standing to advocate for the interests of its members because some of the members themselves had a sufficient interest. [Lansing Sch](#), [487 Mich at 373 n 21](#).

The trial court's May 25, 2021 opinion and order also correctly rejected defendant's so-called "pass-through" argument, i.e., the notion that MAHB's members, who were builders, paid the building fees but were reimbursed by their customers, i.e., the homeowners. Defendant's "pass-through" theory was derived from a comment made by Chief Justice Young during the 2015 oral argument in our Supreme Court. But our Supreme Court itself did not adopt that theory, and defendant has cited no authority supporting such a theory. The trial court agreed with MAHB that,

as an example, such a framework would prevent landlords from ever contesting matters related to property taxes, since tenants pay monthly rent to the landlord that is most certainly meant to cover the cost of the landlords' property taxes. This would mean a property owner would not have standing to sue over property tax matters—an absurd result. It is the same here. If [MAHB's] [*22] members are the ones who paid the Building Department fees, they may challenge it under the Headlee Amendment—the [c]ourt sees no reason why [defendant] should be able to accept the builders' money but remain insulated from the builders' legal challenge. [MAHB] has established that it paid the Building Department fees and, in the absence of any authority to the contrary, this [c]ourt holds that [MAHB] therefore has standing to pursue a Headlee Amendment claim.

The trial court's analysis was convincing. The court correctly

rejected defendant's "pass-through" theory and concluded that MAHB possessed standing to pursue its Headlee Amendment claim.

Despite the resolution of the standing issue at the summary disposition stage, the trial court's February 2, 2023 bench-trial opinion revisited the issue and concluded that MAHB lacked standing to pursue its Headlee Amendment claim. MAHB contends that the trial court was foreclosed from examining the standing issue at the bench trial in light of the earlier summary disposition decision. We disagree.

The litigation was filed in 2010 and assigned to Oakland Circuit Court Judge Shalina Kumar. In May 2021, the summary disposition ruling addressing [*23] standing was rendered by Judge Kumar. But, at the time of the bench trial in August 2022, Oakland County Circuit Court Judge David Cohen presided over the matter. Judge Cohen was not bound by the prior standing decision rendered by Judge Kumar. A circuit court judge is required to follow published decisions of the Court of Appeals and Michigan Supreme Court. [People v Hunt, 171 Mich App 174, 180; 429 NW2d 824 \(1998\)](#). "There is no similar requirement that one circuit . . . judge follow the decision of the other." *Id.* Rather, a published decision of the Court of Appeals is controlling precedent, MCR 7.215(C)(2), unless our Supreme Court takes other action, [Holland Home v Grand Rapids, 219 Mich App 384, 394; 557 NW2d 118 \(1996\)](#).

Although Judge Cohen was not foreclosed from revisiting the issue of standing rendered by the prior circuit judge, we nonetheless question whether the issue of standing was properly presented as an issue to be determined at trial. Defendant sought neither reconsideration nor an interlocutory appeal of the trial court's May 25, 2021 opinion and order concluding that MAHB possessed standing to pursue its Headlee Amendment claim. Instead, defendant ignored that ruling and simply presented the issue again, over 14 months later, in its trial brief. And the trial court did little to refine or define the issues [*24] to be determined at trial; instead, in a May 10, 2022 order, the trial court simply directed the parties to file trial briefs two weeks before the scheduled trial date and allowed the parties, in those briefs, to "outlin[e] any and all issues involved in this action." We are left less than convinced that defendant or the trial court properly placed MAHB on notice that it would be required to present evidence at trial, over and above that presented at the summary disposition stage, regarding standing. In any event, we conclude that the standing decision rendered on summary disposition was correct. Defendant provided no basis for revisiting the issue at the bench trial. At trial, defendant did not present evidence or controvert the affidavits submitted by MAHB addressing standing. Judge Cohen expressed concern about the "pass-through" theory; the fact that "the

homebuilders pay the building fees but ultimately these fees are passed on to homeowners. Therefore, the real injury is to the homeowners and not [MAHB] who is merely the 'middleman' for the fees." However, the testimony addressing "pass-through" was given by Huerta, who acknowledged that he was only speculating about the fees [*25] being passed on to homeowners. Huerta noted that if a contractor paid the fee, he was unaware of the source or whether it was recouped from the homeowner. Huerta admitted that he lacked personal knowledge of how the fee payment occurred. Judge Cohen clearly erred by relying on this speculation. There was no evidence that the fees paid by MAHB's members were passed on to homeowners. Also, as discussed earlier, even if such a "pass-through" of costs occurred, the trial court's summary disposition ruling correctly noted the analytical flaws of defendant's novel theory and the lack of authority to support it.

The trial court further erred in its bench-trial opinion by stating that MAHB's standing hinged on whether its members were qualified electors in the city of Troy. There is no such requirement in order to have standing to pursue a Headlee Amendment claim. As explained earlier, "[s]tanding to pursue violations of the Headlee Amendment is given to all taxpayers in the state." [MAHB IV, 504 Mich at 226; Const 1963, art 9, § 32](#). Further, our Supreme Court in *MAHB IV* remanded this case to the trial court to determine, *inter alia*, whether some of MAHB's members were taxpayers and whether MAHB thus had representational standing to maintain [*26] a claim under the Headlee Amendment. [MAHB IV, 504 Mich at 229 n 58](#). As the trial court correctly ruled at the summary disposition stage, some of MAHB's members paid the fees alleged to constitute unlawful taxes and thus qualified as taxpayers entitled to pursue a Headlee Amendment claim.

In concluding that MAHB's members were required to be qualified electors in order to have standing, the trial court's bench-trial opinion relied on another provision of the [Headlee Amendment, Const 1963, art 9, § 31](#), which states, in relevant part:

Units of Local Government are hereby prohibited from levying any tax not authorized by law or charter when this section is ratified or from increasing the rate of an existing tax above that rate authorized by law or charter when this section is ratified, without the approval of a majority of the qualified electors of that unit of Local Government voting thereon.

However, this provision does not address standing. It does not state that only qualified electors have standing to bring a Headlee Amendment claim. Rather, it provides that a new tax or tax increase may not be imposed without the approval of a

majority of the qualified electors. This does not alter the fact that [Const 1963, art 9, § 32](#) grants standing to all taxpayers in the state.

The trial [*27] court stated that these two constitutional provisions must be read together and that a liberal construction in favor of defendant was required by [Const 1963, art 7, § 34](#), which provides, in relevant part, "The provisions of this constitution and law concerning counties, townships, cities and villages shall be liberally construed in their favor." But the meaning of [Const 1963, art 9, § 32](#) is plain. It unambiguously grants standing to taxpayers and does not refer to qualified electors. See [Hathcock, 471 Mich at 468-469](#) ("This Court typically discerns the common understanding of constitutional text by applying each term's plain meaning at the time of ratification."). There is no need for construction, liberal or otherwise, to discern the meaning of the language of [Const 1963, art 9, § 32](#). See [AFP Specialties, Inc v Vereyken, 303 Mich App 497, 505; 844 NW2d 470 \(2014\)](#) (a liberal-construction rule was inapplicable because the statutory provision at issue was unambiguous and thus "need[ed] no construction, liberal or otherwise, to determine its meaning."); [Riverview v Sibley Limestone, 270 Mich App 627, 631; 716 NW2d 615 \(2006\)](#) (noting that "[l]aws concerning a city must be liberally construed in its favor" under [Const 1963, art 7, § 34](#), but that "the primary purpose of statutory interpretation is to give effect to legislative intent," which is determined by the statutory language if it is unambiguous). The trial court's imposition of a "qualified elector" [*28] requirement for standing contravened the clear text of [Const 1963, art 9, § 32](#).

Accordingly, we agree with MAHB that it possessed standing to pursue its Headlee Amendment claim. The trial court erred in its bench-trial opinion in concluding that MAHB lacked standing on that claim. Moreover, the trial court determined that, if MAHB had standing, its Headlee Amendment claim would succeed on the merits, i.e., that defendant violated the Headlee Amendment because its building fees were unlawful taxes. As will be explained, the trial court did not err in that determination. We thus reverse the judgment for defendant on the Headlee Amendment claim and remand for entry of judgment in favor of MAHB on that claim.

Defendant asserts an alternative ground for affirming the judgment in its favor on the Headlee Amendment claim. Defendant argues that the trial court erred in finding that, if MAHB had standing, its Headlee Amendment claim would succeed on the merits. We disagree with defendant's argument.

"There is no bright-line test for distinguishing between a valid user fee and a tax that violates the Headlee Amendment." [Bolt v Lansing, 459 Mich 152, 160; 587 NW2d 264 \(1998\)](#). "In general,

'a fee is exchanged for a service rendered or a benefit conferred, and some reasonable [*29] relationship exists between the amount of the fee and the value of the service or benefit. A tax, on the other hand, is designed to raise revenue.'" [Shaw v Dearborn, 329 Mich App 640, 653; 944 NW2d 153 \(2019\)](#), quoting [Bolt, 459 Mich at 161](#).

Under [Bolt](#), courts apply three key criteria when distinguishing between a user fee and a tax: (1) "a user fee must serve a regulatory purpose rather than a revenue-raising purpose"; (2) "user fees must be proportionate to the necessary costs of the service"; and (3) a user fee is voluntary in that users are "able to refuse or limit their use of the commodity or service." [[Shaw, 329 Mich App at 653](#), quoting [Bolt, 459 Mich at 161-162](#).]

"These criteria are not to be considered in isolation, but rather in their totality, such that a weakness in one area would not necessarily mandate a finding that the charge is not a fee." [Shaw, 329 Mich App at 653](#) (quotation marks and citation omitted).

"A fee charged by a municipality is presumed reasonable unless it is facially or evidently so wholly out of proportion to the expense involved that it must be held to be a mere guise or subterfuge to obtain the increased revenue." [Id. at 654](#) (quotation marks and citation omitted). This presumption of reasonableness is pertinent to the second [Bolt](#) factor regarding the proportionality of a charge imposed by a city. [Id.](#) This presumption can [*30] be overcome by presenting sufficient evidence to the contrary. [Id. at 654-655](#).

In its bench-trial opinion, the trial court analyzed the merits of the Headlee Amendment claim by applying the [Bolt](#) test. The court concluded:

If [MAHB] had established standing at trial, the [c]ourt would have found a violation of the Headlee Amendment because the [c]ourt finds there was not proportionality between the fees and cost of services, therefore creating an unauthorized surplus that was revenue generating. Further, the [c]ourt finds that [the] fees were not voluntary. Homeowners did not have a choice about the use of building services to carry out necessary repairs. If a homeowner chose not to do a repair, he risked making his property uninhabitable.

The trial court did not err in its application of the [Bolt](#) test. The first two [Bolt](#) factors are closely related and may be analyzed together. [Graham v Kochville Twp, 236 Mich App 141, 151; 599 NW2d 793 \(1999\)](#). Evidence supported the trial court's finding that there was a lack of proportionality between the fees and the cost of services and that this generated revenue in the form of

an unauthorized surplus. In 2010, defendant privatized its Building Department by entering into a contract with SAFEbuilt. Under that contract, defendant retained [*31] 20% to 25% of the Building Department fees. Defendant's own financial records revealed that, following the privatization of the Building Department, defendant consistently generated significant surplus fees every year from 2012 to 2019, resulting in a total surplus of more than \$3.2 million for that time period. This indicates that the excessive portion of the fees served a revenue-raising purpose and that there was a lack of proportionality between the amount of the fees and the cost of service. This conclusion is supported by the testimony of Patrick Anderson, MAHB's expert on economics, public finance, and the Headlee Amendment. Anderson opined that consistently raising revenue to such an extent indicated a revenue-raising purpose and that the excessive portion of the fees that contributed to a surplus qualified as a tax.

Further, Anderson concluded that defendant was blatantly misrepresenting its building inspection costs for the 2019-2020 and 2020-2021 fiscal years. Defendant was including costs from other city departments, even when those departments received separate fees for the relevant activity, thereby engaging in what Anderson viewed as an impermissible "double dip." Anderson [*32] viewed it as inappropriate to charge a building inspection fee to pay for services performed by departments other than the Building Department. From reviewing the city budgets and the Comprehensive Annual Financial Reports (CAFRs), Anderson determined that there were internal inconsistencies in the CAFRs and that defendant was earning more in fees than the amount of its actual costs each year. Anderson believed this could explain why defendant was changing its manner of determining costs; defendant was claiming to have lost money in performing building inspection services. Defendant was improperly counting more than \$400,000 in costs from other departments as direct costs of the Building Department and then calculating indirect costs as a percentage of the alleged direct costs. Anderson stated that defendant was engaging in a "triple dip" by counting as indirect costs a percentage of alleged direct costs from other departments for which defendant collected a separate fee.

Anderson thus believed that defendant collected excessive fees that bore no relationship to the costs of the Building Department. He opined that these excessive fees deposited into the general fund constituted an unauthorized [*33] tax that violated the Headlee Amendment.

The trial court found that Anderson testified in a credible and forthright manner and that his testimony was persuasive. This Court "give[s] deference to the trial court's superior ability to judge the credibility of the witnesses who appeared before it."

[Glen Lake-Crystal River Watershed Riparians](#), 264 Mich App at 531 (quotation marks and citations omitted).

The trial court's findings regarding the first two [Bolt](#) factors were consistent with its findings on the CCA claim. The court found that defendant "increased its direct costs using 'costs' not envisioned by the CCA. These newly designated 'direct costs' escalated the indirect costs proportionately. [Defendant] used this analysis to continue to justify retaining surplus funds." Defendant's "financial reports clearly show that the actual costs of their [B]uilding [D]epartment fell under budget for calendar [sic: fiscal] years ending in 2020 and 2021. The [c]ourt agrees with Mr. Anderson's testimony that [defendant] can only charge for building code work and that other city departments are not performing such work." The court also agreed with Anderson that defendant could not "double dip and charge for services that have separate fees such as [Freedom of Information Act \(FOIA\)](#), [MCL 15.231 et seq.](#) requests, multifamily [*34] property inspections, soil erosion and sidewalk permits and [F]ire [D]epartment inspections. [Defendant] also cannot charge for services provided by the [c]ity [c]lerk and [t]reasurer as these are constitutionally mandated offices."

Overall, the evidence at trial supported the trial court's findings regarding the first two [Bolt](#) factors. The trial court did not err in finding a lack of "proportionality between the fees and cost of services, therefore creating an unauthorized surplus that was revenue generating."

Nor did the trial court err in its finding regarding the third [Bolt](#) factor, i.e., whether the fees were voluntary. The trial court found "that [the] fees were not voluntary. Homeowners did not have a choice about the use of building services to carry out necessary repairs. If a homeowner chose not to do a repair, he risked making his property uninhabitable."

Our Supreme Court has rejected the proposition

that property owners can control the amount of the fee they pay by building less on their property. . . . [W]e do not find that this is a legitimate method for controlling the amount of the fee because it is tantamount to requiring property owners to relinquish their rights of ownership [*35] to their property by declining to build on the property. [[Bolt](#), 459 Mich at 168.]

Moreover, the testimony of defendant's building official, Huerta, supported the trial court's finding on this factor. Huerta agreed that a building permit is required if a furnace or electric water heater fails and must be replaced. If water pipes break and must be replaced, a building permit is required in some instances. If an upstairs washing machine breaks and leaks

water, a building permit is required to replace rotting floor and ceiling. Payment of a building permit fee is not voluntary if an incident occurs that requires such work. The trial court aptly noted that a homeowner would risk making their property uninhabitable by declining to perform necessary repairs. Overall, the court did not err in its finding on this factor.

Accordingly, the trial court properly found that the application of the [Bolt](#) factors leads to the conclusion that the building fee constituted a tax and that defendant therefore violated the Headlee Amendment. Because MAHB had standing to pursue its Headlee Amendment claim and the trial court correctly found a violation of the Headlee Amendment, we reverse the judgment for defendant and remand for entry [*36] of judgment in MAHB's favor on this claim.

III. DEFENDANT'S CROSS-APPEAL

Defendant first argues on cross-appeal that the trial court erred in denying the request for summary disposition in its favor on the CCA claim. Specifically, defendant asserts that it presented sufficient evidence to support a ruling in its favor on the CCA claim and that the judiciary lacks authority to review the discretionary action of its City Council in setting the fee amounts. We disagree.⁶

A trial court's decision on a motion for summary disposition is reviewed de novo. [El-Khalil](#), 504 Mich at 159. MAHB moved for summary disposition under [MCR 2.116\(C\)\(10\)](#). In response, defendant requested summary disposition in its favor pursuant to [MCR 2.116\(I\)\(2\)](#). "If, after careful review of the evidence, it appears to the trial court that there is no genuine issue of material fact and the opposing party is entitled to judgment as a matter of law, then summary disposition is properly granted under [MCR 2.116\(I\)\(2\)](#)." [Lockwood v Ellington Twp](#), 323 Mich App 392, 401; 917 NW2d 413 (2018) (citation omitted). This Court considers de novo whether the judiciary has constitutional and statutory authority to review a municipal decision. See

⁶Defendant's principal brief on cross-appeal also asserts that MAHB's remedy was to present its position to its City Council or to submit an inquiry to the Michigan Department of Treasury. In its brief on cross-appeal, MAHB interprets this argument to mean that MAHB failed to exhaust its administrative remedies. MAHB argues in response that our Supreme Court ruled in 2015 that MAHB was not required to exhaust administrative remedies before filing this lawsuit, see [MAHB II](#), 497 Mich at 288, and ruled in 2019 that MAHB had a private cause of action for declaratory and injunctive relief to redress violations of the CCA, see [MAHB IV](#), 504 Mich at 225-226. In its reply brief, defendant expressly states that it is *not* making an exhaustion-of-administrative-remedies argument. In light of defendant's clarification in its reply brief that it is not making such an argument, we will not address exhaustion of administrative remedies.

[Warda v Flushing City Council](#), 472 Mich 326, 330; 696 NW2d 671 (2005) (citations omitted).

[MCL 125.1522\(1\)](#) states:

The legislative body of a governmental subdivision shall establish reasonable fees to be charged by [*37] the governmental subdivision for acts and services performed by the enforcing agency or construction board of appeals under this act, which fees shall be intended to bear a reasonable relation to the cost, including overhead, to the governmental subdivision of the acts and services, including, without limitation, those services and acts as, in case of an enforcing agency, issuance of building permits, examination of plans and specifications, inspection of construction undertaken pursuant to a building permit, and the issuance of certificates of use and occupancy, and, in case of a board of appeals, hearing appeals in accordance with this act. The enforcing agency shall collect the fees established under this subsection. The legislative body of a governmental subdivision shall only use fees generated under this section for the operation of the enforcing agency or the construction board of appeals, or both, and shall not use the fees for any other purpose.

In [MAHB IV](#), 504 Mich at 216, our Supreme Court explained:

The parties agree that [MCL 125.1522\(1\)](#) places three restrictions on a municipality's authority to establish fees under the CCA. One—the amount of the fee "shall" be reasonable. Two—the amount of the fee "shall" be [*38] reasonably related to the cost of providing the service. And three—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.

Our Supreme Court noted that defendant's "discretion under [MCL 125.1522\(1\)](#) is not unfettered; it is subject to a reasonableness component that ensures payments are related to the costs for building inspection services performed or overhead, not the overall operation of the Building Department." [MAHB IV](#), 504 Mich at 219. "[MCL 125.1522\(1\)](#) does not envision a 'surplus' baked consistently into the fees." [MAHB IV](#), 504 Mich at 219. But defendant is permitted to retain "revenue to cover the direct and indirect costs of the services it provides." [Id.](#) at 221. The Court agreed with defendant that "there is no mandate to set fees that exactly match the expenditures, especially since the fee setting process can only be a best estimate of what the future revenue and expenses will be in the coming year." [Id.](#) at 222 (quotation marks omitted). "[MCL 125.1522\(1\)](#) requires only that the 'fees shall be

intended to bear a reasonable relation to the cost, including overhead.' Exactitude is not required." [MAHB IV, 504 Mich at 222](#). Our Supreme Court remanded the case to the trial court for further findings [*39] on the amount of costs. *Id.*

The trial court correctly determined that a genuine issue of material fact existed regarding whether defendant violated the CCA. Defendant suggests that its evidence, including an affidavit of its Chief Financial Officer (CFO), Rob Maleszyk, provided "a sufficient basis to rule in [defendant's] favor" on the CCA claim. But there was conflicting evidence at the summary disposition stage regarding the amount of defendant's indirect costs in the 2018-2019 fiscal year. Indeed, defendant itself repeatedly altered its methodology for determining costs following our Supreme Court's decision in *MAHB IV*. MAHB's position regarding the amount of indirect costs was supported by the affidavit and report of its expert, Anderson.⁷ The trial court aptly noted the parties' widely varying calculations of indirect costs. The trial court found it troubling that defendant at one point used a methodology to arrive at \$780,728.86 in indirect costs, which was roughly four times the amount of its original calculation, after our Supreme Court ruled in *MAHB IV* that defendant had accumulated an unlawful surplus. See [MAHB IV, 504 Mich at 220](#). Also, the trial court found it concerning that defendant "did not [*40] include this new analysis in its [2019-]2020 CAFR, instead reverting to its old methodology while arguing something different in this [c]ourt."

The conflicting evidence precluded a grant of summary disposition to either party on the CCA claim. Summary disposition is improper when the evidence is conflicting. [Patrick v Turkelson, 322 Mich App 595, 605; 913 NW2d 369 \(2018\)](#) (citation omitted). "A trial court may not weigh evidence when ruling on a summary disposition motion, or make credibility determinations." [Bank of America, NA v Fidelity Nat'l Title Ins Co, 316 Mich App 480, 512; 892 NW2d 467 \(2016\)](#) (citations omitted). "It is for the trier of fact to assess credibility . . ." *Id.*

We also reject defendant's argument that the judiciary lacks authority to review the discretionary action of its City Council in determining the fee amounts. Defendant cites [Warda](#) for the proposition that the judiciary is precluded from reviewing the discretionary action of a legislative body. Defendant's reliance on [Warda](#) is misplaced.

⁷Defendant notes that Anderson lacked municipal finance experience, but it provides no basis to question Anderson's expertise in economics, public finance, and the Headlee Amendment. Any gaps or weaknesses in a witness's expertise affects the weight of the witness's testimony, not its admissibility; and, it is generally for the trier of fact to decide the extent of a witness's expertise. [Surman v Surman, 277 Mich App 287, 309-310; 745 NW2d 802 \(2007\)](#).

In [Warda, 472 Mich at 329-330](#), our Supreme Court considered whether a municipality's decision to deny a police officer's request for reimbursement of attorney fees under [MCL 691.1408\(2\)](#) was subject to judicial review. The Court noted that the statute used the word "may," which indicated "that the decision to pay an officer's attorney fees is a matter left to the discretion of [*41] the municipality." [Warda, 472 Mich at 332](#). The Court further observed "that the statute does not limit or qualify the word 'may' (with, for instance, a requirement of reasonableness) or provide any other standards by which that discretion is to be exercised." *Id.* Hence, the municipal defendant's "city council had full discretion under [MCL 691.1408\(2\)](#) in choosing whether to reimburse plaintiff's attorney fees." [Warda, 472 Mich at 332](#).

While the statute affords the city council the discretion to decide whether to reimburse a claim for attorney fees, the statute says nothing about the limits within which that discretion is to be exercised, let alone by which an appellate court would be guided in its review of a decision made pursuant to that discretion. As such, the Flushing city council's action to deny reimbursement of attorney fees is conclusive. [\[Id. at 333.\]](#)

"[B]ecause the statute provides no limits within which the city council's discretion is to be exercised, let alone by which an appellate court would be guided in its review of an exercise of that discretion, [MCL 691.1408\(2\)](#) affords plaintiff no basis for relief." [Warda, 472 Mich at 335](#). In sum, "a judicially comprehensible standard is required in order to enable judicial review. Here, there is no such standard." [Id. at 339](#).

In contrast to the [*42] statute at issue in [Warda](#), [MCL 125.1522\(1\)](#) provides judicially comprehensible standards to guide the judiciary in reviewing the discretionary municipal determination of the amount of building fees. Our Supreme Court in *MAHB IV* explained that three restrictions were placed on a municipality's authority to enact CCA fees—a reasonable amount, a reasonable relationship to the cost of providing the service, and the fees shall only be used for the operation of the enforcement agency. [MAHB IV, 504 Mich at 216](#). And, this reasonableness component stated in [MCL 125.1522\(1\)](#) was not unfettered but must bear a relationship to the costs of building inspection services. [MAHB IV, 504 Mich at 219](#). Hence, [MCL 125.1522\(1\)](#) provides criteria for the judiciary to apply that were found to be lacking in the statute at issue in [Warda](#). Judicial review is thus permitted in the instant case.

Defendant next argues on cross-appeal that it was entitled to summary disposition regarding whether MAHB had standing to pursue its Headlee Amendment claim. This issue was already

addressed in the context of MAHB's appeal. As explained earlier, the trial court at the summary disposition stage properly ruled in favor of MAHB on the standing issue. Defendant presents no argument on cross-appeal that was not already considered [*43] earlier. We thus reject defendant's argument that it was entitled to summary disposition on the standing issue.

Defendant further argues that it was entitled to summary disposition on the merits of MAHB's Headlee Amendment claim. We disagree.

The pertinent legal principles regarding a Headlee Amendment claim, including the [Bolt](#) factors, were summarized earlier. The trial court ruled that summary disposition on the merits was inappropriate. The court stated that "whether the Headlee Amendment has been violated necessarily relies on the amount of surplus [defendant] has received," and, "given that there exists a question of fact as to the amount of indirect costs associated with Building Department functions," there were questions of fact regarding the first two [Bolt](#) factors, i.e., "the purpose and proportionality of Building Department fees under a Headlee framework."

The trial court provided a more detailed analysis in support of this conclusion:

In the instant case, because there is an open question of fact concerning the amount of indirect costs associated with Building Department functions, with the parties presenting very different figures and calculations for these indirect costs—and therefore, [*44] the amount of surplus [defendant] has received—the [c]ourt cannot yet make a determination concerning whether the fees are regulatory or revenue-raising, or whether the fees are proportional to the costs of the service. Of course, the [Michigan] Supreme Court already held "that the use of the revenue generated by [defendant's] building inspection fees to pay the Building Department's budgetary shortfalls in previous years violates [MCL 125.1522\(1\)](#) because it is not reasonably related to the cost of acts and services provided by the Building Department." [*MAHB IV*], [504 Mich at 229](#). While this holding applied only to the CCA claim, there is good reason to believe it may also apply to [MAHB's] Headlee Amendment claim. However, the [Michigan] Supreme Court also held that [defendant] was within its lawful rights to recoup its indirect costs. *Id.* at [221](#). If the trier of fact does ultimately conclude that the proper indirect costs for 2019 are \$4,227, that may very well yield a substantially different outcome under the [Bolt](#) criteria [than] indirect costs in the amount of \$187,636 or \$780,728.86, as a smaller amount of indirect costs may

make it more likely that the fees are not proportional to the costs and that [defendant's] true purpose was [*45] to raise revenue. . . .

Therefore, given the existence of this factual dispute, the court concluded that summary disposition on the merits of the Headlee Amendment claim was inappropriate.

The trial court's reasoning was sound. The parties presented widely varying calculations and figures for the amount of indirect costs, ranging from \$4,227 to \$780,728.86. The amount of indirect costs was pertinent to the extent of defendant's surplus. Resolution of this factual question was critical to an evaluation of the first two [Bolt](#) factors, i.e., whether the fees served a regulatory or revenue-raising purpose and whether the fees were proportionate to the necessary costs of the service. [Bolt](#), [459 Mich at 161-162](#); [Shaw](#), [329 Mich App at 653](#). The trial court therefore properly declined to grant summary disposition to either party on the merits of the Headlee Amendment claim.

Defendant next argues on cross-appeal that the trial court erred in its bench-trial determination that defendant violated the CCA. Defendant reasons that its expenses exceeded revenue in the 2019-2020 and 2020-2021 fiscal years and that its building permit fees were not disproportionately high. Defendant challenges the trial court's view that it could not include costs incurred [*46] by departments other than the Building Department. Defendant contends that registration under the [Skilled Trades Regulation Act \(STRA\), MCL 339.5901 et seq.](#), was not required for all employees who perform Building Department services and that SAFEbuilt was contractually required to work with other city departments. Defendant further argues that MAHB's CCA claim is moot because defendant terminated its contract with SAFEbuilt. Defendant's arguments are unavailing.

This Court "review[s] a trial court's findings of fact in a bench trial for clear error and its conclusions of law de novo." [Chelsea Investment Group](#), [288 Mich App at 250](#). Clear error exists if there is no evidentiary support for a finding or if this Court has a definite and firm conviction that a mistake has occurred. *Id.* at [251](#) (citation omitted). "The trial court's findings are given great deference because it is in a better position to examine the facts." *Id.* This Court reviews de novo whether an issue is moot. [Garrett v Washington](#), [314 Mich App 436, 449; 886 NW2d 762 \(2016\)](#).

In [MAHB IV](#), [504 Mich at 216](#), our Supreme Court explained the three mandatory restrictions that limited a municipality's authority to establish CCA fees, including fee reasonableness, the fee amount reasonably related to the service cost, and the fee collected to solely be used for the operation of the enforcing agency. This reasonableness component [*47] was designed to ensure that the payments bore a relationship to building

inspection services or overhead, not to fund the entire Building Department operation. *Id.* at 219.

Defendant's argument that its costs exceeded its revenue for the 2019-2020 and 2020-2021 fiscal years hinges on the inclusion of costs incurred by departments other than the Building Department. However, the trial court correctly concluded that it was inappropriate for defendant to include such costs. In support of this conclusion, the trial court accurately summarized relevant provisions of the CCA.

In particular, under the CCA, a unit of local government like defendant may choose to administer and enforce the Michigan building code. [MCL 125.1508a\(2\)](#); [MCL 125.1508b\(1\)](#). The local government shall designate an "enforcing agency" within the governmental unit to carry out the administration and enforcement of the building code. [MCL 125.1508b\(2\)](#); [MCL 125.1502a\(t\)](#). The enforcing agency is subject to the approval of the State Construction Code Commission. [MCL 125.1508a\(5\)](#); [MCL 125.1508b\(6\)](#). The local government is required to certify "that the enforcing agency is qualified by experience or training to administer and enforce the code and all related acts and rules, that agency personnel are provided as necessary, administrative [*48] services are provided, plan review services are provided, and timely field inspection services shall be provided." [MCL 125.1508a\(5\)](#); see also [MCL 125.1508b\(6\)](#) (containing similar language).⁸

[MCL 339.6021\(1\)](#), a provision of the STRA, provides that, "[s]ubject to [subsection \(2\)](#), an individual shall not be appointed or employed as a building official, inspector, or plan reviewer by an enforcing agency, unless the individual is registered under this article and the rules promulgated under this article." [MCL 339.6021\(2\)](#) states, "[a]n individual who becomes employed by a governmental subdivision as a building official, plan reviewer, or inspector, if not already registered, shall within 30 days of employment apply to the [State Construction Code

Commission] for provisional registration."

Upon certification by the State Construction Code Commission, it is the enforcing agency that has authority to administer and enforce the building code. [MCL 125.1522\(1\)](#) refers to acts and services performed by the enforcing agency. Those acts and services of an enforcing agency include "issuance of building permits, examination of plans and specifications, inspection of construction undertaken pursuant to a building permit, and the issuance of certificates of use and occupancy" [MCL 125.1522\(1\)](#).

Defendant's [*49] CFO, Maleszyk, testified that he understood that, under the CCA, building services are to be provided by the enforcing agency. Maleszyk further indicated that he understood that the enforcing agency in this case is defendant's Building Department.

Defendant's building official, Huerta, likewise testified that he understood that, under the CCA, building services are to be provided by the enforcing agency. Huerta further agreed that [MCL 125.1522\(1\)](#) contained a list of activities that could only be performed by the enforcing agency, and Huerta agreed that those activities included issuance of building permits, examination of plans and specifications, inspection of construction undertaken pursuant to a building permit, and issuance of certificates of use and occupancy. Huerta further agreed that the enforcing agency in this case is defendant's Building Department. Huerta understood that STRA registration was required for city employees who performed work as an inspector or plan reviewer. He agreed that none of the employees from other city departments who performed Building Department services had STRA registration.

MAHB's expert, Anderson, testified that estimating indirect costs as a percentage of costs [*50] that are not direct costs of the Building Department is unreasonable and constitutes "double dipping." He explained that, under the CCA and a guidance memorandum from the Michigan Department of Treasury, direct costs are costs of the enforcing agency, i.e., the Building Department. Costs incurred by statutorily required offices such as the city clerk and the city treasurer may not be included. In Anderson's view, defendant was blatantly misrepresenting its building inspection costs. Defendant was including costs from other city departments, even when those departments received separate fees for the relevant activity, thereby engaging in an impermissible "double dip." Anderson viewed it as inappropriate to charge a building inspection fee to pay for services performed by departments other than the Building Department.

From reviewing the city budgets and the CAFRs, Anderson

⁸The approval and certification requirements of [MCL 125.1508a\(5\)](#) and [MCL 125.1508b\(6\)](#) apply when a unit of local government did not enforce the building code before the effective date of the CCA, i.e., December 28, 1999, and when the local government has elected to undertake such enforcement after that date. The parties do not address any implications in the present case of this temporal aspect of these provisions. Defendant does not present any argument disputing the applicability of these provisions in this case, even though the trial court cited the provisions. In any event, these provisions are not critical to the resolution of this case. As will be discussed later, defendant's own witnesses acknowledged that building services are to be provided by the enforcing agency, which they concede is defendant's Building Department, and there was ample evidence to support the trial court's determination that defendant violated [MCL 125.1522\(1\)](#).

determined that there were internal inconsistencies in the CAFRs and that defendant was earning more in fees than the amount of its actual costs each year. In Anderson's view, this explained why defendant was changing its manner of determining costs; defendant was claiming to have lost money in performing building [*51] inspection services. Defendant was improperly counting more than \$400,000 in costs from other departments as direct costs of the Building Department and then calculating indirect costs as a percentage of the alleged direct costs. Defendant was engaging in a "triple dip" by counting as indirect costs a percentage of alleged direct costs from other departments for which defendant collected a separate fee.

Anderson had also reviewed an expense report or spreadsheet recently prepared by defendant's CFO, Maleszyk, in purported support of the 2020-2021 CAFR. In this new expense report, defendant was continuing to calculate indirect costs as a percentage of direct costs that improperly included alleged costs from departments other than the Building Department. This new expense report did not give Anderson confidence that defendant was making any effort to follow the law. Anderson did not view this new document as credible because he believed it was prepared for this litigation and contradicted information in the 2020-2021 CAFR. Anderson preferred to rely on the CAFR because it was legally required and provided to the City Council, the Michigan Department of Treasury, and the public. This new [*52] expense report indicated that defendant was now including \$600,000 in costs from other departments and was continuing to "triple dip" by calculating indirect costs as a percentage of these improperly included direct costs.

Anderson later clarified his testimony regarding the internal inconsistencies in defendant's CAFRs. Anderson testified that the main statements of expenditures in defendant's CAFRs did not show a deficit but showed the actual expenditures. However, there were discrepancies between the statements of expenditures and the "notes" sections of the CAFRs, which showed a deficit. For example, the "notes" section of the 2018-2019 CAFR showed direct costs different from what was in the statement of expenditures in that same CAFR. Significant discrepancies between the "notes" section and the main body of the document likewise existed in the 2019-2020 and 2020-2021 CAFRs. Purported costs from other city departments were included in the "notes" sections and in Maleszyk's spreadsheets.

Anderson testified regarding provisions of defendant's contract with SAFEbuilt requiring SAFEbuilt to coordinate or work in unison with other city departments. Those provisions did not mean that [*53] the other city departments were performing building inspection work.

The trial court found that Anderson "testified in a credible and forthright manner" and that his testimony was persuasive. This Court "give[s] deference to the trial court's superior ability to judge the credibility of the witnesses who appeared before it." [Glen Lake-Crystal River Watershed Riparians](#), 264 Mich App at 531 (quotation marks and citations omitted).

The trial court found that, following the issuance of our Supreme Court's opinion in *MAHB IV*, defendant "increased its direct costs using 'costs' not envisioned by the CCA. These newly designated 'direct costs' escalated the indirect costs proportionately," given that defendant calculated indirect costs as a percentage of direct costs. Defendant "used this analysis to continue to justify retaining surplus funds." The court determined that defendant's "financial reports clearly show that the actual costs of their [B]uilding [D]epartment fell under budget for calendar [sic: fiscal] years ending in 2020 and 2021. The [c]ourt agrees with Mr. Anderson's testimony that [defendant] can only charge for building code work and that other city departments are not performing such work." The trial court agreed with MAHB

that the true direct [*54] costs of the Building Department are those set forth on [page] 38 of the financial reports and that the spreadsheets setting forth other department costs cannot be added to the Building Department costs as "additional" direct costs. The calculation of indirect costs using the percentages set forth on [page] 59 of the financial reports should have been applied to these direct costs. The [c]ourt also agrees with Mr. Anderson's testimony that if you remove the double charges, clerk and treasury charges and costs not related to the [B]uilding [D]epartment's express functions the remaining indirect costs authorized by law are those incurred by [defendant's] Human Resources, Purchasing and Finance Departments. These totaled \$5,772.26 in [the 2019-2020 fiscal year] and \$7,369.00 in [the 2020-2021 fiscal year].

The trial court further expressed its disagreement with defendant's position that

Huerta could assign [B]uilding [D]epartment functions to other departments or that the [SAFEbuilt] contract requiring "coordination" with other departments meant allowing other departments to do [B]uilding [D]epartment work. Nowhere in the CCA does it state that a building official can delegate [B]uilding [*55] [D]epartment functions to other city departments.

The trial court's findings were supported by the evidence at trial, including Anderson's testimony, and the court's legal conclusions conformed with the applicable law. Defendant's

inclusion of costs incurred by other city departments was inconsistent with the CCA. [MCL 125.1522\(1\)](#) requires consideration of costs incurred from services performed by the enforcing agency, which, as admitted by defendant's own witnesses, was the Building Department in this case. The trial court properly concluded that defendant could not "continue to designate other department costs as being direct costs of the [B]uilding [D]epartment and use a percentage of these inflated costs to calculate its indirect costs. This method of calculating costs violates the CCA's requirement that fees be related to [B]uilding [D]epartment costs." The court also correctly reasoned that SAFEbuilt's purported contractual duty to coordinate with other city departments did not mean that the other departments were performing Building Department work. Accordingly, the trial court did not err in its determination that defendant violated the CCA.

Finally, we disagree with defendant's contention that [*56] the CCA claim should have been dismissed as moot in light of the termination of defendant's contract with SAFEbuilt. Courts generally do not decide moot issues. [B P 7 v Bureau of State Lottery, 231 Mich App 356, 359; 586 NW2d 117 \(1998\)](#) (citation omitted). "A case is moot when it presents only abstract questions of law that do not rest upon existing facts or rights." *Id.* An issue is moot when an event occurs that makes it impossible to grant relief. *Id.* In rejecting defendant's mootness argument, the trial court aptly noted that, despite the termination of the contract with SAFEbuilt, defendant "still has to comply with the CCA and ensure that its fees are related to its direct and indirect costs." The evidence at trial indicated that defendant was continuing to calculate its indirect costs in a manner that violated the CCA. Anderson testified that defendant's termination of its contract with SAFEbuilt did not affect any of Anderson's conclusions, given the most recent expense report indicating that defendant intended to continue calculating costs improperly. The trial court therefore did not err in rejecting defendant's contention that the CCA claim was moot.

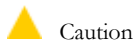
Affirmed in part, reversed in part, and remanded for entry of judgment in favor of MAHB on its Headlee [*57] Amendment claim. We do not retain jurisdiction.

/s/ Anica Letica

/s/ Mark T. Boonstra

/s/ Philip P. Mariani

EXHIBIT 28



Caution

As of: March 27, 2026 10:31 AM Z

In re Wagner

United States Court of Appeals for the Seventh Circuit

September 25, 1986, Argued ; December 11, 1986, Decided

No. 86-1268

Reporter

808 F.2d 542 *; 1986 U.S. App. LEXIS 34759 **; 16 Collier Bankr. Cas. 2d (MB) 28; Bankr. L. Rep. (CCH) P71,573; 15 Bankr. Ct. Dec. 783

IN THE MATTER OF WILLIAM W. WAGNER, Debtor-Appellant

Judgment affirmed; gross income for purposes of the farmer's exemption in bankruptcy had the same meaning as in the Internal Revenue Code because, given the arbitrary nature of the statutory definition of farmer, no higher value than certainty could be served.

Prior History: **[**1]** Appeal from the United States District Court for the Western District of Wisconsin. No. 85 C 949- John C. Shabaz, Judge.

Disposition: Affirmed

LexisNexis® Headnotes

Case Summary

Procedural Posture

Appellant sought review from a United States District Court for the Western District of Wisconsin judgment excluding his individual retirement account distribution from a determination of his farming income for purposes of qualifying for a farmer exemption to the forcing of involuntary bankruptcy under [11 U.S.C.S. § 303\(a\)](#).

Bankruptcy Law > Farming & Fishing Debtors > Eligibility

Bankruptcy Law > ... > Commencement of Case > Involuntary Cases > General Overview

HN1 Farming & Fishing Debtors, Eligibility

A farmer cannot be forced into bankruptcy against his will.

Overview

Appellant found liable for killing his tenant farmer by striking him in head with an iron bar sought to avoid resulting judgment creditors under [11 U.S.C.S. § 303\(a\)](#), which disallowed the forcing of involuntary bankruptcy on a farmer. "Farmer" was defined as one who received more than 80 percent of his gross income from a farming operation owned or operated by him. A determination of whether appellant qualified hinged on whether distribution from appellant's individual retirement account was treated as farming income or excluded from gross income. The bankruptcy judge held it was not farming income, setting aside appellant's property transfers as preferences and holding the debt to judgment creditors nondischargeable, since it was outgrowth of an intentional tort. On appeal, the court affirmed, holding gross income for purposes of the farmer's exemption in bankruptcy had the same meaning as in the Internal Revenue Code.

Bankruptcy Law > Procedural Matters > Judicial Review > Jurisdiction

Civil Procedure > ... > Subject Matter Jurisdiction > Jurisdiction Over Actions > General Overview

Bankruptcy Law > Procedural Matters > General Overview

HN2 Judicial Review, Jurisdiction

The circuit court's appellate jurisdiction in bankruptcy cases is limited to final orders by the district court.

Civil Procedure > Judicial Officers > Judges > General Overview

Outcome

Civil Procedure > ... > Subject Matter

Jurisdiction > Jurisdiction Over Actions > General
Overview

[HN3](#) Judicial Officers, Judges

Under the somewhat relaxed standard of finality that prevails in bankruptcy cases even under the current law, the bankruptcy judge's decision (and hence the district court's order affirming it) is final for purposes of appeal if it resolves all contested issues on the merits and leaves merely the distribution of the assets of the bankrupt estate to creditors to be completed.

Civil Procedure > ... > Justiciability > Ripeness > General
Overview

[HN4](#) Justiciability, Ripeness

A defendant who loses a damage suit need not (indeed, may not) wait till the judgment has been paid before he can appeal. The collection proceedings are a collateral stage of the litigation. This conclusion rests on the practical considerations that the process of collection is unlikely to affect the issues on appeal and that once the defendant's assets are handed over to the plaintiff it may be impossible, or at least very costly, for him to get them back through supplementary proceedings should it turn out that the judgment was erroneous.

Tax Law > ... > Individuals > Adjustments to
Income > Adjusted Gross Income

Tax Law > Federal Income Tax Computation > General
Overview

Tax Law > ... > Tax Accounting > Retirement
Plans > Individual Retirement Plans

Tax Law > ... > Individuals > Adjustments to
Income > General Overview

Tax Law > ... > Individuals > Business
Deductions > General Overview

Tax Law > ... > Individuals > Divorce & Separation
Payments > General Overview

Tax Law > State & Local Taxes > Income
Taxes > General Overview

Tax Law > ... > Income Taxes > Individuals, Estates &

Trusts > Deductions

[HN5](#) Adjustments to Income, Adjusted Gross Income

Money contributed to an IRA is treated for tax purposes as a part of gross income, but not of adjusted gross income; deducting such contributions is one of the adjustments that is made in translating gross income into adjusted gross income.

Bankruptcy Law > Exemptions > Bankruptcy Code
Exemptions

Tax Law > ... > Retirement Plans > Tax
Year > Accounting Period Definitions

Tax Law > ... > Retirement Plans > Tax Year > General
Overview

[HN6](#) Exemptions, Bankruptcy Code Exemptions

If one thing is crystal clear from 11 U.S.C.S. § 1(17) (1976) it is that Congress was not using the word "farmer" in its ordinary-language sense.

Bankruptcy Law > Exemptions > Bankruptcy Code
Exemptions

[HN7](#) Exemptions, Bankruptcy Code Exemptions

Gross income for purposes of the farmer's exemption in bankruptcy has the same meaning as in the Internal Revenue Code.

Counsel: Galen W. Pitman, Johns & Flaherty, South Carolina, for Debtor.

Mark Bromley, Kinney, Urban, Schrader, Bromley & Kussmaul, for Defendant.

Judges: Bauer, Chief Judge, Posner, Circuit Judge, and Eschbach, Senior Circuit Judge.

Opinion by: POSNER

Opinion

[*543] POSNER, Circuit Judge.

The question presented by this bankruptcy appeal -- a question

that appears not to have arisen before -- is whether "gross income," as it appears in the section of the Bankruptcy Code which defines "farmer," is to be given the same meaning that it has in federal income tax law. The significance of the question lies in the **[**2]** fact [HN1](#) that a farmer cannot be forced into bankruptcy against his will. [11 U.S.C. § 303\(a\)](#). (A farmer can, of course, file voluntarily for bankruptcy. Indeed, voluntary bankruptcy for "family farmers" was liberalized recently. See Subtitle B of Title II of the Bankruptcy Judges, United States Trustees, and Family Farmers Bankruptcy Act of 1986, P.L. 99-554, Oct. 27, 1986.)

[*544] Prior to the 1978 overhaul of the bankruptcy law the definition of "farmer" had undergone a painful statutory evolution each stage of which had generated considerable litigation. See Oler, *The Farmer and the Bankruptcy Laws*, 40 Dickinson L. Rev. 122 (1936). In the last stage, the statute, still worded unclearly, had been interpreted to mean "an individual personally engaged in farming," provided that "the principal part of his income" was derived from farming. See 11 U.S.C. § 1(17) (1976 ed.); [In re Beery](#), 680 F.2d 705, 713 (10th Cir. 1982). The substitution of an income test for the earlier tests of whether the individual was "chiefly" **[**3]** or "primarily" engaged in farming -- tests hopelessly vague in practice, as shown by such cases as [Powers v. Silberman](#), 3 F.2d 802 (3d Cir. 1925), and [In re Macklem](#), 22 F.2d 426 (D. Md. 1927) -- was a step toward greater precision; but the statute defined neither "principal part" nor "income," and in particular it failed to indicate whether gross or net income was intended. See [In re Beery, supra](#), 680 F.2d at 713-17. Against this background Congress in the 1978 Code made a fresh start by defining "farmer" as one who "received more than 80 percent of [his] gross income during" his immediately preceding "taxable year . . . from a farming operation owned or operated" by him. [11 U.S.C. § 101\(17\)](#). ([Section 101\(18\)](#) defines "farming operation" to include "farming, tillage of the soil, dairy farming," etc.) No legislative history bears on the question whether "gross income" in the new statute should be given the same meaning that it has in federal income tax law.

The facts of this case are surprisingly lurid for a bankruptcy case. William Wagner has a substantial dairy farm in Wisconsin. In 1983, in circumstances **[**4]** not fully explained in the record, he struck a tenant farmer in the head four times with an iron bar, killing him. Wagner was prosecuted for first-degree murder, but acquitted. The victim's widow, estate, and medical insurer brought a wrongful death suit against Wagner and obtained a damage judgment of nearly \$350,000 in 1985. Six days later Wagner gave mortgages on his farm to the law firm that had handled the tort suit, and to his brother. Later he assigned the milk income from the farm (his major source of income) to his wife, along with half the proceeds from the sale

of a car wash. The mortgages plus the judgment exceeded Wagner's net worth and the income assignment dealt away his major source of income.

The judgment creditors filed a petition for bankruptcy against Wagner under Chapter 7 of the Bankruptcy Code, seeking to set aside the mortgages and assignments as preferences. Rejecting Wagner's claim that he was entitled to the farmer's exemption from involuntary bankruptcy, the bankruptcy judge ordered the mortgages set aside, voided the assignments to Wagner's wife, and held that Wagner's debt to the judgment creditors was not dischargeable, since it was the outgrowth of **[**5]** an intentional tort. The effect of the bankruptcy judge's rulings is that the assets of the farm will, to the extent necessary, be sold to satisfy the tort judgment. The district court affirmed, and Wagner appeals to us.

[HN2](#) Our appellate jurisdiction in bankruptcy cases is limited to final orders by the district court. See [28 U.S.C. § 158\(d\)](#). The district court's order affirming the bankruptcy judge's rulings in this case is final in the sense that nothing remains at the moment to be decided by the district judge, but not necessarily in the sense, intended by [section 158\(d\)](#), that the underlying proceeding has been wound up. See [In re Riggsby](#), 745 F.2d 1153, 1155-56 (7th Cir. 1984). Technically the bankruptcy proceeding continues before the bankruptcy judge and will end only when Wagner, having satisfied (to the extent his assets allow) the debts he owes his creditors, is discharged. Nevertheless, [HN3](#) under the somewhat relaxed standard of finality that prevails in **[**6]** bankruptcy cases even under the current law, see, e.g., [In re Memorial Estates, Inc.](#), 797 F.2d 516, 519 (7th Cir. 1986), the bankruptcy judge's decision (and hence the district court's order affirming it) is final for purposes of appeal if it resolves **[*545]** all contested issues on the merits and leaves merely the distribution of the assets of the bankrupt estate to creditors to be completed. That is the nature of the decision in this case. The bankruptcy judge has held that Wagner is subject to the bankruptcy proceeding, that his mortgages and assignments are void, and that his debt to the judgment creditors is not dischargeable. All that remains is for the trustee in bankruptcy to sell the farm and pay off the creditors (including Wagner's law firm, now demoted to the status of an unsecured creditor). What remains corresponds to the collection stage in an ordinary lawsuit, cf. [In re Morse Elec. Co.](#), 805 F.2d 262, slip op. at 4 (7th Cir. 1986) -- and of course [HN4](#) a defendant who loses a damage suit need not (indeed, may not) wait till the judgment has **[**7]** been paid before he can appeal. The collection proceedings are a collateral stage of the litigation. This conclusion rests on the practical considerations that the process of collection is unlikely to affect the issues on appeal and that once the defendant's assets are handed over to the plaintiff it may be impossible, or at least very costly, for him to get them

back through supplementary proceedings should it turn out that the judgment was erroneous. The present case is thus unlike *In re Goldblatt Bros., Inc.*, 758 F.2d 1248 (7th Cir. 1985), or *Armstrong v. Corn Belt Bank*, 55 Bankr. 755, 14 Collier's Bankr. Cas. 2d 69 (C.D. Ill. 1985), in both of which substantive issues remained to be resolved by the bankruptcy judge.

Since in the present case the bankruptcy judge's order was final, the district judge's order of affirmance was also final, and we can proceed to the merits.

For purposes of applying the definition of "farmer" in [11 U.S.C. § 101\(17\)](#), we look to Wagner's "gross income" in calendar year 1984, his last taxable year before the filing of the bankruptcy petition (Wagner is a calendar-year taxpayer). His gross **[**8]** income -- as it was shown, or at least should have been shown, on his 1984 federal income tax return -- was \$104,000 (we round off all figures to the nearest \$1,000), of which \$72,000 indisputably was farming income because it was proceeds from the sale of milk and cattle. Some of Wagner's other income -- in particular, \$8,000 from the sale of the car wash -- was indisputably not farming income. In dispute is the proper characterization of \$18,000 that he received as a distribution from an individual retirement account to which in previous years he had made contributions from his farming income. If the \$18,000 is either treated as farming income or excluded from gross income, then more than 80 percent of Wagner's gross income came from farming operations and he is exempt from involuntary bankruptcy. Otherwise he falls below the 80 percent threshold and the district court's decision must be affirmed.

We can set to one side the suggestion that the \$18,000 is includable in gross income for purposes of [section 101\(17\)](#) as farming income because its ultimate origin was in a farming operation. Such treatment would involve double counting of a dramatic sort. **[**9]** **HN5** Money contributed to an IRA is treated for tax purposes as a part of gross income, but not of adjusted gross income; deducting such contributions is one of the adjustments that is made in translating gross income into adjusted gross income. See [26 U.S.C. §§ 62\(10\), 219\(a\), 408\(d\)\(1\), \(e\)\(1\)](#). So when Wagner received the money that he contributed to the IRA it was part of his gross income, and since it was income from a farming operation it counted toward the 80 percent threshold for exemption from involuntary bankruptcy. To treat it as farming income when it is withdrawn from the IRA would be to count the same money as farming income twice. A practical consequence would be that if Wagner, who is 67 years old, retired from farming altogether -- sold his farm and moved to Florida -- he would still be a farmer within the meaning of the statute, and hence would be immune from being forced into bankruptcy provided that more than 80

percent of his retirement income came from his IRA. Although double counting could be prevented by excluding the initial receipt of the income that he contributed to an IRA from gross income **[**10]** **[*546]** for bankruptcy purposes, that would result in the extraordinary paradox that a farmer who contributed a large fraction of his farming income to an IRA might as a result not be classified as a farmer in the year the income was received yet be classified as a farmer years later when he left farming and started drawing from the IRA.

The hard question is not whether the \$18,000 that Wagner drew from his IRA should be treated as farming income -- clearly it should not be -- but whether it should be excluded from gross income for bankruptcy purposes because it represents in part deferred income from Wagner's dairy farm. It is not as if Wagner in 1984 obtained less than 80 percent of his income from farming and the rest from some other type of business. He had some indisputably nonfarming income, such as the capital gain from the sale of the car wash, but he was certainly a "farmer" in the ordinary-language sense of the word rather than a person primarily engaged in some other activity who does farming on the side -- a gentleman farmer or hobby farmer. The main supplement to Wagner's 1984 income from farming came from the early withdrawal from his retirement account to finance **[**11]** his defense of the tort suit (early withdrawal not because he couldn't retire at age 67 but because he hasn't retired). And the income that funded that account was income from farming.

But **HN6** if one thing is crystal clear from [section 101\(17\)](#) it is that Congress was not using the word "farmer" in its ordinary-language sense. That had been essentially the approach of the previous law (call it the "mud on the boots" approach). It had led to excessive uncertainty in application and was abandoned for a mechanical approach in which "farmer" is a technical term that means someone who in the taxable year immediately preceding the suit in bankruptcy derives more than 80 percent of his gross income from farming. **From the statutory references to "taxable year" and "gross income," both themselves technical terms,** though of tax law rather than bankruptcy law, it is possible to infer that Congress intended to use these terms in [section 101\(17\)](#) in their tax sense. Certainly "taxable year" is so used; Wagner does not dispute that. Whether "gross income" was intended to be used in its tax sense is less certain. **[**12]** Maybe, as Wagner argues, Congress used "taxable year" merely to spare the farmer the bother of having to keep an additional set of books in order to be sure not to lose his bankruptcy exemption.

Wagner's strongest point is that his IRA distributions are, to a substantial though unquantified extent, a return of capital, rather than income. If he had put a part of his farm income into a

savings account rather than an IRA and had later withdrawn it, only the interest on the deposit would be deemed income for tax purposes. Is it not arbitrary, he asks, to deem all of the distribution from the IRA income, when in fact a substantial part of it is really just the principal being returned to him?

We agree that merely to read [section 101\(17\)](#) does not answer the question whether the statute uses "gross income" in the tax sense. In contrast to several other sections of the United States Code, neither [section 101\(17\)](#) nor any other section pertinent to the farmer's exemption from bankruptcy says that "gross income" means the same thing as it does in the Internal Revenue Code, see [7 U.S.C. § 1929a\(h\)](#); [42 U.S.C. §§ 411\(a\), 1382\(d\)](#) -- though it **[**13]** would be unrealistic to attach any weight to this omission: the United States Code is not the work of a single omniscient intellect. We acknowledge the force of Wagner's analogy of an IRA distribution to a savings-account withdrawal, and the force of his example of a "farmer" who, since most of his income comes from municipal bonds and hence is not counted as gross income for federal income tax purposes, see [26 U.S.C. § 103\(a\)](#), is entitled to the exemption. We recognize that Congress may have used the word "gross" not in order to create a compound expression that would point unequivocally to tax law but to make clear that the bankruptcy exemption could be used by **[*547]** farmers whose net income was low because of heavy expenses. Those are, indeed, the very farmers most likely to have a use for an exemption from involuntary bankruptcy. The traditional rationalization of the farmer's exemption is that the cyclical pattern of farm prices abnormally depresses farmers' net incomes in some years, making it impossible for them to pay their creditors. See, e.g., S. Rep. No. 989, 95th Cong., 2d Sess. 32 (1978). Of course many other businessmen -- owners of ski resorts **[**14]** for example -- are in the same fix; and how farmers as a group can actually benefit from the exemption is unclear, since lenders who do not have access to bankruptcy remedies in the event of default will charge higher interest rates to cover the increased risk of loss, though the present case involves involuntary creditors -- Wagner's tort victims. But none of these are issues for a court to worry about.

Yet, on balance, the interpretation that will best carry out Congress's purposes in the Bankruptcy Code is that **HN7** gross income for purposes of the farmer's exemption has the same meaning as in the Internal Revenue Code. The language and background of [section 101\(17\)](#) show that Congress wanted a mechanical, which is to say an easily applicable, test for "farmer" rather than a test that would reflect the economic realities of agriculture. The use of a flat 80 percent income criterion was certain to produce both overinclusion and underinclusion. Farmers who derive 79 percent of their income from farming are not distinguishable to the naked or any other eye from those

who derive 81 percent of their **[**15]** income from farming. Indeed, Congress's choice of 80 percent rather than 50 or 67 or 75 or 90 was unexplained and seems to have had nothing to do with the nature of farming. See 124 Cong. Rec. 32393 (1978) (remarks of Congressman Edwards); 124 Cong. Rec. 33993 (1978) (remarks of Sen. DeConcini); [In re Blanton Smith Corp.](#), [7 Bankr. 410, 3](#) Collier Bankr. Cas. 2d (MB) 358, 361-62 (Bankr. M.D. Tenn. 1980). Given the quintessential arbitrariness of [section 101\(17\)](#), little would be gained by devoting substantial judicial resources to fine-tuning the concept of "gross income." The population of farmers would still be arbitrarily distributed around the 80 percent mark. But much would be lost. The decision to bring a bankruptcy action must often be and here was made in a hurry. Within a week after the jury's verdict in the wrongful-death case Wagner was taking steps to put his assets and income beyond the reach of judgment creditors. The creditors had to decide forthwith how to proceed -- whether to pursue their remedies under state law or under federal bankruptcy law. Often and here creditors know a fair amount about their debtor's income (here the information would have **[**16]** come out in the tort action, where punitive damages were sought and awarded) and can readily determine what his gross income for tax purposes was last year and how much of it came from farming; if they don't know, and file a petition for involuntary bankruptcy, and in fact the debtor derives more than 80 percent of his gross income (in the tax sense) from farming, the debtor will quickly tell them, and prove it by his tax return. But for either creditor or debtor to decide what the debtor's gross income is in some sense of "gross income" that is significant for the policy of the bankruptcy law would be an altogether more uncertain undertaking, at least until the courts had evolved a jurisprudence of gross income for this purpose. The threshold determination of eligibility for the exemption should not be subject to such uncertainty. Debtors and creditors ought to be able to know from the start whether the debtor is exempt from bankruptcy; they would not know till much later if we embarked on the protracted undertaking of constructing, in common law manner, case by case, a new jurisprudence of gross income. All this assumes moreover that "income" itself is a straightforward concept; **[**17]** it is no more straightforward than "gross" income is. Compare [Howell v. United States](#), [775 F.2d 887 \(7th Cir. 1985\)](#).

We do not want to overstate the difficulties. Because most farming assets -- not **[*548]** only land, buildings, and equipment but also crops and animals -- are pledged as security to creditors, and because secured creditors need not utilize bankruptcy in order to enforce their secured debts, see, e.g., [In re J. Catton Farms, Inc.](#), [779 F.2d 1242, 1247 \(7th Cir. 1985\)](#), farm bankruptcies are (popular belief to the contrary notwithstanding) rare even when agriculture is depressed. Farms "go broke" often enough, but rarely are petitioned into

involuntary bankruptcy even though many real farmers are not protected by the exemption. This is only the third reported case under the 1978 Code in which the exemption has been invoked. But the infrequency of litigation in this area is not a good argument for adopting the qualitative test urged by Wagner. That very infrequency may mean that it could take many years to complete the judicial elaboration of a concept of bankruptcy gross income -- though litigation might become more frequent if farmers **[**18]** who flunked the 80 percent test thought they would have a shot at passing it by recharacterizing their tax gross income for purposes of [section 101\(17\)](#).

If all that were at stake were the correct characterization of IRA withdrawals, the uncertainties of the course urged by Wagner would be minimal. But as his counsel readily acknowledged at argument, the divorce between the tax and bankruptcy meanings of gross income could not be limited to IRA withdrawals. Take a case where a farmer has substantial income from tax-free municipal bonds. Such income is not gross income for tax purposes, but if IRA withdrawals should be deducted from gross income for purposes of applying the bankruptcy exemption, surely tax-free income should be added back; it is real income, however it may be classified for tax purposes. Wagner agrees that it should be added back, because he wants to show that his approach need not on balance enlarge the exemption. But what then of gifts and bequests? In Henry Simmons' influential economic analysis of federal income taxation, all accessions to wealth are treated as income, and income is deemed income when realized, not when received -- so that the appreciation of securities **[**19]** is income even if the securities are not sold. See *Personal Income Taxation* chs. 2, 7 (1938). If Simons' definition of income were adopted for purposes of fleshing out the statutory term "gross income," then a major part of Wagner's IRA withdrawals would indeed be excluded from gross income -- but any gifts or bequests that Wagner received in 1984, and any net appreciation in land, securities, or other property owned by him, would be included in it. There is no limit to the subtleties that lawyers steeped in the economics of income and wealth could excogitate in defense of this or that inclusion or exclusion. Suppose Wagner's children had income in 1984; should some part of that income be assigned to him on the theory that a man derives a real benefit from increases in his children's wealth? Cf. *CBI Industries, Inc. v. Horton*, 682 F.2d 643, 647 (7th Cir. 1982); Becker, *A Treatise on the Family*, ch. 8 (1981). Or suppose he had collected a personal-injury damages judgment some part of which reflected a loss of future earnings. The damages would not be includable in gross income for tax purposes; should they be for bankruptcy purposes, because the damages replaced income **[**20]** that would be included? Wagner's counsel says that, if we rule for him, "litigants can lay down their tax codes and pick up their accounting books." But "gross income" is not an accounting

term; for accountants, "income" is a net concept. They use terms like "revenue" and "gross sales" to mean what Wagner means by "gross income." Wagner has not persuaded us that accounting concepts can readily be transposed to the present context.

Moreover, no matter how brilliantly the courts aligned the concept of gross income in the Bankruptcy Code with the best thinking of economists and accountants on the difference between income and capital, the statutory definition of farmer would still be arbitrary. The brilliance would be wasted, but bankruptcy litigation would be fomented, and both debtors and creditors would be made worse off, since creditors **[*549]** when extending credit to a farmer wouldn't know what their remedies were in the event of default and farmers wouldn't know whether they were exempt from bankruptcy. The way to make [section 101\(17\)](#) work best is to make it work simply. That is most easily done by deeming the statute to incorporate the definition of gross income in federal **[**21]** income tax law. Then everyone will know where he stands. Given the arbitrary nature of the statutory definition of farmer, no higher value than certainty can be served by the interpretation of the words gross income; and the interpretation that best serves that value is the one that equates gross income in the Bankruptcy Code to gross income in the tax code. Needless to say, we express no view on whether the same equation should be made in interpreting other statutes that use the words "gross income" without express reference to the Internal Revenue Code. See 2 U.S.C. § 707(1); 5 U.S.C. § 209(1); [42 U.S.C. § 300n\(3\)\(C\)](#).

AFFIRMED.

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