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Sent: Monday, April 27, 2026 12:58 PM
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Subject: RE: Novi Ice Arena

2. What exactly does it mean that the City cannot "profit" from the operations of the Ice Arena? How is this any different from the rental of any other facility in the City?

We generally don't frame the question as whether the ice arena can make a "profit" or not as an enterprise fund for the City. The City is allowed to have the ice arena pay for itself, which includes both ongoing operations/maintenance and long-term capital improvements. The City is allowed to fund the ice arena by taxes or by rates and fees. The City is allowed to have a reasonable cash reserve (revenue over expenses, plus some amount for future capital needs).

What the City is not allowed to do, however, is use the ice arena to provide a source of revenue for any other operation in the City. Monies accumulated through the charging of rates and fees for the use of the ice arena have to stay in the ice arena fund. They cannot be transferred to any other fund (e.g., general fund) or even the parks fund generally.

The City is not a business. The ice arena is not a business. There are two primary reasons why the City as a whole (outside of the ice arena enterprise fund itself) "cannot profit from the operations of the ice arena".

The first is governmental immunity. One of the exceptions to governmental immunity is what's called the "proprietary function" exception to immunity. Put simply, the City is immune from tort liability (negligence, intentional tort, etc.) if the City is "engaged in the exercise or discharge of a **governmental function**." The "proprietary function" exception to that immunity says that immunity *"shall not apply to actions to recover from bodily injury or property damage arising out of the performance of a proprietary function. . . .* ***Proprietary function shall mean any activity which is conducted primarily for the purpose of producing a pecuniary profit for the governmental agency****, excluding, however, any activity normally supported by taxes or fees."*

Case law has said to be a proprietary function, an activity "(1) must be conducted primarily for the purpose of producing a pecuniary profit; and (2) it cannot normally be supported by taxes and fees." The "profit" question invokes the first prong of that test, and the courts have said that **when determining when a governmental agency's primary purpose is to produce pecuniary profit, the courts should consider (1) whether the profit is actually generated, and (2) where the profit is deposited and how it is spent.**

In a recent case that is now pending before the Michigan Supreme Court, the Michigan Court of Appeals went on to explain as follows:

"If the profit is deposited in the governmental agency's general fund or used to finance other unrelated functions, this could indicate that the activity at issue was intended to be a general revenue raising device*. If the revenue is used only to pay current or long term expenses involved in operating an activity, this could indicate that the primary purpose of the activity was* ***not*** *to produce a pecuniary profit."*

So, the ice arena rates and fees can pay for "current and long range expenses involved in operating the activity," but if the City is in the ice arena business to make money for the City (as opposed to simply operating an ice arena), it runs the risk of losing governmental immunity—which for a facility like this exposes the City to significant liability.

The second issue is the "excessive rates/fees" issue. If the City charges rates and fees that are substantially more than the cost to pay for current operations and what is needed to accumulate a reasonable amount of money and reserves for long-range expenses (and to actually pay for those), it risks hearing the argument that the fees being charged are really illegal ***taxes*** (not voted on by the people) intended to raise revenue and not ***fees*** intended to offset the City's costs to provide for a governmental function. This would be a *Bolt*-type argument similar to the recent challenge to the City's water and sewer fees (which the City won in part because the fees chargedfor those services are used only within the water and sewer system).

A final point of the "profit" issue would be that if the City were found to actually be operating a profit-making endeavor, instead of performing a governmental function, that portion of the property would also not be entitled to an exemption from real property taxes.

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