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OFFICE OF THE
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February 3, 2012

Opinion No. 12-11

"Growth and Development Fees" and "Impact Fees" Levied by Local Utilities

QUESTIONS

1. Are utility districts created under the Utility District Law of 1937 subject to the same requirements as municipal water utilities operated by a board of public utilities established under the Municipal Electric Plant Law of 1935?

2. Must utility districts formed under the Utility District Law of 1937 follow the same guidelines as municipal water utilities for rates, fees, charges, and tolls for services?

3.a. Were "growth and development fees" assessed by the Consolidated Utility District in Rutherford County since 1996 lawfully collected?

b. If the answer to a. is no, should they be refunded?

4.a. Were "impact fees" collected by Columbia Municipal Water lawfully collected?

b. If the answer to a. is no, should they be refunded?

5.a. Does the Utility District Law of 1937 allow utility districts to impose a fee that functions as a tax?

b. If the answer to a. is no, should any such "fees" be refunded?

OPINIONS

1. No. The Municipal Electric Plant Law of 1935 does not apply to utility districts incorporated under the Utility District Law of 1937.

2. No. Utility districts formed under the Utility District Law of 1937 must set rates in accordance with Tenn. Code Ann. § 7-82-403. Water rates set by a public utilities board would be governed by the statutory scheme applicable to the water system when the utilities board took control of it.

3.a. Ordinarily, public utility rates are presumed to be reasonable, and the burden is on the challenging party to prove they are not. Any growth and development fees charged by the

Rutherford County Consolidated Utility District would be valid as authorized "fees," rather than unauthorized taxes, so long as they are used exclusively to operate and expand the water system for the benefit of the party providing the fee. Further, the fees satisfy equal protection requirements so long as they have a reasonable relationship to a legitimate utility district interest and apply equally to all customers in the same class. This Office is unaware of any information that would indicate these fees were unlawfully collected.

b. Given the response to question 3.a., the need to answer question 3.b is pretermitted.

4.a. Chapter 194 of the Private Acts of 1994 expressly authorizes the City of Columbia to charge a water system impact fee. These fees are set forth in the Code of Ordinances of the City of Columbia, §§ 18-308 and -309.

b. Because this Office has concluded the fees related to question 4.a. are authorized, the need to answer question 4.b. is pretermitted.

5.a. A utility district created under the Utility District Law of 1937 has no authority to levy a tax, but does have authority to levy fees to provide utility services to the individuals or entities using the service. As previously mentioned, this Office is unaware of any information indicating the fees in question were unlawfully collected.

b. The response to question 5.b. is pretermitted given the answer to question 5.a.

ANALYSIS

1. Applicability of Municipal Electric Plant Law to Utility Districts Created Under the Utility District Law

This opinion generally concerns how water rates are set by utility districts, whether independently established or operated by a local government. The initial question is whether utility districts created under the Utility District Law of 1937 ("Utility District Law"), codified at Tenn. Code Ann. §§ 7-82-101 to -804, must follow the same requirements as a water utility operated by a board of public utilities created under the Municipal Electric Plant Law of 1935 ("Electric Plant Law"), codified at Tenn. Code Ann. §§ 7-52-101 to -611.

The Utility District Law authorizes a county mayor to approve the incorporation of a utility district. *See* Tenn. Code Ann. § 7-82-202. Once incorporated, a utility district is a "municipality" or public corporation in perpetuity under its corporate name. Tenn. Code Ann. § 7-82-301(a)(1)(A). The district has no "power to levy or collect taxes," and the statute provides that authorized charges for services "shall not be construed as taxes." *Id.* The Utility District Law specifically states that a utility district created under the Utility District Law is generally only subject to its provisions, providing as follows:

> This chapter is complete in itself and shall be controlling. The provisions of any other law, general, special or local, except as provided in this chapter, shall not apply to a district incorporated under this chapter; provided, that nothing in this

> chapter shall be construed as impairing the powers and duties of the department of environment and conservation.

Tenn. Code Ann. § 7-82-107. The Utility District Law itself expresses no intent for the Electric Plant Law to apply to utility districts under its jurisdiction, and indeed by its terms excludes such utilities from the Electric Plant Law.

Conversely, the Electric Plant Law does not mention utility districts, and no other language suggests it was intended to apply to utility districts organized under the Utility District Law. Under the Electric Plant Law, a "municipality" may appoint a board of public utilities to operate its electric plant. Tenn. Code Ann. § 7-52-107(a). As used in the act, "municipality" means "any county, metropolitan government, incorporated city or town in the state of Tennessee." Tenn. Code Ann. § 7-52-102(10). The Electric Plant Law further authorizes the municipality to transfer to the board of public utilities other utilities, including waterworks, over which the municipality has control, stating:

> Municipalities now or hereafter owning or operating a waterworks, sewerage works, or gas system have the power and are hereby authorized to transfer to and confer upon the board the jurisdiction over such waterworks, sewerage works, or gas system now or hereafter vested in any other board, commission, or in the governing body of such municipalities.

Tenn. Code Ann. § 7-52-111(a).

Thus, given the specific directive of Tenn. Code Ann. § 7-82-107, the Electric Plant Law does not apply to utility districts incorporated under the Utility District Law. *See also State v. Marshall,* 319 S.W.3d 558, 562-563 (Tenn. 2010) (Tennessee Supreme Court finding that the General Assembly enacted a separate statutory scheme to regulate public housing, thus public housing is distinct from and not subject to the statutory provisions regulating utilities or hotel accommodations).

2. Guidelines for Utility Rates

The second question is whether a utility district organized under the Utility District Law must follow the same guidelines as municipal water utilities for rates, fees, charges, and tolls for services. Under Tenn. Code Ann. § 7-82-403(a) of the Utility District Law, district commissioners of utilities formed under the Utility District Law must charge "reasonable" rates, fees, tolls, and charges for utility services and must revise them whenever necessary to ensure that the utility system "shall be and always remain self-supporting." Rates and other charges must be sufficient to pay for operating and maintenance costs, including reserves for expenses, and to pay interest, principal, and required reserves for bonds. *Id.*

The Electric Plant Law does not describe the duties of a public utilities board with respect to a municipal water utility over which it has assumed jurisdiction under Tenn. Code Ann. § 7-52-111. Under that statute, the public utilities board would have the power and responsibility

under the separate statutory scheme governing the water system when the public utilities board took control of it.

As previously explained, utility districts formed under the Utility District Law are subject to the provisions of the Utility District Law, and not the Electric Plant Law. Thus a utility district operating under the Utility District Law must set its rates in accordance with Tenn. Code Ann. § 7-82-403(a) and is not subject to any other guidelines or requirements.

3. Consolidated Utility Growth and Development Fees

a. Authority to Charge Growth and Development Fees

In Tennessee, several different statutory schemes of general applicability govern the ownership and operation of a utility system and the setting of utility fees. *See*, *e.g.*, Tenn. Code Ann. § 7-34-114 (Revenue Bond Law); Tenn. Code Ann. § 7-35-414 (sewers and waterworks); Tenn. Code Ann. §§ 9-21-107(8) & -308 (Local Government Public Obligations Law); Tenn. Code Ann. § 5-16-109 (urban type public facilities). These statutes generally require the charging of reasonable utility rates that will enable the system to be and remain self-supporting. This requirement, if not explicit in a statute, is implicit in the term "fees." A fee is imposed for the purpose of regulating a specific activity or defraying the cost of providing a service or benefit to the party paying the fee. *City of Tullahoma v. Bedford County*, 938 S.W.2d 408, 412 (Tenn. 1997). By contrast, a tax is a revenue raising measure levied for the purpose of paying the government's general debts and liabilities. *Id.* The essential test to determine whether fees are really taxes is whether they are, or are not, paid into the general public treasury and disbursable for general public expenses. *Memphis Natural Gas Co. v. McCanless*, 183 Tenn. 635, 650-651, 194 S.W.2d 476, 483 (Tenn. 1946). Water rates charged by a utility district, therefore, should be used only to defray the cost of providing service to the party paying the fee. Those costs would include capital costs for expanding or improving the system to provide service for any new development with respect to which the fee was assessed.

Equal protection principles under the Tennessee and United States Constitutions apply to water rates charged by a public utility. *See Tucker Corp. v. City of Clarksville*, No. M2002-00627-COA-R3-CV, 2003 WL 21250811, *5 (Tenn. Ct. App. May 30, 2003). Thus, a governmental entity may charge different utility rates to different classes of users so long as the classifications are not arbitrary, unreasonable, or discriminatory. Utility rates that do not create a suspect classification or impinge upon a fundamental right will withstand an equal protection challenge if the classification bears some rational relationship to a legitimate state interest. *Id. See also I-4 Commerce Center, Phase II, Unit I v. Orange County*, 46 So.3d 134, 136 (Fla. Ct. App. 2010); *City of Gainesville v. State*, 863 So.2d 138, 144 (Fla. 2003)*; Mullenix-St. Charles Properties, L.P. v. City of St. Charles*, 983 S.W.2d 550, 559 (Mo. Ct. App. 1998), *motion for rehearing and/or transfer to Supreme Court denied* (1999), *application for transfer denied* (1999).

The above standards govern whether growth and development fees charged by the Rutherford County Consolidated Utility District since 1996 were lawfully collected. The Consolidated Utility District was formed and operates under the Utility District Law. *See History of Consolidated Utility District of Rutherford County,* http://cudrc.com/About-us.aspx. The opinion request provided no specific information about the growth and development fees charged by the district. Nor has this Office conducted an independent factual inquiry into the subject. This Office however has reviewed general information about rates charged by the Consolidated Utility District at its web site, http://cudrc.com/. This information includes its 2010 annual report and its current rates. The schedule of rates posted on the district's web site is effective October 1, 2010. This schedule does not include a category of charges called "Growth and Development Fees," but does include general guidelines for developers under the term "Tap Fees." The schedule also includes "System Development Charges by Meter Size" for residential and commercial development. Finally, the schedule includes engineering fees and inspection fees. Two newspaper articles published in 2003 quote the district general manager referring to a "growth fee" in relation to a major expansion of the water system. Doug Davis, *CUD Expansion will double its capacity: To treat 16 million gallons of water per day*, Daily News Journal, 2003 WLNR 18467961 (December 21, 2003); John Callow, *KEEPING AHEAD OF GROWTH: McElroy, CUD working hard to meet demands for service*," Daily News Journal, 2003 WLNR 18468219 (February 9, 2003).

Turning to the question presented, utility districts do not have the authority to tax for general revenue raising purposes. *See Memphis Natural Gas Co. v. McCanless*, 194 S.W.2d at 483. In order for the growth and development fees to qualify as a "fee" instead of a tax, the district must use them to provide services to the party paying the fee and not for any other purpose. Appropriate fees could include costs related to improving and expanding the system to provide service for new development.

Assuming the fees meet these requirements, the question then becomes whether the growth and development fees are "reasonable" rates within the meaning of Tenn. Code Ann. § 7-82-403. Courts have recognized that ratemaking is legislative in character. *City of Knoxville v. Knoxville Water Co.*, 212 U.S. 1, 8, (1909); *AT&T Communications of South Central States*, *Inc. v. Greer*, No. 01A-01-9512-BC-00556, 1996 WL 697945, *7 (Tenn. Ct. App. Dec. 6, 1996). Courts in other jurisdictions have stated that, generally speaking, utility rates set by a municipality are presumed to be valid and reasonable until the contrary has been established; moreover, the burden of overcoming the presumption of validity and reasonableness rests with the challenging party. *See*, *e.g.*, *General Textile Printing and Processing Corp. v. City of Rocky Mount*, 908 F.Supp. 1295, 1305 (E.D. N.C. 1995) (applying North Carolina Law); *Eudora Development Co. of Kansas v. City of Eudora*, 78 P.3d 437, 440 (Kan. 2003).

In an unreported opinion, the Tennessee Court of Appeals recently upheld the City of Clarksville's connection fees for its water and sewage system against a challenge by a developer. *Tucker Corp. v. City of Clarksville*, No. M2002-00627-COA-R3-CV, 2003 WL 21250811, *5 (Tenn. Ct. App. May 30, 2003). Based on a rate study and plan submitted by an engineering firm, the City Council had adopted a higher schedule of connection fees for new development after 1992. The developer claimed, first, that the connection fee was an unauthorized tax. The

Court rejected this challenge. The Court noted that revenues from the fee were not paid into the city's general fund but, instead, were deposited into a water, sewage, and gas utility funds account. The Court stated that the fees had been used solely for the purpose of defraying the cost of providing service for the benefit of the party paying the fee by improving and upgrading the City's sewage and water system. *Id.* at *5. For these reasons, the Court concluded that the connection charge was a utility fee and not an unauthorized tax.

The Court also rejected the developer's claim that the fees violated the Equal Protection Clause of the Tennessee and United States Constitutions. The Court noted that, under an equal protection analysis under either federal or Tennessee law, a classification will be upheld if some reasonable basis can be found for it, or if any state of facts may reasonably be conceived to justify it. The Court found that the connection fee had a reasonable relationship to a legitimate city interest and applied equally to all customers in the same class. The Court stated that "[a]ssessment of the fee would not be unconstitutional even it if resulted in some inequality inasmuch as the rational basis test has been met." *Id.* at *6.

Under these principles, any growth and development fees charged by the Consolidated Utility District would be considered authorized "fees," rather than unauthorized taxes, so long as they are used exclusively to operate and expand the water system for the benefit of the party paying the fee. Further, the fees would withstand equal protection requirements so long as they have a reasonable relationship to a legitimate utility district interest and apply equally to all customers in the same class.

This Office, based upon the information available to it, can find no reason to conclude that the fees at issue were unlawfully collected.

b. Requirement to Refund Unauthorized Fees

This question need not be answered, given this Office has concluded the fees in question appear to be appropriately authorized.[1]

[1] Tennessee law provides processes by which a customer may challenge a utility district's setting of rates. Several Tennessee statutes provide for review of utility district water rates by the Tennessee Utility Management Review Board ("Board), including Tenn. Code Ann. § 7-82-102(a). *See generally* Tenn. Code Ann. § 7-82-702. Tenn. Code Ann. § 7-81-102(a) authorizes the Board to review rates charged and services provided by certain defined public utility districts. This review must be initiated by a petition signed by at least ten per cent of the users within the authorized area of the public utility district. The proceedings must comply with the Uniform Administrative Procedures Act, Tenn. Code Ann. §§ 4-5-101 to -404. Furthermore, under Tenn. Code Ann. § 7-82-401(d), utility district commissioners generally must publish a statement showing, among other information, a statement of the water rates then being charged by the district and a brief statement of the method used in arriving at such rates. Tenn. Code Ann. § 7-82-402(a)(1) permits a water customer to file a written protest of water rates within thirty days of the date that the statement is published. The commissioners must conduct a hearing on the protests in which they examine statements and exhibits and consider arguments by the protesting customers or their counsel. The commissioners must then make written findings as to the reasonableness or unreasonableness of the published rates and record them in the minutes. The commissioners may increase or decrease the rates upon a finding that they are too low or too high. A protesting customer may obtain review of the commissioners' action by written request to the Utility Management Review Board within thirty days. The Board's decision is subject to judicial review in the county of the utility district's principal office under the common law writ of certiorari. This type of judicial review

4. Columbia Power & Water Systems (CPWS) Impact Fees

a. Authority to Collect

The next question is whether impact fees collected by CPWS were lawfully collected. Again, this Office has not conducted an independent factual inquiry into this subject but has reviewed the available material on the CPWS website, http://www.cpws.com/. The CPWS was founded in 1939 under the Electric Plant Law, and in 1941 gained jurisdiction over Columbia's waterworks and sewage distribution system. *Id.*

The impact fees in question were authorized by private act. In 1994, the General Assembly passed a private act explicitly authorizing the Columbia City Council to impose impact fees on new development. 1994 Tenn. Priv. Acts 194. This act provides in pertinent part:

> SECTION 3. It is the intent and purpose of this act to grant to the Columbia governing body the authority to establish a regulatory procedure or system to collect fees from the developer of any new land development activity so as to require the developer to share in the burdens of growth by paying a pro rata share for the reasonably anticipated expansion cost of public improvements generated by the new land development activity.
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> . . . . .
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> SECTION 7. The impact fees collected by the City of Columbia pursuant to this act shall be kept in a separate fund from other revenue of the governmental entity. Funds collected by impact fees shall be used for the acquisition, expansion and development of the capital or public improvements for which they were collected and shall be withdrawn and expended as may be designated by ordinance of the governing body.

Id. at §§ 3, 7.

The Act defined "capital or public improvements" as

> the construction, building, replacement, extension or enlargement of any *waterworks, water distribution system,* sewer or sewerage system authorized by

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is limited to determining whether the Board exceeded its jurisdiction, followed an unlawful procedure, acted illegally, arbitrarily, or fraudulently, or acted without material evidence to support its decision. *See*, *e.g.*, *Harding Academy v. Metropolitan Government of Nashville and Davidson County*, 222 S.W.3d 359, 363 (Tenn. 2007) (citing *Willis v. Tennessee Department of Correction*, 113 S.W.3d 706, 712 (Tenn. 2003)). Tenn. Code Ann. § 7-82-702(19) also allows a customer or developer to challenge a utility district's requirement that a customer or developer build utility systems to be dedicated to the utility district, or the justness and reasonableness of fees or charges against the customer or developer related to the utility systems. The Utility Management Review Board must review the decision of the utility district commissioners, upon written complaint filed, within thirty days of the commissioners' action. Judicial review of the Board's decision is by common law writ of certiorari.

> the governing body of the governmental entity; and includes any one (1) or more or any combination of these public improvements.

Id. at § 2(c) (emphasis added).

The Municipal Technical Advisory Service maintains a copy of the Code of Ordinances of the City of Columbia updated through June 16, 2011. *See* Code of Ordinances for Columbia, http://www.mtas.utk.edu/public/municodes.web.nsf?opendatabase. Section 18-303 lists water service rates, fees, and charges. *Id.* Water impact fees are authorized under Section 18-308. *Id.* Under § 18-308(7) these fees must be used exclusively for the purpose of capital improvements that expand the capacity of the water distribution and collection network. *Id.* Section 18-309 establishes a separately earmarked Water Impact Fee Fund to receive water impact fees.

The water impact fee provided by the private act and implementing ordinances is thus valid and authorized. It must be deposited in a special fund and used solely for water system capital improvements. This characteristic confirms this governmental charge is a fee, not a tax. *See Tucker Corp. v. City of Clarksville, 2003* WL 21250811, at *5. Further, it purports to defray a pro rata share for the reasonably anticipated expansion cost of public improvements generated by new land development activity. This is also an important characteristic of a fee. *Home Builders Ass'n of Middle Tennessee v. Maury County*, No. M1999-02383-COA-R3-CV, 2000 WL 1231374, at *3-4 (Tenn. Ct. App. August 31, 2000), *p.t.a. denied--not for citation* (March 6, 2001); Op. Tenn. Att'y Gen. 86-75 (March 26, 1986). In addition, the fee does not conflict with state general law. *See* Tenn. Code Ann. § 67-4-2913 (city or county may continue to levy impact fees under a private act in effect before June 20, 2006). For all these reasons, the City of Columbia is authorized to collect water impact fees levied under this authority.

b. Requirement to Refund Unauthorized Fees

Because this Office has concluded the impact fees are authorized, this issue is pretermitted.

5. Authority of Utility District to Charge a Tax

a. Fee that is Functionally a Tax

A utility district created under the Utility District Law does not have the authority to impose a tax. Tenn. Code Ann. § 7-82-301(a)(1)(A). Such a charge, therefore, would be unauthorized. As previously stated, this Office has received no information to indicate that the fees in question collected by Consolidated Utility District under the Utility District Law are unauthorized taxes. Rather the assessments at issue appear to be appropriately characterized as fees authorized to be assessed under Tennessee law.

b. Requirement to Refund Unauthorized Taxes by Utility Districts

Given this Office's conclusion that the fees at issue appear to be appropriately authorized, this question is pretermitted.

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