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Opinion No. 03-017

Powers of Utility District

QUESTIONS

Assuming a utility district created under the Utility District Law of 1937, Tenn. Code Ann. §§ 7-82-101, *et seq.*, has adopted no rules and regulations to the contrary, and has no contractual or bond restrictions to the contrary:

1. a. Is a utility district authorized to extend some of its water mains and sewer lines using its own funds in order to increase customer load and promote development in its service area?

b. Assuming the answer to a. is yes, would the answer change if the district has historically required the developer or customer requesting the service to pay the full cost of all water and wastewater extensions?

2. Is a utility district authorized to adopt and enforce a written extension policy that allows the district to expend a portion of its own funds on each requested extension based on economic criteria related to the planned size of the development, potential economic return to the district, cost of the extension, and other reasonable economic factors aimed at assuring the district's investment is protected and calculated to realize a fair return to cover the district's costs of construction, operation and maintenance?

3. Is a utility district authorized to adopt and enforce a written extension policy that provides a two-tier approach whereby developers of subdivisions and other service requesters who require less than a minimum number of taps are required to pay for the entire cost of the extension, while other, larger extension requests that involve more than the minimum number of taps are paid in part by the developer and in part by the district based on such economic criteria as described in Question 2?

4. Is a utility district authorized to expend its own funds to extend utility lines and mains to a newly established industrial park in anticipation of future development activity related to such extension, even if the project is speculative with no actual customers requesting service at the time of the extension?

5. Is a utility district authorized to contribute funds to its local chamber of commerce, its county government or its county's nonprofit economic development corporation for economic

development activities aimed at increasing development in the district's service area in anticipation of increasing its customer base and service loads?

6. Relative to Question 5, assuming a utility district is permitted to join the chamber of commerce as a regular dues paying member under Tenn. Code Ann. § 7-82-111, is a utility district authorized to pay membership dues that are assessed at a higher rate based on the district's number of employees, revenues or other assessment category such as industry type?

7. a. Is a utility district authorized to join with other utility districts in its county to create a nonprofit corporation or other entity to promote economic development activities aimed at bettering the respective utility systems by promoting development and customer growth in the districts' service areas and to pay dues to such organizations for the purpose of funding these activities?

b. May a utility district voluntarily pay a higher rate of dues than regular members to join a select membership status where the increased dues are used for economic development projects and activities aimed at increasing economic development in the district's service area?

8. Is a utility district authorized to incur expenses, and to pay such expenses from its funds, directly related to its recruitment of new industry or commercial development prospects that might increase the service load on the district's system and thereby strengthen the economic operation of the district's system?

OPINIONS

1. a. This action is clearly within the district's authority.

b. So long as the change in extension policy does not cause the rate structure to be unreasonable, it is within the district's authority.

2. Such a policy is within the district's authority, so long as it does not unreasonably discriminate among developments or cause the rate structure to be unreasonable.

3. Such a policy is within the district's authority, so long as it does not unreasonably discriminate among developments or cause the rate structure to be unreasonable.

4. A utility district is authorized to use its own funds to extend service to an industrial park even before any tenants have located there.

5. The Utility District Law expressly authorizes natural gas utility districts, but not other types, to contribute to such organizations. It can be argued, however, that expenses like these to promote development and increased system efficiency are within a utility district's authority to own and operate a utility system. Whether contributions to a local organization for industrial recruitment

or development are within a utility district's authority would depend on specific facts and circumstances, including the size of the contributions relative to district revenues and similar expenditures by other districts; the purpose for which the funds are actually used; and the likelihood that the expenditures will ultimately benefit the customers of the district by increasing system efficiency and lowering utility rates.

6. Depending on the facts and circumstances, Tenn. Code Ann. § 7-82-111 would authorize a utility district to pay membership dues assessed at a higher rate than other members, so long as the assessment structure of dues is reasonable. Whether the assessment structure is reasonable would depend on the classification system, the dues paid by other members, and whether utility districts are unduly singled out for different treatment.

7. a. Whether creating a corporation to promote industrial growth and funding it with utility district revenues is authorized would depend on specific facts and circumstances, including the amount of the revenues spent for this purpose relative to the revenues of each district and similar expenditures by other districts; the purpose for which the funds are actually used; and the likelihood that the expenditures will ultimately benefit the customers of each district by increasing system efficiency and lowering utility rates of each district.

b. Whether a utility district would be authorized to pay a higher rate of dues than other members in an organization to promote economic growth would depend on specific facts and circumstances, including the amount of the revenues spent for this purpose relative to the revenues of each district and similar expenditures by other districts; the purpose for which the funds are actually used; and the likelihood that the expenditures for a district's membership in the select group will ultimately benefit the customers of each district by increasing system efficiency and lowering utility rates of each district.

8. Whether a utility district would be authorized to use its funds to recruit new industry or commercial development prospects would depend on specific facts and circumstances, including the amount of the revenues spent for this purpose relative to the revenues of the district and similar expenditures by other districts; the purpose for which the funds are actually used; and the likelihood that the expenditures for the industrial recruitment will ultimately benefit the customers of each district by increasing system efficiency and lowering utility rates of each district.

ANALYSIS

Introduction

This opinion concerns the authority of a utility district created under the Utility District Law of 1937, Tenn. Code Ann. §§ 7-82-101, *et seq.*, to engage in various activities. The Utility District Law authorizes the creation of a utility district by a county executive upon the petition of twenty-five owners of real property who reside within the boundaries of the proposed district, and after a hearing. Tenn. Code Ann. § 7-82-201. A utility district, once incorporated, is a municipality or public

corporation. Tenn. Code Ann. § 7-82-301(a)(1). Utility districts have no taxing authority. *Id.* A utility district exists and operates for the benefit of its customers. *United Cities Gas Co. v. Wigington,* 815 S.W.2d 506, 508 (Tenn. 1991). Generally, a utility district is the sole public corporation authorized to furnish the utility services it is providing within its service area. *Id.* A utility district is authorized to furnish various utility services, and to carry out this purpose it is authorized to:

> . . . acquire, construct, reconstruct, improve, better, extend, consolidate, maintain and operate such system or systems, within or without the district, and to purchase from, and furnish, deliver and sell to any municipality, the state, any public institution and the public, generally, any of the services authorized by this chapter [the Utility District Law].

Tenn. Code Ann. § 7-82-302(a)(1). A utility district also has the powers outlined in Tenn. Code Ann. § 7-82-304. These include the power to acquire real and personal property, enter into contracts, incur debts, and fix, maintain, collect and revise rates and charges for any service. The powers granted under this statute are the general corporate powers necessary for the transaction of the district's business. The exercise of these powers is, however, limited by the heading of the statute "[p]owers in carrying out purposes." *United Cities Gas Co. v. Wigington, supra* (Tenn. 1991) (the power to develop and operate a public utility does not include the power to sell the system and terminate the corporate existence of the district). In addition, Tenn. Code Ann. § 7-82-306 contains a broad general grant of powers:

> General implementing powers.--Any district created pursuant to the provisions of this chapter shall be vested with all the powers necessary and requisite for the accomplishment of the purpose for which such district is created, capable of being delegated by the general assembly. No enumeration of particular powers herein created shall be construed to impair or limit any general grant of power herein contained nor to limit any such grant to a power or powers of the same class or classes as those enumerated. The district is empowered to do all acts necessary, proper or convenient in the exercise of the powers granted herein.

The Tennessee Supreme Court has noted that the vesting of the powers set forth in this statute is plenary in scope, but is limited to those powers "necessary and requisite for the accomplishment of the purpose for which such district is created." *United Cities Gas Co. v. Wigington, supra.* The statute, therefore, grants a utility district all the powers necessary and requisite for the accomplishment of the purpose for which the district is created, that is, furnishing utility service. The district may do all acts necessary, proper, or convenient to exercise these powers.

Under Tenn. Code Ann. § 7-82-403(a), the board of commissioners of a utility district:

> . . . shall prescribe and collect *reasonable* rates, fees, tolls, or charges for the services, facilities and commodities of its system or systems, shall prescribe penalties for the nonpayment thereof, and shall revise such rates, fees, tolls or charges from time to time whenever necessary to ensure that such system or systems shall be and always remain self-supporting. The rates, fees, tolls or charges prescribed shall be such as will always produce revenue at least sufficient to:
>
> (1) Provide for all expenses of operation and maintenance of the system or systems, including reserves therefor;
>
> (2) Pay when due all bonds and interest thereon for the payment for which such revenues are or shall have been pledged, charged or otherwise encumbered, including reserves therefor.

(Emphasis added). In any gas utility district and in counties within four specific population brackets, this requirement applies only if the district has issued bonds. Tenn. Code Ann. § 7-82-403(b). The Tennessee Court of Appeals has also recognized that the common law requires a municipal water service to impose rates that are "fair and reasonable in view of the existing conditions." *City of Parsons v. Perryville Utility District*, 594 S.W.2d 401, 406 (Tenn. Ct. App. 1979), *p.t.a. denied* (1980).

Under Tenn. Code Ann. § 7-82-402, water users of a district may protest water rates to the commissioners of the district, with the right to appeal to the Utility Management Review Board. In addition, the Utility Management Review Board, which is created under Tenn. Code Ann. §§ 7-82-701, *et seq.*, is generally authorized to review rates charged and services provided by public utility districts. Tenn. Code Ann. § 7-82-102(a)(1). This review is available upon a petition signed by at least ten percent of the users within the authorized area of the utility district. *Id.* The Utility Management Review Board is also authorized to review any decision of any utility district under Tenn. Code Ann. § 7-82-401 upon simple written request of any utility district customer or any member of the public within thirty days of the decision. Tenn. Code Ann. § 7-82-702(7). Rules of the Board provide that a customer of a utility district may ask the Board to review a decision by a utility district board of commissioners regarding complaints concerning services provided and charges for services. Tenn. Reg. Ch. 1200-22-7-.05(3)(c). Review of any decision by the Utility Management Review Board is by common law certiorari within the county of the utility district's principal office. Tenn. Code Ann. § 7-82-702(7). The scope of review under the common law writ is whether the board or tribunal has exceeded its jurisdiction or is acting illegally, fraudulently or arbitrarily. *Powell v. Parole Eligibility Review Board*, 879 S.W.2d 871, 873 (Tenn. Ct. App. 1994), *p.t.a. denied* (1994).

1. Extending Service

The first question is whether a utility district is authorized to extend some of its water mains and sewer lines using its own funds in order to increase customer load and promote development in its service area. This measure clearly falls within the power of the utility district to own and operate a water and sewage system.

The request also asks if the answer to this question would change if the district has historically required the developer or customer requesting the service to pay the full cost of all water and wastewater extensions. Clearly, it is within the district's statutory authority to change this practice. The district, however, should be prepared to articulate the reasons for the change and how it will ultimately benefit customers. Over time, the change in policy will be reflected in the district's rate structure. Under its earlier policy, developers bore the full cost of system expansions. Under the new policy, all of the current customers will ultimately be required to bear the cost of future expansions. So long as the change does not cause the rate structure to be unreasonable, it is within the district's authority. Whether the change would cause the rate structure to be unreasonable would be an issue of facts and circumstances, including the practice of other utilities, and whether the increase in the customer base resulting from the extension would cause the utility to operate more efficiently and lower the rate structure system wide.

2. Extension policy

The next question is whether a utility district is authorized to adopt and enforce a written extension policy that allows the district to expend a portion of its own funds on each requested extension based on economic criteria related to the planned size of the development, potential economic return to the district, cost of the extension, and other reasonable economic factors aimed at assuring the district's investment is protected and calculated to realize a fair return to cover the district's costs of construction, operation and maintenance. Again, such a policy would clearly fall within the district's authority to "acquire, construct, reconstruct, improve, better, extend, consolidate, maintain and operate such system or systems" under Tenn. Code Ann. § 7-82-302(a)(1). The legality of the policy would depend on its reasonableness. The policy could be subject to challenge if it unreasonably discriminates among different developments, or if it causes the rate structure to be unreasonable. The reasonableness of the policy or the resulting rate structure will depend on facts and circumstances.

3. Two-Tier Extension Policy

The next question is whether a utility district is authorized to adopt and enforce a written extension policy that provides a two-tier approach whereby developers of subdivisions and other service requesters who require less than a minimum number of taps are required to pay for the entire cost of the extension, while other, larger extension requests that involve more than the minimum number of taps are paid in part by the developer and in part by the district based on such economic criteria as described in Question 2 above. Such a policy would fall within the district's authority to

"acquire, construct, reconstruct, improve, better, extend, consolidate, maintain and operate" its utility systems under Tenn. Code Ann. § 7-82-302(a)(1). The legality of the policy would depend on its reasonableness. The policy could be subject to challenge if it unreasonably discriminates among different developments and customers, or if it causes the rate structure to be unreasonable. The reasonableness of the policy or the resulting rate structure will depend on facts and circumstances.

4. Extending Service to Industrial Park

The next question is whether a utility district is authorized to expend its own funds to extend utility lines and mains to a newly established industrial park in anticipation of future development activity related to such extension, even if the project is speculative with no actual customers requesting service at the time of the extension. We think this extension clearly falls within the district's authority to "acquire, construct, reconstruct, improve, better, extend, consolidate, maintain and operate such system or systems" under Tenn. Code Ann. § 7-82-302(a)(1). Since tenants are unlikely to locate at the park before it is furnished with water and sewer service, it is not necessary for the district to wait for a tenant's request before extending the system to the industrial park.

5. Contributing Funds to Chamber of Commerce

The next question is whether a utility district is authorized to contribute funds to its local chamber of commerce, its county government, or its county's nonprofit economic development corporation for economic development activities aimed at increasing development in the district's service area in anticipation of increasing its customer base and service loads. Tenn. Code Ann. § 7-82-111 provides:

> Nothing in this chapter shall be construed to prohibit a utility district from becoming a member of a local chamber of commerce.

A utility district, therefore, is authorized to become a member of a local chamber of commerce. Under Tenn. Code Ann. § 7-82-304(12), natural gas utility districts that serve customers in counties within specified population brackets are authorized to provide funding to chambers of commerce and economic and community organizations pursuant to a resolution adopted by the governing body in accordance with the requirements of the statute. The statute does not extend this authority to any other utility districts, including utility districts providing water and sewer service. It can be argued, however, these contributions are within the district's general authority to "acquire, construct, reconstruct, improve, better, extend, consolidate, maintain and operate such system or systems" under Tenn. Code Ann. § 7-82-302(a)(1), even though they are not expressly authorized by the statutes.

Tennessee courts have never addressed the extent to which a utility district may use its revenues for promoting general economic development. Courts in other states have addressed the issue in the context of rate regulation of privately owned utilities. In these cases, the issue is whether advertising or promotional expenses may be reflected in customer rates as an operating expense.

These cases are compiled and discussed in Jane M. Draper, Annotation, *Advertising or Promotional Expenditures of Public Utility as Part of Operating Expenses for Ratemaking Purposes*, 83 A.L.R.3d 963 (1978). Since utility districts derive all their operating revenue from utility rates, the authority of utility districts to incur promotional expenses presents an analogous issue. Whether contributions to a local organization for industrial recruitment or development are within a utility district's authority would depend on specific facts and circumstances, including the size of the contributions relative to district revenues and similar expenditures by other districts; the purpose for which the funds are actually used; and the likelihood that the expenditures will ultimately benefit the customers of the district by increasing system efficiency and lowering utility rates.

6. Chamber of Commerce Membership Dues

The next question is whether, assuming a utility district is permitted to join the chamber of commerce as a regular member under Tenn. Code Ann. § 7-82-111, a utility district may pay membership dues assessed at a higher rate based on the district's number of employees, revenues, or other assessment category such as industry type. Under Tenn. Code Ann. § 7-82-111, a utility district is authorized to be a member of the local chamber of commerce. Depending on the facts and circumstances, this statute would authorize a utility district to pay membership dues assessed at a higher rate than other members, so long as the assessment structure of dues is reasonable. Whether the assessment structure is reasonable would depend on the classification system, the dues paid by other members, and whether utility districts are unduly singled out for different treatment.

7.a. Creation of a Joint Entity to Promote Economic Development

The next question is whether utility districts within a county may jointly create a nonprofit corporation or other entity to promote economic development activities, and to fund these organizations by paying dues. Under Tenn. Code Ann. § 12-9-104, any public agency may exercise its powers jointly with any other public agency. Under the same statute, these agencies may enter into agreement with one another for joint or cooperative action, and the agreement may establish a corporation not for profit. Tenn. Code Ann. § 12-9-104(c)(1). A public agency includes any political subdivision of the State. Tenn. Code Ann. § 12-9-103(1)(A). Since a utility district is a "municipality" under Tenn. Code Ann. § 7-82-301(a)(1), it is a public agency within the meaning of Tenn. Code Ann. § 12-9-103. *See also* Op. Tenn. Atty. Gen. 85-205 (June 27, 1985) (an emergency communications district is a public agency within the meaning of this statute). Several utility districts, therefore, may establish a not for profit corporation as part of an interlocal cooperative agreement for a joint exercise of their powers.

The real question, however, is whether a utility district is authorized to support the activities in which the corporation will engage. The answer to this question depends on whether this support is "necessary or requisite" to the utility district's authority to own, operate, develop, and maintain a utility district. The analysis of this question is very similar to the analysis of a utility district's authority to contribute funds to a chamber of commerce or other organization to support economic development. Whether creating a corporation to promote industrial growth and funding it with

utility district revenues is authorized, therefore, would depend on specific facts and circumstances, including the amount of revenues used for this purpose relative to the revenues of each district and similar expenditures by other districts; the purpose for which the funds are actually used; and the likelihood that the expenditures will ultimately benefit the customers of each district by increasing system efficiency and lowering utility rates of each district.

b. Higher Level of Dues for Select Membership

The next question is whether a utility district may voluntarily pay a higher rate of dues than regular members to join a select membership status where the increased dues are used for economic development projects and activities aimed at increasing economic development in the district's service area. We assume your question refers to membership in a jointly formed organization like the one discussed in Question 7.a. above. The analysis of this issue is similar to the analysis discussed above. Whether a utility district would be authorized to pay a higher rate of dues than other members in an organization to promote economic growth would depend on specific facts and circumstances, including the amount of the revenues spent for this purpose relative to the revenues of each district and similar expenditures by other districts; the purpose for which the funds are actually used; and the likelihood that the expenditures for a district's membership in the select group will ultimately benefit the customers of each district by increasing system efficiency and lowering utility rates of each district.

8. Use of Utility District Funds to Promote Industrial Development

The last question is whether a utility district is authorized to incur expenses, and to pay such expenses from its funds, directly related to its recruitment of new industry or commercial development prospects that might increase the service load on the district's system and thereby strengthen the economic operation of the district's system. The analysis of this issue is similar to the analysis in Questions 5 and 7. Whether a utility district would be authorized to use its funds to recruit new industry or commercial development prospects would depend on specific facts and circumstances, including the amount of the revenues spent for this purpose relative to the revenues of the district and similar expenditures by other districts; the purpose for which the funds are actually used; and the likelihood that the expenditures for the industrial recruitment will ultimately benefit the customers of each district by increasing system efficiency and lowering utility rates of each district.

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