S T A T E O F T E N N E S S E E
OFFICE OF THE
ATTORNEY GENERAL
PO BOX 20207
NASHVILLE, TENNESSEE 37202

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Opinion No. 07-124

City Acquiring Ownership of a Water Utility District

QUESTION

May a municipality acquire ownership of a water utility district once all or part of the territory served by the water utility district has been annexed by the municipality?

OPINION

A city's right to acquire utility district property upon annexation of property within the service area of a utility district is governed by Tenn. Code Ann. § 6-51-111. Under this statute, the city and district must attempt to reach a written agreement for the transfer of the district's property rights and assets "that justice and reason may require in the circumstances." Tenn. Code Ann. § 6-51-111(a). If the district has outstanding debt, any agreement or arbitration award must contain the provisions set forth in Tenn. Code Ann. § 6-51-111(c). If a private utility provides utility service to the city, the private utility's rights to acquire the property are governed by Tenn. Code Ann. § 6-51-111(d)(1). If the utility district has an outstanding loan from the Farmers Home Administration or its successor agencies, federal law provides that the city's annexation will not change the utility district's exclusive right to provide service within the annexed territory. A utility district may voluntarily consolidate with a city as a separate department of the city by following the procedure described in Tenn. Code Ann. § 7-82-202(f).

ANALYSIS

This opinion concerns the power of a city to acquire ownership of a water utility district once all or part of the territory served by the water utility district has been annexed by the municipality. The respective rights of a city and a utility district upon a city's annexation of territory served by a utility district are governed by Tenn. Code Ann. § 6-51-111. The statute provides in relevant part:

> (a) Upon adoption of an annexation ordinance or upon referendum approval of an annexation resolution as provided in this part, *an annexing municipality and any affected instrumentality of the state of Tennessee, including, but not limited to, a utility district . . . shall attempt to reach agreement in writing for allocation and conveyance to the annexing municipality of any or all public functions,* rights, duties, property, assets and liabilities of such state instrumentality that justice and reason may require in the circumstances. . . . *The annexing municipality, if and to the*

extent that it may choose, shall have the exclusive right to perform or provide municipal and utility functions and services in any territory that it annexes, notwithstanding § 7-82-301 or any other statute, subject, however, to the provisions of this section with respect to electric cooperatives.

(b) Subject to such exclusive right, any such matters upon which the respective parties are not in agreement in writing within sixty (60) days after the operative date of such annexation shall be settled by arbitration with the laws of arbitration of the state of Tennessee effective at the time of submission to the arbitrators, and § 29-5-101(2) shall not apply to any arbitration arising under this part and § 6-51-301. The award so rendered shall be transmitted to the chancery court of the county in which the annexing municipality is situated, and thereupon shall be subject to review in accordance with §§ 29-5-113 — 29-5-115 and 29-5-118.

(c)(1) If the annexed territory is then being provided with a utility service by a state instrumentality that has outstanding bonds or other obligations payable from the revenues derived from the sale of such utility service, the agreement or arbitration award referred to in subsections (a) and (b) shall also provide that:

(A) The municipality will operate the utility property in such territory and account for the revenues therefrom in such manner as not to impair the obligations of contract with reference to such bonds or other obligations; or

(B) The municipality will assume the operation of the entire utility system of such state instrumentality and the payment of such bonds or other obligations in accordance with their terms.

(2) Such agreement or arbitration award shall fully preserve and protect the contract rights vested in the holders of such outstanding bonds or other obligations.

(d)(1) Notwithstanding the provisions of any law to the contrary, *if a private individual or business entity provides utility service within the boundaries of a municipality under the terms of a privilege, franchise, license, or agreement granted or entered into by the municipality, and if the municipality annexes territory that includes the service area of a utility district, then such private individual or business entity and the utility district shall attempt to reach agreement in writing for allocation and conveyance to such private individual or business entity of any or all public functions, rights, duties, property, assets, and liabilities of such utility district that justice and reason may require in the circumstances. If an agreement is not reached, then notwithstanding the change of municipal boundaries,* ***the service area of the utility district shall remain unchanged, and such private individual or business entity shall not provide utility service in the service area of the utility district.***

(Emphasis added). In addition, federal law protects the rights of rural utilities that have obtained loans from the Farmers Home Administration or its successor agencies. 7 U.S.C. § 1926(b). This statute provides in relevant part:

> The service provided or made available through any such association *shall not be curtailed or limited by inclusion of the area served by such association within the boundaries of any municipal corporation or other public body*, or by the granting of any private franchise for similar service within such area during the term of said loan; nor shall the happening of any such event be the basis of requiring such association to secure any franchise, license, or permit as a condition to continuing to serve the area served by the association at the time of the occurrence of such event.

(Emphasis added). If this statute is applicable to the utility district, then it would also affect the rights of the city, the private utility, and the utility district with regard to utility service in the annexed territory. The statute is further discussed in *Town of Rogersville ex rel. Rogersville Water Commission v. Mid-Hawkins County Utility District*, 122 S.W.3d 137, 140-142 (Tenn. Ct. App. 2003), *p.t.a. denied* (2003).

Tennessee statutes also describe the process by which a utility district may voluntarily consolidate with a city as a separate department of the city. Tenn. Code Ann. § 7-82-202(f) provides:

> A municipality may acquire a utility district to be operated as a department separate from any other municipal utility. Whenever a utility district by resolution adopted by its governing body agrees or proposes to consolidate with a municipality as a separate department of such municipality by transferring all of its property and obligations to such municipality, it shall petition the county mayor of the county in which it was created for an order approving the resolution to permit such consolidation, merger, acquisition or transfer of its franchise facilities, assets and obligations to a municipal corporation for the purpose of more efficiently and conveniently furnishing the service or services authorized by its order of creation. Upon such petition being filed, such county mayor shall proceed in exactly the same manner as provided in this chapter for the creation of a utility district, and upon a finding that the public convenience and necessity requires consolidation, merger, acquisition or transfer and that the same is economically sound and feasible and in the public interest, an order shall be entered approving such resolution. Upon the approval of such resolution by order of the county mayor, such utility district shall be dissolved and the assets, obligations, legal rights and duties of such district shall become those of the department of the municipality. Such order shall provide that the department of the municipality shall assume the operation of the utility system and account for the revenues from the system in such a manner as not to impair the obligations of contract with reference to bond issues or other legal obligations of the district, and shall fully preserve and protect the contract rights vested in the owners

> of such outstanding bonds, obligations or contractual interests. Such department of the municipality shall be operated separately from any other utility department of the municipality. The governing body of the municipality shall be the governing board of such department and shall appoint an advisory committee on utilities if the area served by the utility district is outside the boundaries of the municipality. The governing body of the municipality shall, by ordinance, create such advisory committee to be composed of either former utility district commissioners or residents and customers of the utility system so acquired. The advisory committee members shall be appointed by the governing body of the municipality in the number and for the term specified by the ordinance. When the former utility district ceases to be a separate department and is merged with the other utility services of the municipality into one (1) utility system, such advisory committee may be dissolved. No portion of such utility district shall be made a part of a municipal utility service without consideration being paid to the department composed of such utility district.

In accordance with the above statutory provisions, therefore, a city may acquire ownership of a water utility district once all or part of the territory served by the water utility district has been annexed by the municipality.

ROBERT E. COOPER, JR.
Attorney General and Reporter

MICHAEL E. MOORE
Solicitor General

ANN LOUISE VIX
Senior Counsel

Requested by:

Honorable John Mark Windle
State Representative
108 War Memorial Building
Nashville, TN 37243-0141