STATE OF TENNESSEE
OFFICE OF THE
ATTORNEY GENERAL
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Opinion No. 11-35

Utility District Operating at a Loss

QUESTIONS

1. What authority does a county legislative body have to dissolve a utility district that:

(a) has failed to furnish the services that the utility district proposed to provide when it was created under Tenn. Code Ann. §§ 7-82-101, *et seq.*, or

(b) is operating at a substantial loss?

2. If the county becomes the provider of utility services in the service area of the district pursuant to Tenn. Code Ann. § 7-82-202(e), does the county absorb all the liabilities of the utility district, including repayment of bonds issued by the utility district?

3. Does Article II, Section 29, of the Tennessee Constitution require the county to hold a referendum before it may assume the debt obligations of a utility district under Tenn. Code Ann. § 7-82-202(e)?

4. Does the last sentence of Tenn. Code Ann. § 7-82-301(a)(1)(B) permit the county to begin furnishing services within the utility district's service area where the utility district is not providing services?

5. Does Tenn. Code Ann. § 7-82-505(b) authorize a county mayor to file an action for a court to appoint a receiver to administer a district that has defaulted on its bond obligations?

OPINIONS

1. A county legislative body has no unilateral authority to dissolve a utility district.

2. Yes. Under Tenn. Code Ann. § 7-82-202(e), a utility district board must pass a resolution proposing to consolidate by transferring its assets and liabilities to a city or county. The petition for the transfer must include the utility district's liabilities, and the county to which the system is transferred must preserve the contract rights of third parties against the utility district.

3. No. A utility district is a public corporation and providing sewer service is a public purpose. It is the opinion of this Office, therefore, that Article II, Section 29, of the Tennessee Constitution does not require approval in a referendum of the county's assumption of the liabilities of a utility district under Tenn. Code Ann. § 7-82-202(e).

4. Yes. The county may furnish services within the service area of the utility district, but only upon order of the county mayor after a petition has been filed and it has been established that the public convenience and necessity require the change. The statute does not require the entity providing the service to assume any liabilities of the district. If the utility district has received federal aid, federal statutes could affect the county mayor's right to change the service area of the district.

5. No. Assuming the county is not a bondholder of the district and has no other property interest in its assets, a county mayor is not authorized to petition a court to place a utility district in receivership under this statute.

ANALYSIS

1. Authority of County Commission to Dissolve a Utility District

This opinion addresses a number of questions about utility districts created under Tenn. Code Ann. §§ 7-82-101, *et seq*. Tenn. Code Ann. § 7-82-201 describes the process by which a utility district is established. Once a utility district has been incorporated, it is a municipality or public corporation in perpetuity under its corporate name.

The first question concerns the authority of a county commission to dissolve a utility district under certain circumstances. The first situation is when the district has failed to provide the services it was authorized to provide when it was chartered. The second situation is when the utility district is operating at a substantial loss.

A utility district may petition the county mayor to be dissolved upon the transfer of its assets and liabilities to a city or county, or to be dissolved and consolidated with a city or county as a separate department. Tenn. Code Ann. § 7-82-202. In addition, a financially distressed utility district may agree to consolidate with another utility district or with a municipal utility. Tenn. Code Ann. § 7-82-704. But no statute authorizes a county commission unilaterally to dissolve a utility district.

2. Consolidation of Utility District with County

The next question is the effect of consolidation of a utility district with a county as authorized by Tenn. Code Ann. § 7-82-202(e), which provides in relevant part:

> (e)(1)(A) [W]henever a utility district by resolution of its governing body agrees or proposes to consolidate with a municipality or a county by transferring all of its property ***and obligations*** to the municipality or county, the governing body or bodies shall petition the county mayor of the county or counties in which they

> were created . . . for an order permitting the merger, consolidation or transfer of its franchise facilities, assets ***and obligations*** to a municipality or a county for the purpose of more efficiently and conveniently furnishing the service or services authorized by their order of creation. Upon the petition being filed, the county mayor or mayors shall proceed in exactly the same manner as provided in this chapter for the creation of a utility district, except as set forth in subsection (g).
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> (B) Upon a finding that the public convenience and necessity requires . . . the transfer of any utility district into a municipality or county and that the . . . transfer is economically sound and feasible and in the public interest, an order shall be entered approving the . . . transfer of the utility district or districts.
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> (iii) If the petition is for the transfer of all franchises, assets ***and liabilities*** to a municipality or a county, then the utility district shall be dissolved and provision made in the order for an equitable distribution of the assets and for the termination of the existence of the utility district and shall establish the legal rights, duties and obligations of the entities and parties involved.
>
> (iv) The order ***shall*** provide that the . . . municipality or county to which a transfer is made shall assume the operation of the system or systems then being . . . transferred and shall account for the revenues from the system or systems in such a manner as not to impair the obligations of the contract with reference to bond issues or other legal obligations of the utility district or districts, ***and shall fully preserve and protect the contract rights vested in the owners of the outstanding bonds, obligations or contractual interests.***

(emphasis added). Subsection (g) of the statute requires the petition to be filed with the Utility Management Review Board at the same time it is filed with the county mayor. This petition, however, is not subject to the approval or disapproval by the Utility Management Review Board.

As the request indicates, this statute requires the utility district board to pass a resolution agreeing to transfer its assets and liabilities to a city or county. The petition for the transfer must acknowledge and preserve the utility district's liabilities, and the county to which the system is transferred must maintain the contract rights of third parties against the utility district.

3. Requirement for Referendum if a County Assumes the Obligations of a Utility District

The next question is whether a county's assumption of utility district obligations under Tenn. Code Ann. § 7-82-202(e) must be approved by a referendum under Article II, Section 29, of the Tennessee Constitution. Article II, Section 29, provides in relevant part:

> The General Assembly shall have power to authorize the several counties and incorporated towns in this State, to impose taxes for County and Corporation

> purposes respectively, in such manner as shall be prescribed by law; and all property shall be taxed according to its value, upon the principles established in regard to State taxation. But the credit of no County, City or Town shall be given or loaned to or in aid of any person, company, association or corporation, except upon an election to be first held by the qualified voters of such county, city or town, and the assent of three-fourths of the votes cast at said election.

The lending of credit clause requires an expenditure for public purposes. This is because it is "fundamental that the public taxes or, which is the same thing, the public credit can not be donated or applied to anything but a public use . . .." *McConnell v. City of Lebanon,* 203 Tenn. 498, 509 (Tenn. 1958). The word "credit," as it is used in this provision of the Constitution, has been held to mean, "the imposition of some new financial liability upon a county, city or town which in effect results in [the] creation of a public debt for the benefit of private enterprises . . .." *Copley v. Fentress County,* 490 S.W.2d 164, 169 (Tenn. Ct. App. 1972). The Tennessee Supreme Court has held that, "the act authorizing the lending of credit should provide for the election; otherwise it is fatally incomplete and is void." *Berry v. Shelby County.* 139 Tenn. 532, 201 S.W. 748 (Tenn. 1918).

Providing sewer service is clearly a public purpose. Further, by assuming responsibility for the contractual obligations of a utility district, including its bonds, the county would be incurring a new financial liability and, therefore, lending its credit. In 1987, this Office concluded that a county may not guarantee a debt issue of a utility district without a referendum as required under Article II, Section 29. Op. Tenn. Att'y Gen. 87-135 (August 6, 1987). In that situation, however, no statute authorized such a guarantee. In this case, Tenn. Code Ann. § 7-82-202(e) clearly authorizes a county to assume a utility district's obligations. Further, that opinion does not discuss cases that have found the referendum requirement not to apply when a county or city lends its credit for the benefit of a public corporation.

A utility district is a municipality or public corporation. Tenn. Code Ann. § 7-82-301(a)(1)(A); *First Utility District of Carter County v. Clark,* 834 S.W.2d 283, 287 (Tenn. 1992). Where a lending of credit is in aid of a public corporation, a referendum is unnecessary. *Ransom v. Rutherford County,* 123 Tenn. 1, 130 S.W. 1057 (Tenn. 1910) (city or county may issue general obligation bonds to help finance schools owned and operated by the State without a referendum); *Dodd v. Roane County,* 174 Tenn. 267, 124 S.W.2d 953 (Tenn. 1939) (county could lend its credit in aid of a city without a referendum); *State ex rel. Bigham v. Powers,* 124 Tenn. 553, 137 S.W. 1110 (Tenn. 1911) (county may appropriate tax funds to pay the initial cost of establishing a drainage district without an election); Op. Tenn. Att'y Gen. 98-104 (June 11, 1998) (city may lend money to the city housing authority without a referendum); Op. Tenn. Att'y Gen. 90-39 (March 19, 1990) (county is authorized to issue its general obligation bonds and contribute the proceeds to a utility district to finance cooperative arrangements under Tenn. Code Ann. §§ 5-16-101, *et seq.,* without a referendum). For this reason, it is the opinion of this Office that Article II, Section 29, does not require the county's assumption of the liabilities of a utility district under Tenn. Code Ann. § 7-82-202(e) to be approved in a referendum.

4. County Providing Sewer Service in Utility District's Service Area

The next question is whether the county could provide sewer service in the service area of a utility district under the last sentence of Tenn. Code Ann. § 7-82-301(a)(1)(B). This statute provides:

> So long as the district continues to furnish any of the services that it is authorized to furnish in this chapter, it shall be the ***sole public corporation empowered to furnish such services in the district***, and no other person, firm or corporation shall furnish or attempt to furnish any of the services in the area embraced by the district, ***unless and until it has been established that the public convenience and necessity requires other or additional services;*** provided, that this chapter shall not amend or alter §§ 6-51-101 – 6-51-111, and 6-51-301.

(emphasis added). Tenn. Code Ann. §§ 6-51-101, *et seq.*, and Tenn. Code Ann. § 6-51-301 address the right of an annexing city to provide utility services within the annexed territory. Assuming the service area of the utility district is located in an unincorporated part of the county, these statutes would not be relevant to this question.

Tennessee courts have concluded that Tenn. Code Ann. § 7-82-301(a), formerly codified at Tenn. Code Ann. § 6-2607, provides the only method by which the service area or exclusive franchise of a utility district may be modified. *Consolidated Gray-Fordtown-Colonial Heights Utility District v. O'Neill*, 209 Tenn. 342, 354 S.W.2d 63 (Tenn. 1962); *Town of Rogersville v. Mid Hawkins County Utility District*, 122 S.W.3d 137 (Tenn. Ct. App. 2003), *p.t.a. denied* (2003); *Chandler Investment Co. v. Whitehaven Utility District,* 44 Tenn. App. 1, 311 S.W.2d 603 (Tenn. Ct. App. 1957), *p.t.a. denied* (1958). In each of these cases, the court found that residents in the service area of a utility district had a right to petition the county mayor to change the service area or to allow another utility to provide a service in the area. Residents of the service area of a utility district, therefore, could petition the county mayor to allow the county to provide sewer service in the service area of the district. Further, none of these cases states that such a petition may be brought only by residents. The statute itself does not specify or limit what other parties might bring this petition. This Office has concluded that a city may petition the county mayor to change the service area of a utility district or to allow the city to furnish services within the service area of the utility district. Op. Tenn. Att'y Gen. 02-110 (October 7, 2002). The party that brings the petition must establish that "the public convenience and necessity requires" that the county provide the service. The statute does not require the entity providing the service to assume any liabilities of the district. If the utility district has received federal aid, federal statutes could affect the county mayor's right to change the service area of the district. *Town of Rogersville,* 122 S.W.3d at 140-41; *Dyersburg Suburban Consolidated Utility District v. City of Dyersburg,* 2007 WL 1859460 (Tenn. Ct. App. June 29, 2007). Both of these cases involved utility districts that had received a loan from the Farmers' Home Administration.

5. Authority of a County Mayor to Place a Utility District in Receivership under Tenn. Code Ann. § 7-82-505

The next question is whether the following statute authorizes a county mayor to petition a court to place a utility district in receivership:

> If any default be made in the payment of the principal of or interest on such bonds [of a utility district], any court having jurisdiction of the action may appoint a receiver to administer the district, and the system or systems, with power to charge and collect rates sufficient to provide for the payment of all bonds and obligations outstanding against the system or systems and for the payment of operating expenses, and to apply the income and revenues of the bonds, in conformity with the provisions of this chapter, and any covenants with bondholders.

Tenn. Code Ann. § 7-82-505(b). The statute does not specify who has standing to ask the court to appoint a receiver. Generally, however, a receivership is a remedy by which the court takes possession of the assets of the entity placed in receivership through its court-appointed receiver. 75 C.J.S. *Receivers* § 2 (2010). The purpose of a receivership under Tenn. Code Ann. § 7-82-505(b) appears to be to protect the interests of the bondholders of a utility district that has defaulted on bonds issued under Tenn. Code Ann. §§ 7-82-501, *et seq*. Generally, a receiver may be appointed only when the party moving for the receivership has a legal or equitable right to apply for such relief, and such party must have an interest in the subject matter. 75 C.J.S. *Receivers* § 10 (2010). An applicant who has no right to, interest in, or lien on the property in question cannot successfully request the appointment of a receiver. *Id.* Assuming the county is not a bondholder of the district and has no other property interest in its assets, a county mayor is not authorized to petition a court to place a utility district in receivership under this statute.

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