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Opinion No. 12-72

"In Lieu of" Tax Payments on Gas System in Charter County

QUESTIONS

1. Does Chapter 984 of the 2012 Tennessee Publics Acts (hereinafter "Chapter 984") violate the provision of Article XI, Section 9, of the Tennessee Constitution, that requires local approval of any act of the General Assembly "private or local in form or effect applicable to a particular county or municipality either in its governmental or its proprietary capacity"?

2. Does Chapter 984 violate the provision of Article XI, Section 9, of the Tennessee Constitution that states the General Assembly may act with respect to a home rule municipality "only by laws which are general in terms and effect"?

3. Does Chapter 984 violate Article VII, Section 1, of the Tennessee Constitution, allowing for counties to adopt a charter government, or the implementing statutes by which Shelby County has adopted a charter form of government?

4. Because Chapter 984 only applies to a municipality operating a gas system located in a county that has adopted a charter form of government, does Chapter 984 violate Article XI, Section 8, of the Tennessee Constitution, which prohibits the General Assembly from suspending any general law for the benefit of any particular individual or passing any law for the benefit of individuals inconsistent with Tennessee's general laws?

5. If the answer to Question 4 is no, how will Chapter 984 be enforced?

OPINIONS

1. Chapter 984 is not "private or local in form or effect applicable to a particular county or municipality either in its governmental or its proprietary capacity" within the meaning of Article XI, Section 9, and, thus, does not require local approval under that provision.

2. Chapter 984 does not violate the "home rule" provision of Article XI, Section 9.

3. Chapter 984 does not violate Article VII, Section 1, or its implementing statutes.

4. No rational basis has been articulated or appears to exist for applying a different rule for a municipality in charter counties, as opposed to non-charter counties, regarding the authority

for a municipality to make tax equivalent payments on its gas system. Accordingly, Chapter 984 is constitutionally suspect under Article XI, Section 8, of the Tennessee Constitution.

5. In light of the answer to Question 4, Question 5 is pretermitted.

ANALYSIS

This opinion addresses the constitutionality of Chapter 984 of the Public Acts of 2012 ("Chapter 984"). The caption of Chapter 984 broadly states its purpose is "to amend Tennessee Code Annotated, Title 7, relative to local government." Chapter 984 specifically amends Tenn. Code Ann. § 7-39-405 regarding the payment of "in lieu of" tax payments by a municipality operating a gas system. Prior to the passage of Chapter 984, Tenn. Code Ann. § 7-39-405 stated:

> The municipality's governing body, in the resolution provided for in § 7-39-404(4), shall direct payment of the amounts to be paid as tax equivalents to the taxing jurisdictions in which its gas plant in service is located in accordance with and subject to any terms, conditions, contracts or agreements now in effect.

Tenn. Code Ann. § 7-39-405 (2011). Chapter 984 re-designates the aforementioned language as subsection (a) and adds the following as subsection (b):

> (b) Notwithstanding the provisions of any private act or home rule charter, or any part thereof, relating to the distribution of payments in lieu of taxes, unless a written agreement was executed prior to April 2012, or becomes effective on the first day of any fiscal year thereafter, by another taxing jurisdiction and:
>
> (1) A municipality,
>
> (2) Located in any county having a charter form of government,
>
> (3) That owns and operates a gas system,
>
> and such written agreement provides for a different payment, then each taxing jurisdiction shall receive a payment that is equal to that portion of the total tax equivalent payment that is calculated using each such taxing jurisdiction's tax rate pursuant to § 7-39-404(1)(A).

2012 Tenn. Pub. Acts. Ch. 984, § 1. Chapter 984 thus provides a different methodology for the payment of in lieu of tax payments for a municipality operating a gas system in a charter county as opposed to a municipality operating a gas system in a non-charter county. Chapter 984 states its provisions shall take effect upon becoming a law, and thus Chapter 984 became effective when signed by the Governor on May 10, 2012. *Id.*, § 2.

Tenn. Code Ann. § 7-39-405 is part of the Municipal Gas System Tax Equivalent Law of 1987, codified at Tenn. Code Ann. §§ 7-39-401 to -406. The intent of this law is set forth at Tenn. Code Ann. § 7-39-402 as follows:

> The purpose of this part is to provide the complete law of this state with respect to payments in lieu of taxes on the property and operations of all gas systems owned and operated by incorporated cities or towns, by counties, and by metropolitan governments, and to repeal the specific provisions of any private act, home rule charter or metropolitan government charter, or any part of any private act, home rule charter or metropolitan government charter, relating to payments in lieu of taxes, except for provisions relating to the distribution of any such payments, but not to repeal any other provisions of such private acts or charters or parts of the private acts or charters. This part is remedial in nature and this part shall be liberally construed to effectuate the purpose of this part.

Tenn. Code Ann. § 7-39-404 details the process and conditions whereby a municipality shall pay from its gas system revenues annual payments in lieu of taxes, referred to as "tax equivalents," on its gas system and gas operations to the respective taxing jurisdictions in which the municipality's gas system is located. Tenn. Code Ann. § 7-39-404 provides in relevant part:

> Notwithstanding any provision of law to the contrary in this code or in the provisions of any private act, every municipality may pay or cause to be paid from its gas system revenues for each fiscal year an amount for payments in lieu of taxes, referred to as "tax equivalents", on its gas system and gas operations, which, in the judgment of the municipality's governing body, shall represent the fair share cost of government properly to be borne by the municipality, subject, however, to the following conditions and limitations:
>
> > (1) The total amount so paid as tax equivalents for each fiscal year shall not exceed a maximum amount equal to the sum of the following:
> >
> > > (A) With respect to each of the respective taxing jurisdictions in which the municipality's gas system is located, the equalized property tax rate, determined as provided in this section, for the taxing jurisdiction as of the beginning of such fiscal year, multiplied by the net plant value of the gas system and the book value of materials and supplies within the taxing jurisdiction as of the beginning of such fiscal year, multiplied by the assessment ratio in effect as of the beginning of such fiscal year; and
> >
> > > (B) Four percent (4%) of the average of revenue less cost of gas from gas operations for the preceding three (3) fiscal years;

Tenn. Code Ann. § 7-39-404(1). Subsection (4) of the statute provides:

> The total amount to be paid as tax equivalents, including that to be paid for the municipality and any other taxing jurisdiction, for each fiscal year, determined in accordance with and subject to this part, shall be set forth in a resolution adopted

> by the municipality's governing body after consultation with the supervisory body, if different from the governing body, and ***the municipality's gas system shall pay to the municipality and any other specified taxing jurisdictions amounts as provided in that resolution.*** Such determination shall be made as early in such fiscal year as possible and shall become final at the end of such year;

Tenn. Code Ann. § 7-39-404(4) (emphasis added).

1. The initial question is whether Chapter 984 requires local approval under Article XI, Section 9, of the Tennessee Constitution (the "Local Approval Requirement"). This provision states in relevant part:

> [A]ny act of the General Assembly private or local in form or effect applicable to a particular county or municipality either in its governmental or its proprietary capacity shall be void and of no effect unless the act by its terms either requires the approval by a two-thirds vote of the local legislative body of the municipality or county, or requires approval in an election by a majority of those voting in said election in the municipality or county affected.

Tenn. Const. art. XI, § 9.

The Local Approval Requirement is only applicable if the enactment, irrespective of its form, is local in effect and application. *Farris v. Blanton*, 528 S.W.2d 549, 551 (Tenn. 1975) (an act that was general in its form but could only apply to Shelby County required local ratification under the Local Approval Requirement); *Lawler v. McCanless*, 220 Tenn. 342, 351, 417 S.W.2d 548, 552-53 (1967) (a general law limited by population bracket to Gibson County required local ratification under the Local Approval Requirement).

By its terms, Chapter 984 is general in application since it applies to all counties in Tennessee that have enacted a charter form of government or that enact a charter form of government in the future. Currently two counties in Tennessee have enacted a charter form of government, Knox and Shelby.[1] Each of these counties appears to contain a city that provides natural gas service: Knoxville, through the Knoxville Utilities Board; and Memphis, through Memphis Light, Gas, and Water.[2] For these reasons, Chapter 984 is not "private or local in form or effect applicable to a particular county or municipality either in its governmental or its proprietary capacity" and thus Chapter 984 is not subject to the Local Approval Requirement.

2. Both Memphis and Knoxville have voted to adopt home rule under Article XI, Section 9, of the Tennessee Constitution. *Tennessee County Government Handbook*, at 115 (Aug. 2010), *available at* http://www.cfas.tennessee.edu. Under the "home rule" provisions of Article XI, Section 9, "the General Assembly shall act with respect to such home rule municipality only by laws which are general in terms and effect." Tenn. Const. Art. XI, § 9. For the reasons discussed

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[1] *See Tennessee County Government Handbook*, at 115 (Aug. 2010), *available at* http://www.cfas.tennessee.edu; Ron Darden, *The Charter County Form of Government*, *available at* http://www.mtas.tennessee.edu.

[2] *See* Knoxville Utilities Board, http://www.kub.org/ (last visited June 19, 2012); Memphis Light, Gas & Water Board, http://www.mlgw.com/ (last visited June 19, 2012).

above, Chapter 984 is "general in terms and effect" and thus Chapter 984 complies with this provision of Article XI, Section 9. *See Civil Service Merit Bd. of City of Knoxville v. Burson*, 816 S.W.2d 725, 728-29 (Tenn. 1991) (quoting *Farris v. Blanton*, 528 S.W.2d at 552) (stating that the inquiry under Article XI, Section 9 is "whether th[e] legislation [in question] was designed to apply to any other county in Tennessee, for if it is *potentially* applicable throughout the state it is not local in effect") (emphasis in original).

3. By its terms, Chapter 984 applies only in counties that have adopted a charter form of government. The limited scope of Chapter 984 does not offend either Article VII, Section 1, of the Tennessee Constitution, or its implementing statutes codified at Tenn. Code Ann. §§ 5-1-201 to -215. This constitutional provision states in relevant part:

> The General Assembly may provide alternate forms of county government including the right to charter and the manner by which a referendum may be called. The new form of government shall replace the existing form if approved by a majority of the voters in the referendum.

Tenn. Const. art. VII, § 1, ¶ 3. This provision is not self-executing. *Jordan v. Knox County*, 213 S.W.3d 751, 767 (Tenn. 2007). Thus, it does not become operative without the aid of legislation. *Id.* By enacting Tenn. Code Ann. §§ 5-1-201 to -215, the General Assembly has provided the statutory framework within which a county may adopt a charter form of government. However, neither Article VII, Section 1, nor this statutory scheme prevents the General Assembly from passing a statute that applies only to charter counties. Thus, Chapter 984 does not violate Article VII, Section 1, or its implementing legislation.

4. The next question is whether Chapter 984, because it applies only to municipalities that operate a gas system in a charter county, violates Article XI, Section 8, of the Tennessee Constitution. This provision states in relevant part:

> The Legislature shall have no power to suspend any *general law* for the benefit of any particular individual, nor to pass any law for the benefit of individuals inconsistent with the general laws of the land; nor to pass any law granting to any individual or individuals, rights, privileges, immunitie [immunities] or exemptions other than such as may be, by the same law extended to any member of the community, who may be able to bring himself within the provisions of such law.

Tenn. Const. Art. XI, § 8 (emphasis added).

This provision of the Tennessee Constitution, similar to the Fourteenth Amendment of the United States Constitution, "guarantees citizens the equal protection of the laws." *Gallaher v. Elam*, 104 S.W.3d 455, 460 (Tenn. 2003). This protection applies to counties and cities as well as individuals. *Civil Service Merit Bd.*, 816 S.W.2d at 731; *White v. Davidson County*, 210 Tenn. 456, 464, 360 S.W.2d 15, 19 (1962). Tennessee courts have long recognized that this constitutional provision does not prohibit the General Assembly from making distinctions in the law based on classification, but instead forbids those classifications that are capricious, unreasonable and arbitrary and which "contravene some general law which has mandatory

statewide application." *Civil Service Merit Bd.*, 816 S.W.2d at 730-31 (quoting *Leech v. Wayne County*, 588 S.W.2d 270, 273 (Tenn. 1979)).

Classifications that do not affect a fundamental right or discriminate as to a suspect class are generally subject to the rational basis test. *State v. Tester*, 879 S.W.2d 823, 828 (Tenn. 1994). Chapter 984 addresses "in lieu of" tax payments made by a municipality operating a gas system in a charter county to other taxing jurisdictions in which parts of the system are located. Since this classification does not implicate a fundamental right nor involve a suspect class, it is subject to review under the rational basis test.

Under the rational basis test, a classification will be upheld "'if any state of facts may *reasonably be conceived* to justify it.'" *Gallaher v. Elam*, 104 S.W.3d at 462 (quoting *Riggs v. Burson*, 941 S.W.2d 44, 53 (Tenn. 1997), *cert. denied*, 522 U.S. 982 (1997)) (emphasis added). The question is "whether the challenged classifications have a reasonable relationship to a legitimate state interest." *Gallaher*, 104 S.W.3d at 461. State legislatures have the initial discretion to determine what is "different" and what is "the same," and they are given considerable latitude in making those determinations. *Id.*

Despite the "considerable latitude" provided the General Assembly under the rational basis test, in this case there appears to be no reasonable justification for applying a different standard for a municipality in a charter county, as opposed to a municipality in a non-charter county, in its determination and distribution of "in lieu of" tax payments to the respective taxing jurisdictions in which the municipality's gas system is located.

The legislative history of Chapter 984, originally proposed as Senate Bill 1165/House Bill 1376, reflects that members disagreed about its effect. Senator Norris, who sponsored Senate Bill 1165 in the Senate, explained the purpose of Chapter 984 as follows:

> Senator Norris: The issue arose a little over a year ago when the House took action on the bill. I've held it for the last twelve months, in hopes that perhaps in Shelby County, the City of Memphis and Shelby County would be able to work out their differences. They've been unable to do so. I met with Mayor Wharton about this in January, I believe; I met with Mayor Luttrell. This provision of the act only applies to two counties as I understand it, Knoxville and Knox County and Shelby County. In Knox County they have a written agreement that specifies pursuant to Title 7 how the payments are to be apportioned. In Shelby County they don't. They are trying to resolve their differences as to past payments; this is prospective only. It provides that in the absence of a written agreement, the City of Memphis will pay directly to Shelby County, which is also a taxing authority, its portion, excuse me, MLGW will pay directly to Shelby County. Right now MLGW is giving all the payments in lieu of taxes to the city and letting the city redistribute. The city hasn't been distributing the county's portion to it, so this is intended to clear that up.

Senate Floor, 107th General Assembly, 2nd Sess. (April 26, 2012) (remarks of Senator Norris) (emphasis added).[3]

Thus, as explained by the Senate sponsor, Chapter 984 applies only where a municipality that operates a gas system in a charter county, and another taxing jurisdiction where the system is located, have been unable to enter into a binding agreement regarding payment of in lieu of property tax payments. In the absence of such agreement, the gas system *must* make tax equivalent payments directly to each taxing jurisdiction. Those payments must be equal to that portion of the total tax equivalent payment that is calculated using each such taxing jurisdiction's tax rate pursuant to Tenn. Code Ann. § 7-39-404(1)(A).

This is a very different rule from that governing "in lieu of" tax payments made by any municipality that owns and operates a gas system and is not located in a charter county. Under Tenn. Code Ann. § 7-39-404, any such municipality "may" make in lieu of tax payments on its gas operations to itself and to other taxing jurisdictions where its system is located. These payments may not exceed a maximum determined by a formula in the statute. The maximum is the sum of two components: one based on the other taxing jurisdiction's property tax rate and value of the city's gas system located in that jurisdiction (Tenn. Code Ann. § 7-39-404(1)(A)) and the other based on net operating revenue (Tenn. Code Ann. § 7-39-404(1)(B)). The total amount to be paid as tax equivalents must be set forth in a resolution adopted by the governing body of the municipality. Tenn. Code Ann. § 7-39-404(4). Under this provision, the gas system makes tax equivalent payments directly to each taxing jurisdiction. But under Tenn. Code Ann. § 7-39-405, the resolution must direct payment to the taxing jurisdictions in which the municipality's gas plant is located "in accordance with and subject to any terms, conditions, contracts or agreements now in effect." When these provisions are read together, the governing body operating the gas system has the authority to execute an agreement with the impacted taxing jurisdictions which may provide for a different process by which tax equivalent payments are made to the taxing jurisdictions.

More importantly, however, under the statute most municipalities "may" make "in lieu of" tax payments to impacted taxing jurisdictions. Where Chapter 984 applies, unless the municipalities have a different agreement, a taxing jurisdiction *must* receive an "in lieu of" property tax payment equal to the taxing jurisdiction's property tax rate on the value of the city's gas system located in that jurisdiction.

At least one member of the General Assembly was concerned Chapter 984 might have this more drastic result. On January 23, 2012, the House amended House Bill 1376 and passed it for the third and final time. House members discussed the amendment — now Chapter 984 — at some length. Representative Turner offered the following observation:

> Representative Turner: I have some notes here that I would like to share with you in reference to House Bill 1376. Number one, it says it is not fair, not wise for legislation to produce a result that gives Shelby County a greater PILOT payment from MLG and W for gas than Memphis, when Memphis is the only municipality

[3]The legislative history is available at http://wapp.capitol.tn.gov/apps/BillInfo/Default.aspx?BillNumber=SB1165.

> with greater responsibility regarding MLG and W and when only 12.53% of MLG and W's gas assets are outside of the city of Memphis. The second point, this literally gives Shelby County a windfall from the investments made by the citizens of Memphis. Third point, at a time when every government is trying to fund budgets and continue public services with no revenue stream, we are asked to create a revenue stream for Shelby County which will result in a loss of revenue up to six million dollars for the city of Memphis

House Floor, 107th General Assembly, 2nd Sess. (January 23, 2012) (remarks of Representative Turner).

Regardless of whether, as asserted by its Senate sponsor, Chapter 984 is merely procedural in effect, or whether it sets a minimum mandatory payment due taxing jurisdictions that have made no agreement with the municipality operating the system, no rational or reasonable basis has been articulated or is otherwise apparent for applying different rules for a municipality that operates a gas system in a charter county as opposed to a municipality that operates a gas system in a non-charter county. There appears to be no connection between the form of the government in the county where a municipality is located and the right of other municipalities where the system is located to receive tax equivalent payments with respect to the system. For this reason, Chapter 984 would likely be found constitutionally suspect as an unreasonable classification contrary to the general law under Article XI, Section 8, of the Tennessee Constitution.

5. The final question is pretermitted based on the response to Question 4.

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