STATE OF TENNESSEE
OFFICE OF THE ATTORNEY GENERAL

April 1, 2014

Opinion No. 14-42

Providing Natural Gas Within City Limits

QUESTIONS

1. Does a city have authority to be the sole provider of natural gas within its corporate limits?

2. If the answer to Question 1 is yes, and City A exercises that authority when natural-gas customers within its corporate limits are being provided such service by City B, can City A require by ordinance that those gas customers purchase gas only from City A and exclude City B from providing natural-gas service within City A's limits?

3. If the answers to Questions 1 and 2 are yes, will City B continue to owe in-lieu-of-tax payments if its gas lines remain in City A, and is City B legally obligated to remove its gas lines from City A?

OPINIONS

1. Yes. A city may choose to be the sole provider of gas utility services within its corporate limits.

2. Yes. City A may, upon reasonable notice to City B, require natural-gas customers within its city limits to use only City A's natural-gas system and exclude City B from continuing to operate within City A's corporate boundaries.

3. City B's obligation to make in-lieu-of-tax payments would be governed generally by the resolution it adopted under Tenn. Code Ann. § 7-39-404, but that obligation continues only so long as part of City B's "gas system" is located in City A. City B could be required to remove its gas lines from City A if they interfered with the use of the streets in City A or with City A's operation of its own utilities.

ANALYSIS

1. and 2. Generally, a Tennessee city has the sole right to provide utilities within its boundaries. Under Tenn. Code Ann. § 6-51-111(a), a municipality has exclusive right to perform or provide municipal and utility functions and services in any territory that it annexes, subject to some conditions. Under Tenn. Code Ann.

§ 60-2-201(11)-(12), municipalities under a mayor-aldermanic charter have authority to acquire, construct, own, or operate public utilities and to grant exclusive franchises for such utilities. *See City of South Fulton v. Hickman-Fulton Counties Rural Electric Coop. Corp.*, 976 S.W.2d 86, 89 (Tenn. 1998) ("Municipalities in Tennessee have the right to grant exclusive franchises for public utilities and public services . . . ."). *See also* Tenn. Code Ann. § 6-54-109 (a city must approve change of control of any corporation providing utility service within city limits). Thus, a city may choose to be the sole provider of natural-gas utility service within its boundaries.

Since a city has authority to be the exclusive provider of natural-gas service within its corporate limits, it also has the right to exclude other utilities from operating within its boundaries. If a city has granted an exclusive franchise to operate a utility within its boundaries, however, the franchise controls as long as it remains in effect. But once the franchise expires, the city's exclusive authority is restored. Accordingly, if City A exercises its authority to be the sole provider of natural gas within its corporate limits when City B is currently providing such service, and City B's exclusive franchise has expired, City A may, upon reasonable notice, exclude City B from continuing to operate within City A's limits. *See* 12 Eugene McQuillin, *The Law of Municipal Corporations* § 34:69 (3d ed. 2006)) (quoted with approval in *Town of Middleton v. City of Bolivar*, No. W2011-01592-COA-R3-CV, 2012 WL 2865960, at *11 (Tenn. Ct. App. July 13, 2012) (no perm. app. filed)) (where utility company continues to operate after its franchise has expired, it does so under an implied contract that is cancelable upon reasonable notice).

> After the expiration of a franchise to use the streets, no further obligations between the city and the grantee can be implied from the franchise. The franchise may be granted to another company. The right of the company to use the streets, as well as the right of the city to demand the service, ceases. Continued use may be enjoined as a public nuisance. The former grantee may be compelled to discontinue the use of the streets and to remove its property at its own expense, and it does not acquire any right by adverse possession. . . .
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> . . . .
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> After the expiration of a franchise to use the streets, the public service company should be allowed a reasonable length of time to negotiate an extension or renewal of the franchise or close out its business, and it has the right to enter upon the streets of the municipality to remove its plant without let or hindrance. The municipality does not become the owner of such property in the

> absence of any relevant provision and cannot, on expiration of the franchise, take possession of such property. . . .

12 McQuillin, *supra,* § 34:69 (footnotes omitted). Thus, absent a current franchise agreement, City B may operate a utility in City A only with City A's permission. Accordingly, City A may require that natural-gas customers within its corporate boundaries purchase gas from City A and not from City B.[1] This Office is aware of no State or federal law pertaining to consumer rights or deregulation that would compel a different conclusion.

3. The authority and obligation of a city to make in-lieu-of-tax payments is governed by the Municipal Gas System Tax Equivalent Law of 1987, Tenn. Code Ann. §§ 7-39-401 to -406. Under Tenn. Code Ann. § 7-39-404, a municipality that owns or operates a gas system "may" make tax-equivalent payments from its gas-system revenues to itself and to other taxing jurisdictions where the system is located. The municipality must pass a resolution setting the amount to be paid to itself and to other jurisdictions. Tenn. Code Ann. § 7-39-404(4).

> 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:
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> (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
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> (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) (emphasis added). Requiring a city gas system to make in-lieu-of-tax payments, either to the city that operates it or to other cities where it is located, is optional. Therefore, if City B adopted a resolution that provides for such payments, its obligation to make tax-equivalent payments to City A would be governed by that resolution.

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[1] In Tenn. Att'y Gen. Op. 01-125 (Aug. 7, 2001), this Office opined, in the context of municipal *sewer* service, that a city could, under certain circumstances, be estopped from forcing its residents to disconnect from another city's sewer system and hook up to the city's own new system. There is no reason to offer the possibility for any similar estoppel to apply here.

Nevertheless, under the statute the city is authorized to make tax-equivalent payments only to another taxing jurisdiction where its gas system is located. The term "gas system" means "all tangible and intangible property and resources of every kind and description used or held for use in the purchase, generation, transmission, distribution, and sale of gas energy." Tenn. Code Ann. § 7-39-403(6). If City B stops providing gas service to City A but does not remove its pipes from City A, part of its system will still be "located" there; however, should City B take affirmative steps to abandon these pipes, they would no longer be "used or held for use in the purchase, generation, transmission, distribution, and sale of gas energy" within the meaning of § 7-39-403(6). At that point, assuming no other part of its gas system is located in City A, City B would not be authorized or required to make further in-lieu-of-tax payments to City A, even if City B had by previous resolution agreed to do so.

There appear to be no State or federal statutes that would impose an obligation on City B to remove its gas lines, and no Tennessee case addresses this issue. Some non-Tennessee cases suggest that a city may compel a utility to remove its equipment from city streets once the utility's franchise has terminated. *See*, *e.g., Bankers' Trust Co. v. City of Raton,* 258 U.S. 328 (1922) (city could not be enjoined from requiring a waterworks company to remove its system from the city's streets after the waterworks' franchise was terminated). But *The Law of Municipal Corporations*, cited above, states that after a franchise expired, "[r]emoval of underground pipes was not compelled . . . , and the owner was given the option whether to remove them, where they did not interfere with the usual use of the streets and alleys." 12 McQuillin, *supra*, § 34:69. The treatise cites *Village of Lapwai v. Alligier*, 78 Idaho 124, 299 P.2d 475 (1956). In that case, a city sought an injunction to require a water company that had been providing water in the city limits to remove its water system after its franchise expired. The Supreme Court of Idaho held that the company could not be required to remove its underground water pipes because both parties had stipulated that they did not interfere with the usual use of the surface of the streets and alleys of the city. *Village of Lapuai,* 299 P.2d at 479. This authority supports the conclusion that City A would have to establish that City B's underground pipes interfere with the use of the city streets or the city's operation of its own utilities before City B could be required to remove them.[2]

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[2] If the pipes were to pose a threat to public safety, City A may also be able to force their removal in the exercise of its police power.

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