STATE OF TENNESSEE
OFFICE OF THE ATTORNEY GENERAL

April 14, 2014

Opinion No. 14-46

City's Water and Sewage Rates Outside Corporate Limits

QUESTION

Can a city operating a water and sewage system lawfully impose on consumers located outside its corporate limits a rate that is twice the rate charged to consumers located within its corporate limits?

OPINION

The fact that a city imposes a water and sewage rate on customers outside its corporate limits that is twice the rate charged to customers within its corporate limits does not by itself establish that the higher rate is invalid. The rate is presumptively valid, and a party seeking to challenge it bears the heavy burden of proving that the rate is not just and equitable.

ANALYSIS

"Every incorporated city and town in this state is authorized and empowered to own, acquire, construct, extend, equip, operate and maintain within or without the corporate limits of such city or town a waterworks system or a sewage system, to provide water or sewerage service and to charge for such service." Tenn. Code Ann. § 7-35-401(a). Under Tenn. Code Ann. § 7-35-414(a),

> [t]he governing body of any city or town acquiring and operating a waterworks or sewerage system under this part has the power, and it is the governing body's duty, by ordinance, to establish and maintain just and equitable rates and charges for the use of and the service rendered by the waterworks or sewerage system, to be paid by the beneficiary of the service. The rates and charges shall be adjusted so as to provide funds sufficient to pay all reasonable expenses of operation, repair, and maintenance, provide for a sinking fund for payment of principal and interest of bonds when due, and maintain an adequate depreciation account, and the rates and charges may be readjusted as necessary from time to time by amendment to the ordinance establishing the rates then in force. . . .

Tenn. Code Ann. § 7-51-401 authorizes a municipality to extend the services of its utilities beyond its corporate limits but provides that in such event the municipality "shall establish proper charges for the services so rendered that any such outside service is self-supporting." Tenn. Code Ann. § 7-51-401(a), (b).

Tennessee courts have held that it is permissible to have different rates among customers. For example, the Tennessee Supreme Court held, "without hesitation or equivocation, that a public utility may impose differing rates among customer classes." *CF Indus. v. Tenn. Pub. Serv. Comm'n*, 599 S.W.2d 536, 544 (Tenn. 1980). In addition, the Tennessee Court of Appeals has held that "it is not essential that all rates throughout a large territory served from a single water system be the same, and rates in each part of such territory may be fixed at a level which is fair and reasonable in view of the existing conditions." C*ity of Parsons v. Perryville Util. Dist.*, 594 S.W.2d 401, 406 (Tenn. Ct. App. (1979). *See also Mitchell v. City of Wichita,* 12 P.3d 402, 408 (Kan. 2000) (stating that municipal water plant serving customers outside city limits may make separate classification of such customers for ratemaking purposes).

Nevertheless, classifications of customers for rate-making purposes cannot be unjustly discriminatory:

> A classification must, however, in order to be valid, comport with the rule or principle of sound legislative classification, in that there must be some actual difference of situation and condition, bearing a reasonable and just relation to the matter of rates; and an arbitrary or unreasonable classification amounts to unjust discrimination

City of Parsons, 594 S.W.2d at 406 (quoting 94 C.J.S. *Waters* § 297 (1956)).

Tennessee courts have remarked on the absence of a clear test for determining the reasonableness of a utility's rates. In *CF Indus.*, for example, the Supreme Court pointed out that there is no "single formula or a combination of formulas in fixing rates and none is exclusive or more favored than others." 599 S.W.2d at 544 (quoting *Application of Arkansas Louisiana Gas Co.*, 558 P.2d 376, 379 (Okl. 1976)). Rulings from other state courts do not provide additional clarity. For instance, though an Illinois appellate court has held that a 50% surcharge the City of Chicago imposed on unincorporated residents was "unreasonable" and "discriminatory," *see Bobrowicz v. City of Chicago*, 522 N.E.2d 663, 669 (Ill. App. Ct. 1988), the Kansas Supreme Court has upheld a 100% surcharge to nonresident customers, *see Usher v. City of Pittsburg*, 410 P.2d 419, 421 (Kan. 1966).

Ratemaking is essentially a legislative and not a judicial function, and a court must accord the agency's determination great deference. *CF Indus.*, 599 S.W.2d at 542. Any challenge to the validity of a particular rate must overcome a presumption that the rate established by the agency is correct, and there is a heavy burden on a party who attacks it to make a convincing showing that the rate is invalid. *Tenn.*

Am. Water Co. v. Tenn. Regulatory Auth., No. M2009-00553-COA-R12-CV, 2011 WL 334678, at *14 (Tenn. Ct. App. Jan. 28, 2011).

Therefore, the mere fact that a city imposes a water and sewage rate on customers outside the corporate limits at twice the rate changed to its customers within the corporate limits does not demonstrate that the higher rate is not just and equitable. The rate is presumed valid. A Tennessee court must accord great deference to the utility's determination. The plaintiff would bear the heavy burden of proving that the rate is not just and equitable.

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