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Reply to:
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November 21, 2001

Mr. David Waddell
Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243

RE: United Cities Gas Petition for Approval of New or Revised Franchise Agreements with Kingsport, Bristol, Morristown and Maury County
Docket No. 00-00562

Dear Mr. Waddell:

Enclosed are an original and thirteen copies of the Response to Motion for Partial Summary Judgment in the above-referenced docket for filing. If you have any questions with respect to this matter, kindly contact me at (615) 741-3533. Thank you.

Sincerely,

Timothy C. Phillips
Assistant Attorney General

cc: Jonathon Wike, Esq.
Joe A. Conner, Esq.

Enclosures

BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:		
UNITED CITIES GAS PETITION FOR APPROVAL OF NEW OR REVISED FRANCHISE AGREEMENTS WITH KINGSPORT, BRISTOL, MORRISTOWN AND MAURY COUNTY	)	Docket No. 00-00562

RESPONSE TO MOTION FOR PARTIAL SUMMARY JUDGMENT

I. INTRODUCTION

The Tennessee Attorney General, through the Consumer Protection Division of the Office of the Attorney General ("Attorney General") opposes United Cities Gas Company's ("United Cities") Motion for Partial Summary Judgment. The Attorney General submits that summary judgment in favor of United Cities on the issue referenced in the present motion is not appropriate. Specifically, the request by United Cities is procedurally defective, contrary to the law and sound public policy, and not supported by the facts presented in the record in this docket.

II. ARGUMENT

A. THE MOTION IS PROCEDURALLY DEFECTIVE.

By filing its motion United Cities seeks the benefit of Rule 56 of the Tennessee Rules of Civil Procedure. However, United Cities by oversight or by design has not satisfied the

requirements of Rule 56. Specifically, Untied Cities did not submit a "separate concise statement" as required by Rule 56.03.

The method used by United Cities thwarts the policy envisioned by Rule 56.03 vital to the proper and economical resolution of the issue raised. United Cities has effectively curtailed the plain view approach required by Rule 56, which is designed to prevent such cloaking. For instance, the motion of United Cities appears to assume that the assessments involved are not cost based. However, since they did not provide the "statement" required in Rule 56 this is not readily apparent. The same holds true for numerous other facts asserted by United Cities, including its claims with respect to the municipalities functioning in their propriety capacity and United Cities' unsubstantiated claims of arms length negotiations.

A party seeking the benefits of a rule of civil procedure should be required to satisfy its requirements.

B. ALLOWING THIS TAX IS CONTRARY TO SOUND PUBLIC POLICY AND THE LAW

First and foremost, it is important to understand that a party may not eliminate the import of a general argument by focusing on only one prong of the argument that threatens their position. The case of the *City of Chattanooga v. BellSouth Telecommunications, Inc.*, 2000 WL 122199 (Tenn. Ct. App., Jan. 26, 2000) is a rather important case, but the Attorney General's objection to approval of the city ordinances at issue in the present docket extends beyond the issues raised by United Cities in its motion. Approval of this petition is not appropriate as the petition is contrary to the Tennessee tax structure.

Further, the petition is not consistent with sound public policy. The Tennessee Regulatory Authority ("Authority") must satisfy the directives of the legislature. In doing so, the Authority should take into consideration the obvious intent of the legislature regarding franchise taxes and the edicts of the code establishing the duties of the Authority. Pursuant to Tenn. Code Ann. § 65-4-107, the Authority must determine whether each of the ordinances involved "is necessary and proper for the public convenience and properly conserves the public interest." The subject ordinances may successfully serve the interests of the municipalities involved, but clearly do not take into consideration the rate-payers. Clearly, a franchise tax based on United Cities' gross revenues has no relation to the city's costs. Neither United Cities, nor the municipalities involved have been able to produce any such costs estimates. This fact is undisputed by the parties.

Further, the Attorney General requests that the Authority take into consideration the dynamics involved in this matter. Unlike franchise agreements of the early 1900s, these ordinances were not submitted to the voters for approval. The money is collected by United Cities and passed on to the City. The City is then free to use the extra revenue at its descretion. The voters' only say in this process comes at the stage in which the Authority reviews the petition for approval. There is no question that the measure is revenue generating. The case law demonstrates that it is a tax. The question becomes who is accountable to the voters. United Cities will blame the city managers and the Authority for approving the measure. The city managers have passed the matter to the Authority. The Authority stands as the only protector of the rights of the voters with respect to the soundness of this policy.

The single thrust of United Cities' motion rests on the conclusion that the municipalities

involved were functioning in their proprietary capacities at the time the subject ordinances were passed. United Cities relies on Bob Elam's affidavit in support of this conclusion. As a result, the motion must fail because the affidavit of Bob Elam does not address the functional capacity of the municipalities involved. The word "proprietary" is not mentioned in Mr. Elam's affidavit. Further, there are no facts contained within the affidavit suggesting which function the municipalities were serving.

A review of the attachments to the petition filed in this docket belies the claim of "negotiations." The documentation presented by United Cities in its petition clearly shows little involvement and even less choice by United Cities prior to the municipalities passing the subject ordinances. Each of the new ordinances were simply presented to United Cities for acceptance. Neither ordinance was presented to the voters as was the case in the early 1900s.

More importantly, regardless of which capacity a municipality is acting in, a municipality cannot tax certain things. *See* Tenn. Code Ann. § 67-4-401. Under general revenue law, municipalities may not tax gas, water, or electric companies. Tenn. Code Ann. § 67-4-404. Furthermore, municipalities do not have the power to levy any kind of franchise tax. *See* Tenn. Code Ann. § 67-4-2102.

No concessions will be offered by the Attorney General in this matter on the idea that the measures submitted for approval are anything but a tax. The ordinances (2203 and 2344) from Morristown even refer to the measures as a "tax." Further, to the extent the measures raise revenue beyond cost then each is a tax. The case law is very clear:

> An important characteristic and distinguishing feature of a tax is that it is designed and imposed for the purpose of raising revenue. *City of Tullahoma,* 938 S.W.2d at 412; *Memphis Retail Liquor*, 547 S.W.2d at 245-6. If the revenue raised by the

> government assessment provides a general benefit to the public of a sort typically financed by a general tax, then the assessment will usually be deemed a tax rather than a fee. *See City of Chattanooga,* 2000 WL 122199 at pp. 6-7.

In *City of Chattanooga v. BellSouth Telecommunications, Inc.,* the City of Chattanooga ("City") enacted an ordinance which required telecommunications service providers to obtain a franchise from the City and to pay an annual "franchise fee" of five percent of gross revenue in exchange for permission to occupy rights-of-way in the City. *See City of Chattanooga*, 2000 WL 122199 at 1. The Court of Appeals found the City to be acting in its governmental capacity since two of the defendants held prior franchises that were granted to their predecessors by the city, and the city could not revoke or impair rights previously given by it while acting in its proprietary capacity. *See id.* In other words, the City could not modify the franchise, by imposing fees, while acting in its proprietary capacity. *See id.* So, in order for the "franchise fee" to be valid, the City must have enacted the ordinance under its governmental or "police powers" and the fee must not be construed as a tax. *See id.* at 2. It is simply not enough to demonstrate the functional capacity of the cites invloved, but United Cities has the burden of demonstrating that these measures are not a tax.

According to T.C.A. §65-21-103, a municipality is permitted to exact a rental for the use of rights-of-way under its governmental, or police powers. *See* Tenn. Code Ann. § 65-21-103. When municipalities exact charges using their governmental, or police, powers "[t]he fact that the fees charged produce more than the actual cost and expense of enforcement and supervision, is not an adequate objection to the exaction of the fees. *The charge made, however, must bear a reasonable relation to the thing being accomplished.*" *City of Chattanooga*, 2000 WL 122199 at 4 (citing *Porter v. City of Paris*, 201 S.W.2d 688 (Tenn. 1947)) (emphasis added).

In the *City of Chattanooga* case, the City argued that its ability to charge rental fees was not limited to the cost of regulation. *See City of Chattanooga*, 2000 WL 122199 at 2. The City argued that the term "rental" allowed for the City to generate revenue beyond the cost of regulation without constituting a tax. *See id.* In support of this argument, the City cited *Memphis Retail Liquor Dealer's Ass'n v. City of Memphis* ("*City of Memphis*"). *See Memphis Retail Liquor Dealer's Ass'n v. City of Memphis,* 547 S.W.2d 244 (Tenn. 1997). It is this case that reminds us that it is actions rather than labels which led to accurate definition. The issue was whether an inspection fee of five percent of the wholesale price of liquor constituted a tax or a fee. *See id.* The Supreme Court distinguished fees from taxes stating that "[i]n Tennessee, taxes are distinguishable from fees by the objectives for which they are imposed. If the imposition is primarily for the purpose of raising revenue, it is a tax; if its purpose is for the regulation of some activity under the police power of the governing authority, it is a fee." *See id.* at 246.

Although the amount of income generated by the five percent fee was disproportionate to the city's administrative costs, the court, in the *City of Memphis* case, nevertheless found the fee not to be a tax. *See id.* However, the court based its finding on the fact that the activity upon which the fee was being levied was the liquor industry. *See id.* According to the court, the amount of the fee had a "permissible regulatory effect" because that which was being regulated is recognized as being hurtful to the public. *See id.*

The additional impact on the public welfare justifies treatment of the measure as a fee. It certainly does not seem the same can be said of public utilities. Even if it could, the public utilities are sufficiently regulated by the Authority. *See* Tenn. Code Ann. §§65-4-104; 65-4-105.

Thus, the court in *City of Chattanooga* distinguished the Memphis case. The court stated that the City's construction of the word "rental" would allow it to exact fees that were not reasonably related to the regulatory cost while acting in its governmental capacity. *See City of Chattanooga,* 2000 WL 122199 at 3. Therefore, the City would be able to perform the same functions in its governmental capacity as it could while acting in its proprietary capacity. *See id.* The court stated this construction would render the Supreme Court's distinction between the two capacities of municipalities meaningless. *See id.* Accordingly, the court found the "franchise fee" imposed on BellSouth to be a tax. *See id.* The court stated its decision did not rest on the fact that the fee produced more than the amount needed to regulate, but instead, rested on the fact that "[t]here is no evidence to support the proposition that the five percent fee will 'bear a reasonable relation' to the use of the rights-of-way." *See City of Chattanooga,* 2000 WL 122199 at 4.

B. THE FRANCHISE AGREEMENT MADE BETWEEN THE CITY OF BRISTOL AND UNITED CITIES AND THE CITY OF MORRISTOWN AND UNITED CITIES IMPAIRS UNITED CITIES' RIGHTS, THUS PLACING THE CITY OF BRISTOL AND THE CITY OF MORRISTOWN IN A GOVERNMENTAL CAPACITY.

It is important at the outset to review the distinctions drawn by Untied Cities and establish their import. The motion of Untied Cities cites three factors as distinguishing the present docket from the case in *City of Chattanooga*. First, great emphasis is placed on the fact that the City of Chattanooga imposed a tax on "all companies providing telephone services within" its borders. If the City of Chattanooga had not, it would be subject to a discrimination claim. This fact really has no relevance to the present circumstance. More importantly, how does it distinguish the present docket. United Cities is the only natural gas supplier to

Morristown and Bristol. In fact, the ordinance hits the industry generally.

Second, there is no indication in the *City of Chattanooga* case that suggests there were no negotiations with the telephone service providers. The case instead deals with defining tax and fee. As for the present docket, the attachments to the petition suggest that any talks that actually took place were less "negotiations" and more dictation. The municipalities passed the ordinances and then simply submitted them to Untied Cities.

Finally, United Cities cites to the City of Chattanooga's attempt to raise their "franchise fee" by five percent. The same is true in the present case. As discussed below, the municipalities of Bristol and Morristown clearly have forced substantive changes in the relationship between them and United Cities.

At the time the City of Bristol and United Cities entered into negotiations for a new franchise agreement, United Cities was operating under the franchise agreement granted by Ordinance No. 95-60. This franchise agreement imposed a five percent franchise fee on all gross revenues received by United Cities from the sale of gas within the City. In 1999, the City of Bristol and United Cities reached an agreement on a new franchise. The new franchise agreement extends the period of the franchise for a period of 30 years from the date of the amendment, gives the City of Bristol a right of first refusal to purchase United Cities' assets in the City of Bristol on the same terms and conditions of any offer presented to United Cities by a third party, and increases the franchise fee by one percent. *See* Affidavit of Bob Elam.

United Cities also had a prior franchise agreement with the City of Morristown. This franchise was for 20 years and was granted on December 18, 1979 pursuant to Ordinance No. 2203. This franchise agreement did not provide for a franchise fee, but did leave that option

open for the City. The City exercised this option in 1983 by imposing a five percent fee on gross receipts on gas sales within the corporate limits of the City. The current franchise before the Authority also places a five percent fee on the gross receipts. This new franchise agreement also requires United Cities to maintain an office within the City, to specify the gas main extension policy, and to specify a default and cure provision. *See id.*

The Tennessee Court of Appeals, in *City of Chattanooga v. BellSouth Telecommunications, et al.*, stated that:

> A municipality has authority to act in either its proprietary capacity or its governmental capacity. *See Bristol Tennessee Housing Auth. v. Bristol Gas Corp.*, 407 S.W.2d 681 (Tenn. 1966). Acting in its proprietary capacity, a municipality may exact a charge for the use of its rights-of-way unrelated to the cost of maintaining the rights-of way, but in its governmental capacity, it may only act through an exercise of its police power to regulate specific activity or to defray the cost of providing services or benefit to the party paying the fee. *City of Chattanooga v. BellSouth Telecommunications, et al.*, 2000 WL 122199 citing *City of Tullahoma v. Bedford County*, 938 S.W.2d 408 (Tenn. 1997); *Bristol Tenn. Housing Auth.; City of Paris v. Paris-Henry County Public Utility District*, 340 S.W.2d 885 (Tenn. 1960).

United Cities defines the issue in this matter in applying *City of Chattanooga* as to whether the City of Bristol and the City of Morristown were acting in a governmental or proprietary role in affecting the franchise fee found in the agreements. The court in *City of Chattanooga* stated: ***"Acting in its proprietary capacity, a municipality may not revoke or impair rights previously given by it to a third party by a subsequent enactment."*** *City of Chattanooga v. BellSouth Telecommunications et al.*, 2000 WL 122199 citing *Bristol Tenn. Housing Auth.*; *Shelby County v. Cumberland Telephone & T. Co.*, S.W.342 (Tenn. 1918) (emphasis added). In concluding that the City of Chattanooga was acting in its governmental

capacity, the Court went on to state, "Because two of the defendants hold prior franchises granted to their predecessors, ***the City may not modify the franchise by imposing a fee under the City's proprietary funcitons***." *City of Chattanooga v. BellSouth Telecommunications et al.*, 2000 WL 122199 at 1 (emphasis added)

Although the actions of the city in *City of Chattanooga* are somewhat dissimiliar to the actions taken by the City of Bristol, the City of Bristol still acted to modify the franchise agreement so as to impair the rights of United Cities that the City of Bristol had previously extended. Under the new franchise agreement, the City of Bristol gets a right of first refusal to purchase United Cities' assets in the City of Bristol on the same terms and conditions of any offer presented to United Cities by a third party and the franchise fee is increased by 1%. *See* Affidavit of Bob Elam. These alterations of the original franchise clearly constitute an impairment of rights following the reasoning of the Court in *City of Chattanooga. See City of Chattanooga v. BellSouth Telecommunications et al.*, 2000 WL 122199 at 1. The actions of the City of Morristown also constitute an impairment of United Cities' rights previously given to it by the City of Morristown by a subsequent enactment. This new franchise agreement requires United Cities to maintain an office within the City, to specify the gas main extension policy, and to specify a default and cure provision. *See* Affidavit of Bob Elam.

Thus, by the City of Bristol and the City of Morristown acting to impair the rights of United Cities, the cities placed themselves in a governmental capacity. When cities are acting in their governmental capacities, they may only "act through an exercise of [their] police power to regulate specific activity or to defray the cost of providing services or benefit to the party paying the fee." *See id.* citing *City of Tullahoma v. Bedford County*, 938 S.W.2d 408 (Tenn. 1997);

Bristol Tenn. Housing Auth., 407 S.W.2d at 681; *City of Paris v. Paris-Henry County Public Utility District*, 340 S.W.2d 885 (Tenn. 1960). Moreover, when exercising police power, any charges exacted by the municipality "must bear a reasonable relation to the objective to be accomplished." *City of Chattanooga*, 2000 WL 122199 at 2 (citing *Porter v. City of Paris*, 201 S.W.2d 688 (Tenn. 1947).

Although the court in *Lewis v. Nashville Gas & Heating Co.* did state that a city is acting in its proprietary capacity where a franchise fee is negotiated as a contract between a city and an individual utility, the court in *City of Chattanooga* has since refined this notion by finding that if the negotiations lead to impairment of rights previously given by the city to the utility then the city is acting in its governmental capacity. *See Lewis v. Nashville Gas & Heating Co.*, 40 S.W.2d 409, 412 (Tenn. 1931); *See also City of Chattanooga* 2000 WL 122199 at 1.

The Attorney General does wish to point out critical differences in the present docket and the matter of *Lewis v. Nashville Gas* and *Nashville Gas & Heating Co. v. Nashville*, 152 SW2d. 229 (Tenn. 1941). The first is the obvious age of these two (2) decisions. Each predates important tax legislation outlined in this response. While the decison in *Nashville Gas & Heating Co. v. Nashville* partially addresses this concern, the reasoning in that case is so heavily dependent on the concession that the measure under scrutiny was a tax the decision is of little precedential value.

Moreover, and this goes to the concept of what is sound public policy in this case as well, in *Lewis v. Nashville Gas* and *Nashville Gas & Heating Co. v. Nashville* the measures involved called for acceptance by the voters of the special contracts imposing these taxes. This is not the case in the present situation.

In the instant action, the City of Bristol and the City of Morristown "negotiations" lead to an increase in the franchise fee (in one instance, the City of Bristol) and requirements that effectively impaired the rights previously given to United Cities by the cities. Because the rights of United Cities were impaired in this manner, according to the *City of Chattanooga*, the City of Bristol and the City of Morristown were acting in their governmental capacities.

Because the cities were acting in their governmental capacities, the franchise fee imposed in both of the new franchise agreements must be exacted only by the cities acting through an exercise of [their] police power to regulate specific activity or to defray the cost of providing services or benefit to the party paying the fee. Moreover, when exercising police power, any charges exacted by the municipalities must bear a reasonable relation to the objective to be accomplished.

Accordingly, the Attorney General's objection to the franchise fees imposed in the City of Bristol and the City of Morristown franchise agreements based on the holding in the *City of Chattanooga* is not misplaced.

III. Conclusion

Based on the foregoing reasons, the Attorney General requests that the Authority deny United Cities' motion for partial summary judgment. The reasoning set out in the *City of Chattanooga* case should not be excluded from this docket. The decision pulls together the legislation and case law very effectively. The result is the obvious conclusion that the Cities of Bristol and Morristown were not acting in the proprietary capacity at the time these ordinances were passed. Further, the measures at issue are clearly tax mechanisms.

Respectfully submitted,

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Certificate of Service

I hereby certify that a true and correct copy of the foregoing was served via facsimile transmittal and U.S. Mail on November 21, 2001.

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