Coates' Canons Blog: Do North Carolina Local Governments Have Authority to Assess Impact Fees for Water and Sewer Public Enterprises?

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An impact fee is a charge on new development to pay for the construction or expansion of off-site capital improvements that are necessitated by and/or benefit the new development. A local government typically assesses impact fees as part of its development approval process. Paying the fees is often a condition of receiving a building permit or certificate of occupancy.

North Carolina local governments have specific statutory authority to require subdivision developers to pay fees in lieu for certain road and recreational land infrastructure projects that benefit the new development. *See* **G.S. 160A-372** (municipalities); **G.S. 153A-331** (counties). There is no specific authority to charge impact fees under general law, though. (A handful of units have local act authority to assess impact fees for certain purposes.) And North Carolina courts have repeatedly refused to hold that impact fee authority is implied from a unit's regulatory powers, at least when the revenues are used to fund general government infrastructure. *See, e.g.*, Lanvale Properties, LLC v. County of Cabarrus, 366 N.C. 142 (2012); Union Land Owners Ass'n v. County of Union, 201 N.C. App. 374 (2009), *disc. rev. den'd*, 364 N.C. 442 (2010); Amward Homes, Inc. v. Town of Cary, 206 N.C. App. 38 (2010), *aff'd by an equally divided court*, 365 N.C. 305 (2011).

But what about the authority to impose impact fees on new development to fund a unit's public enterprise (water or sewer) systems? Relying on a federal district court case from the late 1980's, most local governments have assumed that there is implied authority under the public enterprise fee statutes (**G.S. 160A-314** and **G.S. 153A-277**) to assess impact fees to mitigate against the impact of the new development on the unit's water or sewer systems. This reliance may be misplaced, though. There are several reasons to question the continued validity of the court's holding in that case and, correspondingly, to question the authority to impose impact fees to fund water and sewer capital outlay.

This blog post analyzes the federal district court case and discusses why it may not reflect current law. It then details the framework a North Carolina court likely would use to analyze this issue today.

Public Enterprise Fee Statutes

A local government is authorized to own and/or operate certain public enterprises, including water supply and distribution systems and wastewater collection, treatment, and disposal systems. **G.S. 153A-274** (counties); **G.S. 160A-311** (municipalities).

A local unit's governing board has authority to finance the cost of these public enterprises "by levying taxes, borrowing money, and appropriating any other revenues therefor, and by accepting and administering gifts and grants. . . ." **G.S. 153A-276** (counties); *see also* **G.S. 160A-313** (municipalities). However, for many local governments the most significant revenue source is user fees. A local government may

> [e]stablish and revise from time to time schedules of rents, rates, fees, charges, and penalties for the use of or the services furnished by any public enterprise.

G.S. 153A-277 (counties); *see also* **G.S. 160A-314** (municipalities).

Federal District Court Upholds Impact Fees in 1988

The term "impact fee" is not explicitly listed in the public enterprise fee statutes. Nevertheless, in 1988, a federal district

court held that the Town of Wrightsville Beach "had the authority to impose impact and tap fees under the public enterprise statute and that *no specific enabling legislature [was] necessary*." South Shell Investment v. Town of Wrightsville Beach, 703 F.Supp. 1192 (1988) (emphasis added). The case involved a challenge by developers to the authority of a town to impose water and sewer impact fees and tap fees on proposed new development. The town had adopted an ordinance pursuant to which it assessed water and sewer tap fees on all properties that connected to the town's water and sewer systems. The amount of the tap fees varied according to meter size. The town also assessed a usage fee on each newly constructed living unit in all residential and commercial structures. The usage fee was set at a flat rate for residential properties and varied by meter size for commercial properties. (The town later changed the name from "usage fee" to "impact fee.") The fees were payable as a condition of the town issuing a certificate of occupancy or certificate of compliance.

The plaintiffs, developers of property in a recently annexed area on Shell Island, constructed at their own expense certain water and sewer lines, a lift station, and a well and dedicated these to the town. The plaintiffs also paid the requisite tap and impact fees. Town records indicated that the tap and impact fee revenues were placed in the town's capital reserve account and intermingled with other funds. Funds in the town's capital reserve account were used to pay for many different capital projects, including several not related to water or sewer service.

Plaintiffs subsequently sued the town, claiming, among other things, that the town lacked statutory authority to assess the fees. The federal district court rejected this claim. The found it significant that there was "no language in [G.S. 160A-314] limiting a town's authority to impose fees for the use of the services as a method of raising money for capital expansion or requiring that a town only increase rates for the services furnished to fund such improvements." *Id.* at 1206. The court further noted that "[t]here [was] no constitutional or statutory restriction limiting Wrightsville Beach's discretion to set fees for connecting to the Town's water and sewer lines." *Id*. Citing to two North Carolina cases as precedent, the court thus held that the town had clear authority to impose the tap and impact fees, even though there was no specific enabling legislation.

Impact Fee Authority Not Certain in 2014

There are a number of reasons that local governments should be careful in relying on *South Shell Investment* as definitive authority to assess impact fees in 2014, though.

First, *South Shell Investment* is a federal district court case. As such, it is not binding precedent on a North Carolina state court.

Second, the case was decided over twenty years ago and (as discussed below) does not reflect the likely approach a North Carolina state court would take in analyzing the issue today.

Third, neither of the state court cases cited at the time by the *South Shell Investment* court as precedent for its holding actually involved impact fees.

The first case cited by the court was *Town of Spring Hope v*. *Bissette*, 305 N.C. 248 (1982). In that case the North Carolina Supreme Court held that **G.S. 160A-314** was broad enough to authorize the town to increase its periodic water and sewer rates to finance the construction, operation, and maintenance of an upgraded water treatment plant. The new plant was required to maintain the town's permit to discharge treated water. The fee at issue was assessed on all current customers of the water and sewer system. An owner of a launderette refused to pay the increased fee, claiming that the town exceeded its authority in charging for "services to be furnished" as opposed to "services furnished" by the public enterprise.

The court disagreed, holding instead that the fee was assessed for a service that the customer currently received. According to the court, the upgrade "was not intended to, nor did it result in, providing a new or higher level of service to the sewer system's customers." *Id.* at 251-252. When the new plant went into operation, "the customers received nothing they had not received before," thus, the rate "did not reflect any service yet to be furnished." *Id.* To the contrary, it "represented the cost of a necessary improvement to the already existing sewer system without which the Town could not continue to provide sewer service." *Id.* The town was free to set the fee amount above the level necessary to cover current operating costs. It could also factor in the costs of upgrading the water treatment plant.

In so holding, the court noted the generally recognized authority for a local government utility to charge fees to cover both operating and capital costs. And it cited favorably to the court of appeals' determination that:

> The great weight of authority is to the effect that in the setting of such rates and charges, a municipal body may include not only operating expenses and depreciation, but also capital cost associated with actual or anticipated growth or improvement of the facilities required for the furnishing of such services.

Id. at 251. But it is important to put the quoted language in context. The court was addressing the authority to include future capital costs in calculating the fee charged to current customers for current services. It was not opining on the authority to charge impact fees on new development not currently being served by the utility.

The second case that the district court relied on is *Atlantic Construction Co. v. City of Raleigh, 230 N.C. 365 (1949)*. In that case, the court held that the city had authority to charge reasonable connection fees and to otherwise "fix the terms upon which the service may be rendered and its facilities used." *Id.* at 369. It was likely cited by the *South Shell Investment* court as precedent for upholding the tap fees at issue in that case. And it continues to provide support for a local unit's authority to charge tap or connection fees as a condition of connecting to the public enterprise system. But *Atlantic Construction* does not address the issue of a local unit's authority to assess more generalized impact fees on new development.

All of these factors counsel against relying on *South Shell Investment* as definitive authority to impose impact fees.

Current Framework for Analyzing Local Government Authority

Even if *South Shell Investment* does not provide definitive authority (or perhaps any authority) for a local government to assess impact fees to fund water and sewer capital outlay that does not mean that the authority does not exist. The North Carolina Supreme Court recently provided a framework for analyzing the scope of local government authority.

According to the court,

> When the enabling legislation " 'is clear and unambiguous, there is no room for judicial construction, and the courts must give it its plain and definite meaning.' But when a statute granting power to a municipality is ambiguous, the enabling legislation "shall be broadly construed and grants of power shall be construed to include any additional and supplementary powers that are reasonably necessary or expedient to carry them into execution and effect."

King v. Town of Chapel Hill, ___ N.C. ___, 758 S.E.2d 364, 369 (2014) (internal citations omitted).

A court may also interpret statutory grants of authority broadly when "necessary to give effect to 'any powers that are reasonably expedient to [a county's or municipality's] exercise of the power.'" Lanvale Properties, LLC v. County of Cabarrus, 366 N.C. 142 (2010) (internal citations omitted).

Applying this framework to interpret an actual statutory provision, however, is not always easy. What is clearly "plain" to one person (or court) may be totally "ambiguous" to another. And even if a statute is clearly ambiguous, it is hard to predict how broadly (if at all) a court might read the authority. It is equally difficult to figure out when a court might determine when an implied power is reasonably necessary to a unit's exercise of its explicit authority.

Applying Statutory Construction Framework to Public Enterprise Fee Statutes

Looking at the public enterprise fee statutes, a court might hold that the language is unambiguous in so far as it does not include explicit authority to impose impact fees. *See, e.g.,* Smith Chapel Baptist Church v. City of Durham, 350 N.C. 805 (1999) (using plain language standard to narrowly construe public enterprise statute).

A court also might rely on a plain language interpretation to conclude that the phrase "the use of or the services furnished by" allows a local unit to charge only current customers of the public enterprise. In fact, in *Bissette,* the North Carolina Supreme Court went through great pains to explain that the capital fee at issue in that case was imposed for services currently being provided and not for services that would be furnished in the future. It did so to address an argument made

by the defendant in the case that the local government only had statutory authority to assess fees for "the use of or the services furnished by" a public enterprise. (The defendant had argued unlike the fee statutes applicable to a county or municipality, the fee statute applicable to a water and sewer authority (which is a separate legal entity from a county or municipality) authorizes the authority to assess "rates, fees, and other charges for the use of and for the services furnished *or to be furnished* by any water system or sewer system or parts thereof owned or operated by the authority." **G.S. 162A-9** (emphasis added).)

On the other hand, a court might find the fee statute ambiguous, and thus susceptible to a broad interpretation, at least with respect to charging fees for future capital outlay. *Cf.* BellSouth Telecomms., Inc. v. City of Laurinburg, 168 N.C.App. 75, *disc. review den'd*, 615 S.E.2d 660 (2005) (broadly interpreting a city's public enterprise authority for "cable television" to authorize the provision of internet services over its fiber optic network)*; see also* King v. Town of Chapel Hill, ___ N.C. ____, 758 S.E.2d 364 (2014) (interpreting general police power broadly because the statute is "by its very nature ambiguous, and its reach cannot be fully defined in clear and definite terms.").

Perhaps more likely, a court could determine that broadly interpreting a unit's public enterprise fee authority is necessarily expedient to a local unit's ability to effectively manage its enterprise system. *Cf.* Homebuilders Ass'n of Charlotte, Inc. v. City of Charlotte, 336 N.C. 37 (1994) (applying G.S. 160A–4 to uphold the city's imposition of user fees in conjunction with the provision of regulatory services and the use of public facilities because the user fees were "reasonably necessary or expedient to the execution of the City's power to regulate the activities for which the services are provided.") But it is important to note that not all impact fees are alike. A court may be more receptive to upholding an impact (capacity) fee that is assessed on any property that connects to the unit's water and sewer system, as opposed to an impact fee assessed only on new development. Likewise, an impact fee may be more likely to pass judicial scrutiny if the fee amount approximates the actual projected costs to the water or sewer system to serve the newly-connected property, and if the local unit segregates the impact fee revenue so that it is only used for water and sewer expenses.

The outcome of any impact fee challenge is not certain, though, particularly given the court's recent reticence to imply impact fee authority in other contexts. In light of this uncertainty, a local unit is well advised to consult with its attorney about the (continued) propriety of imposing impact fees in this context.

Links

- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-372.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_153A/GS_153A-331.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-314.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_153A/GS_153A-277.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_153A/GS_153A-274.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-311.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_153A/GS_153A-276.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-313.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_162A/GS_162A-9.html