Coates' Canons Blog: Providing Utility Services Outside Territorial Boundaries: Recent Developments

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Municipalities and counties are authorized, but not required, to provide utility services to properties that lie beyond their territorial borders. *See* **G.S. 160A-312**; **G.S. 153A-275***; see also* City of Randleman v. Hinshaw, 2 N.C. App. 381 (1968) ("A [local government] which operates its own water and sewer system is under no duty to furnish water or sewer service to person outside its limits. It has the discretionary power, however, to engage in this undertaking.") (The same is true of **water and sewer authorities**,**sanitary districts** (on a limited basis),**metropolitan water districts**,**metropolitan sewerage districts**,**metropolitan water and sewerage districts**, and**county water and sewer districts**.)

Local governments are likewise authorized to adopt different user fee rate schedules for services provided extraterritorially (to nonresident customers). *See, e.g.*, **G.S. 160A-314**; **G.S. 153A-277**. Many local governments charge rates to nonresident customers that are significantly higher than those imposed on resident customers. Local governments also often impose different terms of service on nonresident customers.

A recent court of appeals opinion, ***United States Cold Storage, Inc. v. Town of Warsaw*, No. COA 15-341, __N.C.App. ___ (Apr. 2016)**, gives some new guidance on the contours of a local unit's authority to set the terms of service for nonresident public enterprise utility customers. The court's opinion has two significant holdings. The first is that a municipality may condition its provision of utility services to a property located outside its boundaries on the property owner's agreement to voluntary annex the property into the municipality's corporate limits. The second is that a municipality (and likely other government utilities) may not unfairly discriminate among similarly situated nonresident customers.

Facts of*United States Cold Storage, Inc. v. Town of Warsaw*

In 1995 the plaintiff, United States Cold Storage, Inc. (USCS), purchased land from Duplin County, on which it constructed a refrigerated warehouse facility. The Town of Warsaw provided water and sewer services to the unincorporated part of the county where the property is located. Pursuant to the land purchase agreement, Duplin County agreed to secure a commitment from the Town of Warsaw not to annex the warehouse facility property for at least eight years. The facility was completed in 1997, and, pursuant to a contractual arrangement with USCS, the town provided sewer services to the facility.

In 2013, the town sent a letter to USCS, requesting that it petition for voluntary annexation of its Duplin County facility. (The legislature had significantly limited a town's ability to do an involuntary annexation in 2012.) USCS refused. The town then notified USCS of its plan to cease providing sewer services to the facility if USCS did not seek voluntary annexation.

In a declaratory judgment action, the trial court found that the town had the authority to condition its continued provision of sewer services to the facility on USCS's agreement to voluntarily annex into the town, because the town was not unfairly discriminating between USCS and other similarly situated non-resident sewer customers. The court of appeals upheld the declaratory judgment.

Public Enterprise Utility Service as an Incentive for Voluntary Annexation

The court's central holding is that a municipality may condition its continued provision of public enterprise utility services to a nonresident customer on that customer's agreement to voluntarily annex the property being served into the town. And

the municipality need not demonstrate any connection between the annexation and the public enterprise service. In other words, a municipality may condition continued utility service on the performance of a non-utility related action by the nonresident customer.

On the surface, this holding appears inconsistent with existing North Carolina Supreme Court precedent. Specifically, in *Dale v. City of Morganton*, 270 N.C. 567 (1967), the court held that

> [a] city may not deprive an inhabitant, otherwise entitled thereto, of light, water or other utility service as a means of compelling obedience to its police regulations, however valid and otherwise enforceable those regulations may be. The right of a city to cut off or refuse a service rendered by it in its proprietary capacity must be determined as if the city, in its capacity of supplier of such service, were a person separate and apart from the city as a unit of government.

Id. at 573. In so holding, the court expanded a well-settled principle for private utility providers—that a utility may not "lawfully refuse its service because of a controversy with the applicant concerning a matter which is not related to the service sought"—to apply to local government utilities.

Arguably the majority opinion in *United States Cold Storage, Inc.* fails to follow *Dale's* precedent. There was no indication of any direct connection between the annexation of the USCS facility and operation of the town's sewer system. The town did not have a utility-based rational for compelling the voluntary annexation petition. Instead, the town desired to annex this property to increase its property tax base to help fund other government services.

The court attempted to distinguish *Dale*, claiming that its holding applies only to service provision to resident customers—customers located within a utility's territorial boundaries. It is true that *Dale* involved the provision of utility service to a property within city limits. However, in a decision issued just a year before *Dale*, the supreme court affirmed a temporary restraining order prohibiting a city from terminating water service to a nonresident customer for reasons unrelated to the provision of that water service. *Hall v. City of Morganton, 268 N.C. 599 (1966)*. In that case, the City of Morganton supplied water service to a property located outside the city. At the time the property owner applied for water service, and paid the $300 tap fee, a private electric provider served the property. Some time after the city began providing water service to the property, the city notified the property owner that it would terminate the water service if the property owner did not switch from the private provider to the city's system for electric service. In an opinion that is bereft of analysis, the court simply held that it would not allow the city to engage in this "wrongful act."

The *United States Cold Storage, Inc.* court does not fully explain its rational for distinguishing *Dale* and does not address *Hall*. One interpretation is that the court's holding is simply incompatible with that supreme court precedent. The dissent in *United States Cold Storage, Inc.* argued as much. There is another possible interpretation, though. The court's majority opinion might be better understood as consistent with another line of North Carolina Supreme Court cases dealing with nonresident public enterprise utility customers.

In fact, *Hall* notwithstanding, North Carolina courts have consistently held that the relationship between a local unit and a nonresident utility customer is "purely a matter of contract, on such terms as the [local unit is] willing to grant and the [customer is] willing to accept." Atlantic Construction Company v. City of Raleigh, 230 N.C. 365, 347 (1949); *see also* Honey Properties, Inc. v. City of Gastonia, 252 N.C. 567 (1960); Fulgham v. Town of Selma, 238 N.C. 100 (1953); Mulberry-Fairplains Water Assoc., Inc. v. Town of North Wilkesboro, 105 N.C. App. 258 (1992); Town of West Jefferson v. Edwards, 74 N.C. App. 377, 385 (1985). *See generally* Bailey v. Town of Maggie Valley, 193 N.C. App. 454 (2008); Southside Trust v. Town of Fuquay-Varina, 69 Fed. Appx. 136 (4th Cir. 2003).

In *Atlantic Construction Company,* the supreme court upheld a connection charge assessed only on nonresident sewer customers. The City of Raleigh had adopted an ordinance implementing a $100 fee for connecting a sewer main located outside the city to the city's sewer system. No fee was required for connections made to the city residents' properties. The plaintiffs, owners of property outside the city's corporate limits, challenged the validity of the connection feed. Specifically, they claimed that the fee was *discriminatory*—because similarly situated nonresidents who had made sewer connections prior to the effective date of the ordinance were not required to pay any fee—and *unreasonable*—because it had no basis in cost and was charged regardless of the number of outlets, size of pipes, or number of persons or families served.

Construing the rate statute then in effect (G.S. 160-256), the court held that "a city is free to establish by contract or by

ordinance such fees and charges for services rendered to residents outside its corporate limits as it may deem reasonable and proper." *Id.* at 369. The court reasoned that a municipality has no legal right to compel nonresidents to utilize its utility services and, conversely, that nonresidents are not in a position to compel the city to provide the services to them. Thus, the nature of the relationship between the city as utility provider and its nonresident customers is purely voluntary, governed only by their agreements.

In *Fulghum v. Town of Selma*, 238 N.C. 100 (1953), the supreme court held that a town had the authority to "specify the terms upon which nonresidents may obtain its water." *Id.* at 105. The town had supplied water to a town resident (Mr. Fulghum), who, in turn, re-sold the water to nonresident customers. Fulghum owned the water lines through which the water was transported outside the town. Even though Fulghum was reselling the water to nonresident customers, the town charged him resident customer rates (which were lower than the town's nonresident customer rates). The town subsequently amended its fee ordinance to increase the charge for water supplied by it for consumption outside town limits. Fulghum refused to pay the higher rate. He filed suit against the town, claiming that the town enacted the ordinance only to coerce him to abandon his water service to the nonresident customers and force him to transfer his water lines to the town. The court noted that the customer contract between the town and Fulghum was terminable at-will by either party, and thus held that the town had the right to change the terms of the contract by raising the fees charged for water that would be consumed outside town limits. According to the court,

> [w]hen a municipality engages in supplying water to its inhabitants, it owes the duty of equal service in furnishing water only to consumers within its corporate limits. It is under no legal obligation to supply water to a resident for resale to others either within or without its municipal limits.

Id.

Both these cases involved rate-setting authority and arguably serve as precedent only in this context. However, in *Honey Properties, Inc. v. City of Gastonia*, 252 N.C. 567 (1960), the supreme court held that the city could condition its provision of water and sewer services to a nonresident property owner on the condition that the property owner transfer ownership of the property owner's water lines to the city if the property subsequently was annexed into the city. In so holding, the court extended its *Atlantic Construction Company* precedent to include other terms of service for nonresident customers.

Based on this line of cases, it was reasonable for the *United States Cold Storage, Inc*. court to hold that the central holding of *Dale* is inapplicable to dealings with nonresident customers.

The holding raises a few important questions, though. First, in this case the town altered the terms of service for a nonresident customer to impose an additional condition on continuing the service. Could the town have instead made agreeing to voluntary annexation (at some known or unknown future date) a condition of a contract for initial service with a nonresident customer? The answer is yes. There is no reason to believe that the court's reasoning would not apply to an initial contract for service with a nonresident customer.

Second, instead of disconnecting sewer service, could the town have instead forced the property owner to annex the property into the town. The answer is no. A municipality may terminate its utility service if the property owner refuses to annex his/her property according to the contract terms. It may not force the annexation, though. *Cf.* Cunningham v. City of Greensboro, 212 N.C. App. 86 (2011).

Third, could the town have made voluntary annexation a condition of utility service for this nonresident customer but not for other nonresident customers? The answer is it depends on whether other nonresident customers are in the same customer class as this customer.

Government Utility May Not Discriminate Among Similarly-Situated Nonresident Customers in Setting Terms of Service

The authority to set the terms of service for nonresident customers, while broad, is not unlimited. The "second" holding of *United States Cold Storage, Inc.* is that a municipality must treat similarly-situated nonresident customers similarly when setting and applying terms of service. (In this case, the court determined that there were no other nonresident customers in USCS's customer class.) The same is true of resident customers. A municipality may establish different customer

classes, but, within a class, the unit must apply rates and other terms of service equally. This holding likely applies to other government entities that provide public enterprise utility services—counties, water and sewer authorities, sanitary districts, etc.

Note that the holding does not require that the terms of service for nonresident customers be reasonable. Courts have generally declined to review the reasonableness of rates and other terms of service imposed on nonresident customers. *See* Atlantic Construction Co. v. City of Raleigh, 230 N.C. 365 (1949); *see also* Handy v. City of Rutland, 598 A2d 114 (Vt. 1991) (citing *Atlantic Construction* for the proposition that "the reasonableness of extraterritorial sewer or water rates is not subject to judicial review"); Payson Sanitary Dist. Of Gila County v. Zimmerman, 581 P.2d 1148 (Ariz. Ct. App. 1978) (citing *Atlantic Construction* for proposition that a sanitary district's "relationship to subscribers beyond its limits arises only through contract and the reasonableness or unreasonableness of its charges for access to its system is not subject to judicial review"); City of Texarkana v. Wiggins, 246 S.W.2d 622 (Tex. 1952) (Calvert, J. dissenting) (citing *Atlantic Construction* as in accord with the "overwhelming weight of authority" that reasonableness of rates charged to nonresidents is not judicially reviewable).

Prospective Guidance for Local Officials

United States Cold Storage, Inc. provides helpful guidance to local units, particularly municipalities, about the contours of their authority to set the terms of service for nonresident customers.

- A municipality may condition the provision of public enterprise utility service to a nonresident customer on that customer's agreeing to voluntarily annex his/her property into the municipality.
- A local government utility is free to set terms of service for nonresident customers that are different than those that apply to resident customers. The terms of service for nonresident customers likely do not even have to be reasonable.
- However, in setting and applying the terms of service, a local government utility may not unfairly discriminate among similarly-situated nonresident customers. It must treat nonresident customers in the same customer class the same.

Links

- www.ncleg.net/EnactedLegislation/Statutes/PDF/BySection/Chapter_160A/GS_160A-312.pdf
- www.ncleg.net/EnactedLegislation/Statutes/PDF/BySection/Chapter_153A/GS_153A-275.pdf
- www.ncleg.net/EnactedLegislation/Statutes/PDF/BySection/Chapter_162A/GS_162A-6.pdf
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