IN THE COURT OF APPEALS OF TENNESSEE

AT KNOXVILLE

CITY OF CHATTANOOGA, TENNESSEE,	) C/A NO. 03A01-9902-CV-00056) E1999-01573-COA-R3-CV) HAMILTON CIRCUIT
Plaintiff-Appellant,	)
vs.	) HON. W. NEIL THOMAS, III,) JUDGE
BELLSOUTH TELECOMMUNICATIONS, INC., MCI METRO ACCESS TRANSMISSION SERVICES, INC., AMERICAN COMMUNICATIONS SERVICES, INC., and TCG MIDSOUTH, INC.,	)
Defendant-Appellee.	) AFFIRMED) AND) REMANDED

RANDALL I. NELSON and LAWRENCE W. KELLY, Chattanooga, for Plaintiff-Appellant.

DAVID A. HANDZO, JANIS C. KESTENBAUM, JENNER & BLOCK, Washington, and H. FREDERICK HUMBRACHT, JR., BOULT, CUMMINGS, CONNERS & BERRY, PLC, Nashville, for MCI Metro Access Transmission Services, Inc.

C. CREWS TOWNSEND and LEAH M. GERBITZ, MILLER & MARTIN, LLP., Chattanooga, for American Communication Services of Chattanooga, Inc.

J. HENRY WALKER, and FRED A. WALTERS, Atlanta, and ROBERT G. NORRED, JR., SPEARS, MOORE, REBMAN & WILLIAMS, INC., Chattanooga, for Bellsouth Telecommunications, Inc.

O P I N I O N

Franks, J.

In this declaratory judgment action brought by the City of Chattanooga ("City"), the Trial Judge held the disputed ordinance invalid, and the City has

appealed.

In 1996, the City enacted Ordinance No. 10377 entitled "An Ordinance to Amend Chattanooga City Code, Part II, Chapter 32, by adding a new Article XI Relative to Telecommunications Services within the City of Chattanooga." The Ordinance requires those wishing to provide telecommunications services within the City to obtain a franchise from the City. It requires that any franchise occupying any right-of-way of the City to pay a franchise fee of "five percent of its 'gross revenue'[1] to the City each year." The Ordinance also requires franchisees to furnish the City for its exclusive use, an underground duct (with underground installations); pole space (with aboveground installations); four dark fiber optic fibers; and engineering assistance for initial hookup by the City.

After this action was brought, defendants had it removed to Federal District Court where a trial was had, but the action was ultimately dismissed for lack of jurisdiction, with remand to the State Court.

Upon remand, the parties filed motions for summary judgment and after oral argument, the Trial Judge entered a Memorandum of Opinion and Order denying the City's summary judgment, and granting defendants' summary judgment.

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[1] "Gross revenue" is defined by the Ordinance as: "all revenue of any kind collected by Provider from any source whatsoever for customer access to a long distance carrier or provider using a Telecommunications Services system within the City of Chattanooga. For the purposes of this section, 'gross revenue' shall not include (1) any taxes which are collected by Provider from its customers, (2) lease or rental fees received from a lessee or sublessee or Provider's System for which a five percent (5%) franchise fee on the lessee's or sublessee's gross revenue is paid to the City pursuant to this Article, or (3) revenues from sale of capacity in Provider's System for which a franchise fee on the purchaser's gross revenue is paid to the City pursuant to this Article."

The dispositive issue on appeal is does the franchise fee imposed by the Ordinance violate State law, as either an impermissible tax or as an ultra vires act of police powers?[2]

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 Tullahoma v. Bedford County*, 938 S.W.2d 408 (Tenn. 1997); *Bristol Tenn. Housing Auth.*; *City of Paris v. Paris-Henry County Public Unity District*, 340 S.W.2d 885 (Tenn. 1960).

The franchise fees imposed by the Ordinance under consideration must necessarily come under the City's governmental function and not its proprietary function. 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. *Bristol Tenn. Housing Auth.; Shelby County v. Cumberland Telephone & T. Co.*, 203 S.W.342 (Tenn. 1918). 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 functions. T.C.A. §65-21-103 requires such fees to be imposed

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[2] The issue of whether the franchise fee violates the Federal Telecommunications Act of 1996, is pretermitted.

without discrimination. Moreover, T.C.A. §67-4-401 and 67-4-406 prohibit a city from taxing providers of telecommunications services for the privilege of doing business within the city. *See Holder v. Tennessee Judicial Selection*, 937 S.W.2d 877 (Tenn. 1996).

Accordingly, to be valid, the fee imposed by Ordinance 10377 must be enacted under an exercise of the City's police powers, and cannot constitute a tax. In exercising these powers, the charge exacted by the municipality must bear a reasonable relation to the objective to be accomplished. *Porter v. City of Paris*, 201 S.W.2d 688 (Tenn. 1947). T.C.A. §65-21-103 permits a city to exact a rental for the use of the right-of-way under its governmental, or police, powers. This section provides, in pertinent part:

> While any . . . city within which such line may be constructed shall have *all reasonable police powers to regulate the construction, maintenance, or operation* of such line within its limits, *including the right to exact rentals* for the use of its streets and to limit the rates to be charged; provided, that such rentals and limitations as to rates are reasonable and imposed upon all telephone and telegraph companies without discrimination. (Emphasis added).

The City argues that under this statute, in the exercise of its police powers, it may charge a telecommunications provider a rental unrelated to the cost of regulation. The City argues that the term "rental" is not limited to the cost of regulation, but allows generation of revenue in excess of regulation without constituting a tax, and cites to *Memphis Retail Liquor Dealer's Ass'n v. City of Memphis*, 547 S.W.2d 244 (Tenn. 1977) in support of its argument.

The Trial Court found that "rental" derived from the City's police power and must therefore bear a reasonable relationship to the thing being accomplished, and

that the amounts collected could not be disproportionate to the expenses involved. The *City of Memphis* case involved an inspection fee of 5% of the wholesale price of liquor, and the Supreme Court was faced with whether this constituted a fee or a tax. The Court made this distinction:

> In 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.

547, S.W.2. at 246.

While the Court held that the income generated was not totally disproportionate to the cost of administration,[3] it specifically held that "this argument might be valid if the activity regulated was anything other than the liquor business." The Court went on to say that "the amount of the license fee may itself have a permissible regulatory effect" where the occupation regulated "while they are tolerated, are recognized as being hurtful to the public morals, productive of disorder, or injurious to the public, such as the liquor traffic." *Id.* The Trial Court in this case observed that "it would hardly seem that the telecommunications industry needs the type of regulation identified," by the Court in *City of Memphis.*

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

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[3] In that case, the income was approximately two hundred times the cost of regulation.

financed by a general tax, then the assessment will usually be deemed a tax rather than a fee. *Id.* If the franchise fee would generate income to the City beyond that necessary to regulate and manage the telecommunications industry, such "fee" would be generally considered to be a tax rather than a fee. To counter, the City argues that it should be able to collect revenue generating rent on defendant's use of its public right-of-way, similar to the rent charged by the City for the private use of its publicly-owned theater. However, this comparison supports the argument that the City's ordinance was meant to be revenue generating instead of simply a fee to defray the cost of regulation.

The City's urged construction of the term "rental" to allow for revenue above mere "compensation", would enable the City to exact the same charge in its exercise of its police powers as it can in the exercise of its proprietary powers, thereby rendering meaningless our Supreme Court's decisions making the distinction. *In Porter v. City of Paris*, the Supreme Court held under the City's police powers, the fee imposed must "bear a reasonable relation to the thing being accomplished." 201 S.W.2d at 691. Recently, the Court defined "fee" as that which is "imposed for the purpose of regulating specific activity or defraying the cost of providing a service or benefit to the party paying the fee." *City of Tullahoma v. Bedford County*, 938 S.W.2d 408 (Tenn. 1997).

The record reveals that the 5% fee does not necessarily bear any relation to the cost to the City of the franchisees' use of the City's rights-of-way. The fee varies based upon the provider's gross revenue, and is therefore measured by the provider's earnings and not to the burdens assumed by the city in regulating the

particular provider. This is particularly true because a telecommunications provider must pay 5% of its gross receipts, regardless of the extent to which the provider uses the City's rights-of-way. *Cf. Bell Atlantic-Maryland, Inc. v. Prince George's County, Maryland,* 49 F.Supp.2d 805, 818 (D. Md. 1999), appeal docketed, 99-1784 (4th Cir. June 14, 1999) (holding that under §253(c) of the FTA, fees for access to public rights-of-way must be directly related to the "cost of the [local government] of maintaining and [using] the public rights-of-way . . . . These costs must be apportions to [a telecommunication provider] based on its degree of use, not its overall level of profitability.")

The City cites us to the fact that it spent more than twenty million dollars from 1991 to 1996 for street paving and improvements, and offered evidence that the street cuts made by utility companies damaged the integrity of the street and necessitated repaving more frequently than otherwise necessary. The City estimated the total revenue from the Ordinance would be about $725,000 per year, but it did not know, and had not determined, the percentage of any street improvements or repaving that would be attributed to telecommunications construction, as opposed to other utilities. Likewise, there was no evidence presented as to what portion of street maintenance relates to street cuts.

The City chose a fee of 5% of gross revenue, based upon what some other cities charge telecommunication providers for the use of rights-of-way, which the Trial Judge referred to as a "me too" rationale. The mere fact that other cities charge similar rates, is not conclusive as to the reasonableness of the fee. *See AT&T Communications of the Southwest, Inc. v. City of Dallas,* 8 F.Supp. 2d 582, 593 (N.D.

Tex. 1998). But the Trial Judge incorrectly reasoned that the provisions requiring the telecommunications providers to repair the cuts they make and to post bonds before construction, adequately reimburse the City. The City does have the right to be reimbursed for the added cost of repaving more frequently. *In Porter*, the Court said:

> The 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*. (Emphasis supplied).

201 S.W.2d 688, 691. Thus, while the City may charge a fee beyond the mere repair of its rights-of-way, such fees must bear a reasonable relation to the cost to the City. There is no evidence to support the proposition that the 5% fee will "bear a reasonable relation" to the use of the rights-of-way.

Finally, the City raised in oral argument the case of *BellSouth Telecommunications, Inc. v. City of Orangeburg*, 1999 WL 1037 160 (S.C. November 8, 1999), where the South Carolina Supreme Court upheld a franchise fee in the amount of 5% of gross revenue imposed by the City of Orangburg on BellSouth.

The Trial Court in the City of Orangeburg found the fee to be fair and reasonable in part because "the only other telecommunications franchise, a cable television company, paid the same fees". The Court in *City of Orangeburg*, reasoned that South Carolina had delegated to municipalities the power to enact ordinances "necessary and proper for the security, general welfare, and convenience of the municipality or for preserving health, peace, order, and good government in it." This power included the ability to ensure that the grant of franchise privileges operates to benefit the public.

The City of Chattanooga has been given a limited range of police powers in regulating telecommunications providers. It has not been given the full range of powers found in *City of Orangeburg*. The proper measure for a franchise fee under our cases is not the "franchise's value as a business asset", but rather the cost to the City of allowing the franchise to use its public rights-of-way.

The Trial Judge found the franchise fee to constitute a tax. Regardless of whether the franchise fee in the ordinance is characterized as a fee or a tax, the record fails to establish the fees created by the ordinance come within the statutory authority granted to the plaintiff. The same holds true for the savings provision of the ordinance that provides for a per foot fee if the percentage based fee is struck down. A fee calculated based upon the amount of the City's rights-of-way actually used, could be a type of fee that would be proper and reasonably related to the regulation of the industry. However, there is no evidence that the per foot charge does, in fact, bear a reasonable relation to such cost. Accordingly, we hold that neither the fees based upon the gross percentage of revenue nor the per foot charge is a reasonable exercise of the City's police powers. We affirm the judgment of the Trial Court, holding the ordinance invalid.

We remand with the cost of the appeal assessed to plaintiff.

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Herschel P. Franks, J.

CONCUR:

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Houston M. Goddard, P.J.

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D. Michael Swiney, J.