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Municipal Water Supply for Nonresidents: Recent Developments and a Suggestion for the Future

Joseph L. Sax
Berkeley Law

MUNICIPAL WATER SUPPLY FOR NONRESIDENTS: RECENT DEVELOPMENTS AND A SUGGESTION FOR THE FUTURE

JOSEPH L. SAX*

Each year brings a new crop of cases testing the obligations of cities to those outsiders who use, or who would like to use, city water. A casual examination of the decisions would suggest no noteworthy developments. The years seem to be bringing a steady, if rather slow, repudiation of the traditional view that since cities have no duty to serve outsiders at all, if they choose to provide service, they can do so on any terms they might contract for. In its place is a growing acceptance of the view that a city which serves outsiders is in many ways like a public utility, and must therefore provide its service on reasonable and nondiscriminatory terms.[1]

Perhaps because it is assumed that the trend is salutary and that the problem is solving itself, there has been very little serious commentary dealing with this issue. Except for occasional reports on how the balance was shifting between no-duty states and rule-of-reason states, no careful examination has been made of the actual status of outsiders who depend on municipal water supplies.[2] A close look at

* Associate Professor of Law, University of Colorado, Boulder.

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1. The cases are collected at Annot., 4 A.L.R.2d 595 (1949), supplemented to date. In the last two years the rule of reasonableness has been recognized or reaffirmed in Connecticut, Barr v. First Taxing Dist., 151 Conn. 53, 192 A.2d 872 (1963); Oregon, Kampstra v. Salem Heights Water Dist., 237 Ore. 336, 391 P.2d 641 (1964); Kentucky, Roaring Fork Coal Co. v. Wilder, 380 S.W.2d 271 (1964); Texas, Hatten v. City of Houston, 373 S.W.2d 525 (Tex. Civ. App. 1963); and Rhode Island, Carvalho v. Levesque, 191 A.2d 165 (R.I. 1963). See also Sengstock, Extraterritorial Powers in the Metropolitan Area 16-37 (1962).

Of course, the no-duty rule is by no means dead; it still has active enthusiasts. *E.g.*, City of Colorado Springs v. Kitty Hawk Dev. Co., 392 P.2d 467, 471 (Colo. 1964), *appeal dismissed*, 379 U.S. 647 (1965); Hobby v. City of Sonora, 142 Cal. App. 2d 457, 298 P.2d 578 (3d Dist. Ct. App. 1956).

2. *E.g.*, Sengstock, *op. cit. supra* note 1. This comment will only be concerned with the status of the rule of reasonableness in those states which have adopted it. It assumes that the traditional no-duty rule is both erroneous and that it is dying. As to its error, only this will be said: despite its numerous adherents, the rule seems plainly ignorant of the doctrine of unconstitutional conditions [Note, *Unconstitutional Conditions*, 73 Harv. L. Rev. 1595 (1960)]; unaware of the nature or modern judicial treatment of contracts of adhesion [Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Con-*

recent developments would show that the current complacency is unjustified. The reasonableness doctrine, as it is in fact evolving, is not significantly helping the outsiders; in reality, they are not much better off under a reasonableness rule than they were under the absolutist no-duty rule.[3] The purpose of this comment is to suggest some steps that might usefully be taken in order to forge the rule of reasonableness into a genuinely effective remedy.

The practical difficulty, as the outsiders formulate it, is that many suburban communities are unable to provide their own water systems and are often wholly dependent upon a nearby city to service their water needs on a contract basis. The city's frequently monopolistic position, plus its immunity from political reprisal by nonresidents, it is claimed, may induce it to offer to provide water only at unreasonably high rates or at rates which unjustifiably discriminate between residents and nonresidents.[4] While one may debate whether the cities intend or desire to discriminate, or to take unfair advantage of their position, the record is replete with ordinances providing for rates to outsiders ranging upwards to as much as four or five times the resident rate.[5]

It was widely thought that the problem of discrimination and excessive rates was on its way to solution a dozen years ago when the

tract, 43 Colum. L. Rev. 629 (1943)]; and uninformed about the revolution that has begun to take place over the old view that government services are a mere privilege or matter of grace, and outside the usual protection given property-like rights [Reich, *The New Property*, 73 Yale L.J. 733 (1964)].

3. See, *e.g.*, Barr v. First Taxing Dist., 151 Conn. 53, 192 A.2d 872 (1963); Hatten v. City of Houston, 373 S.W.2d 525 (Tex. Civ. App. 1963); Carvalho v. Levesque, 191 A.2d 165 (R.I. 1963). See also Wells v. City of Jackson, 223 Miss. 228, 77 So. 2d 925 (1955); Phinney Bay Water Dist. v. City of Bremerton, 58 Wash. 2d 298, 362 P.2d 358 (1961); Faxe v. City of Grandview, 48 Wash. 2d 342, 294 P.2d 402 (1956); Delony v. Rucker, 227 Ark. 869, 302 S.W.2d 287 (1957); Town of Terrell Hills v. City of San Antonio, 318 S.W.2d 85 (Tex. Civ. App. 1958).

A number of states have statutes expressly allowing a city to charge nonresidents higher rates than it charges its own residents. While this comment does not deal directly with these provisions, the views expressed here would seem equally applicable to states with such laws, since the laws may be interpreted as implicitly incorporating (or as constitutionally having to incorporate) a rule of reasonableness. See Wells v. City of Jackson, Phinney Bay Water Dist. v. City of Bremerton, and Delony v. Rucker, *supra*.

4. The situation is aggravated by the fact that a city's monopolistic position and water affluence is often attributable to special preferences given by state law. *E.g.*, Cal. Water Code, §§ 1460-62; Tex. Rev. Civ. Stat. Ann. art. 7472 (1954); N.M. Stat. Ann. § 14-48-1 (1953); Ariz. Rev. Stat. Ann. §§ 45-143 to -147 (1956); Ore. Rev. Stat. § 537.190 (1963); S.D. Code § 61.0101 (Supp. 1960); Wyo. Stat. Ann. § 41-3 (1957); Metropolitan Suburban Water Users Ass'n v. Colorado River Water Conservation Dist., 148 Colo. 173, 365 P.2d 273 (1961). Of course, almost all cities have a preference in the form of eminent domain power.

5. See cases cited in notes 1 and 3 *supra*.

leading case of *City of Texarkana v. Wiggins*[6] was decided. There the city charged outsiders fifty per cent more than it did residents, and it had a special tap fee for outsiders that was three to five times the city rate. In answer to a suit claiming that the differential rate was an unlawful discrimination, the city urged the traditional defense that since it could withhold service althogether, it was free to provide service on any terms it desired to impose. The court rejected the defense, holding that outside consumers were entitled to service at reasonable rates, and further that the mere physical fact of residence outside the city limits was not a sufficient basis for a rate difference. Since issue had been joined on the basic issue of whether there was a duty of reasonableness, and not on whether the rates were in fact reasonable, the record contained no evidence to justify a rate differential, such as a comparison of the costs of supplying residents and nonresidents. Thus, having found a duty of reasonableness and no evidence to support a differential charge, the court held for the nonresidents.

Most counsel for nonresidents in subsequent cases[7] have thought the *Texarkana* case provided an easy path to victory. Under the reasoning of that case, they have been urging that a differential charge is per se unreasonable and therefore unlawful. But having learned a lesson from the *Texarkana* case, the cities now uniformly introduce evidence which might justify charging outsiders a higher rate. While this evidence varies considerably from case to case, there are a few quite regular claims: (1) where the water system is financed by general obligation bonds, or from property taxes, rather than solely from water revenues, city residents are burdened with an obligation beyond that reflected in water rates, and a differential is justified in the rates charged outsiders to compensate for their freedom from city tax obligations; (2) where outside areas are more sparsely settled than city areas, the cost of maintenance and service may be higher; (3) a city meter connection improves the value of the property served; as to city residents that value can be returned in part through higher taxes based on a higher assessment, but outsiders, being free from city property taxes, return nothing for the enhancement of their property created by the availability of city water.

Faced with introduction of evidence of these or similar bases for distinction, the courts have generally agreed that service to outsiders must be provided on a reasonable and nondiscriminatory basis, and

6. 151 Tex. 100, 246 S.W.2d 622 (1952).

7. The following discussion is based on the cases cited in notes 1 and 3 *supra*.

have agreed also that the mere fact of residence beyond the city limits is not a sufficient basis for a rate differential. Nevertheless, they hold that the burden is on the plaintiff to show unreasonableness, and where the city adduces evidence of a basis for differential treatment—such as the fact that the system is financed by property taxes, for which only residents are responsible—the plaintiff's burden of showing unreasonableness has not been met. Judgment is thereupon entered for the defendant city.

Since a city can almost always introduce some reason for legitimately charging outsiders a higher rate, the cities are winning almost every case. The practical consequence is that even where the courts accept the rule of reasonableness, the outsiders are losing as badly as they did under the traditional no-duty cases.

I am far from suggesting that the outsiders should be winning all these cases. I do suggest, however, that the reasonableness rule as presently applied is not yielding nonresidents much in the way of practical results. The reason is simply that while they have won a theoretical right to be charged no more than reasonable rates, they are not getting the courts to examine the reasonableness of the particular rates at issue; thus, in a number of the recently litigated cases, the otusiders may very well have lost even though they were being charged highly unreasonable rates.

The lesson seems clear. Plaintiffs' council must cease limiting themselves to the discrimination per se approach that has thus far prevailed, and must force a specific and detailed analysis of the basis for the rate differential at issue.

Thus, where the city loses the taxes based on increased value, the amount of added tax money which a water connection would bring must be evaluated; that specific amount and no more may be added to the outsider's water bill. Where outsiders get fire protection financed by general city revenues, the value of that service for outsiders may be evaluated and that sum added to their rates. Likewise the value of the residents' assumption of a general obligation to pay for the capital cost of the system must be evaluated as to that portion of the capital structure attributable to outside uses, and that amount may then be charged to nonresidents. In short, in order to effectuate a reasonableness test, the additional cost of serving outside areas, if any, must be specifically substantiated and precisely calculated; if it costs twice as much to service outside areas, then and only then may the city double, for outsiders, that portion of the charge per gallon allocated to service costs.

No doubt it will be suggested that to make such calculations may involve a very complicated and sophisticated economic analysis. This is quite likely, as we know from public utility rate procedures. But if such analysis is not undertaken, we are relegated to acceptance of one of two quite undesirable alternatives. Either we tolerate the present situation as it operates in practice, telling outsiders they are entitled to reasonable rates, but not examining whether a given rate is reasonable in fact—with the result that a city, which can almost always suggest some sensible basis for charging outsiders higher rates, is virtually left free to charge any higher rate they choose, whether it is fifty per cent more than city rates, or five times the city rate. Without an economic analysis, we simply do not know what sort of surcharge is justifiable. The other alternative—to hold that any differential between resident and nonresident rates is per se unreasonable—is equally offensive. This would often have the effect of forcing residents to subsidize outsiders, a situation which already seems to prevail excessively as to a number of municipal services.

If the reasonableness rule is to serve as a useful basis for limiting municipal power over outsiders, the principal need is to find a practicable procedure for eliciting the economic data which will determine whether the substantive law is being violated. As we have seen, the substantive rules themselves are pretty well agreed upon. The essential rule seems to be that a city may charge outsiders higher rates than those charged insiders, so long as the differential is based upon actual differences in the costs of supplying services or in the capital investment attributable to the group being served. A city may also charge enough to bring a fair rate of return on the capital investment attributable to the group served, so long as the rate of return is no higher on the services to outsiders than it is on service to residents.[8]

8. There is, however, one substantive problem that is still pretty much at large. There is some judicial authority for the proposition that a principle of germaneness is requisite in setting the terms upon which outsiders will be served. What a rule of germaneness means is that a city cannot tell outsiders that it will sell them water at thirty cents if they agree to buy city supplied electricity, but at forty-five cents if they get their electricity from a private supplier [Hicks v. City of Monroe, 237 La. 848, 112 So. 2d 635 (1959)]. It would prohibit a city from using its water power to coerce outsiders to annex, or to adhere to city building and zoning regulations. The Colorado court, which still follows the traditional no-duty theory, allows a city to exact both a promise of annexation and a cash bonus for granting water service. City of Colorado Springs v. Kitty Hawk Dev. Co., 392 P.2d 467 (Colo. 1964). The City of Boulder, Colorado, appears to take full advantage of the court's liberality; in return for agreeing to supply outsiders with water under a "permit revocable at any time . . . , at the pleasure of the . . . City Council" it exacts, *inter alia*, an agreement to petition for

The real challenge is thus not in finding a rule, but in finding a way to make the existing rule work. If a claim is made that a city discriminates against nonresidents, how is that charge to be proved? The courts have quite uniformly taken the view that the burden of proving unreasonableness is upon the nonresidents who are making the challenge, with the apparent proviso that where the plaintiffs show a differential in rates, the city must make some general showing that there is a basis for a difference (such as the fact that the water system is financed by general obligation bonds rather than by revenue bonds).

What obligations the parties have beyond this point is not yet clear, since the problem has not arisen in recently reported cases. Yet this practical problem of responsibility for compiling the specific cost data, and for bearing the burden of proving whether the facts justify the charges imposed, is of the highest importance.

It seems a fair speculation that if the nonresident protestants must bear the burden of gathering, compiling, and analyzing all relevant economic data, the chances of their winning a rate case would be enormously restricted.[9] On the other hand, the mere fact of a rate

annexation, to comply with the city plumbing, building, and electrical codes, zoning laws and "all other applicable laws of the City of Boulder." Standard Form Utility Ordinance, in the author's possession. A rule of germaneness would also forbid a city from conditioning service or rates upon the grant of an easement across an applicant's property for uses not related to serving him. The Rhode Island court, in a somewhat ambiguous opinion, permitted such a condition to be imposed. See Carvalho v. Levesque, 191 A.2d 165 (R.I. 1963).

The argument for adopting a rule of germaneness is the same as that for adopting the general rule of reasonableness. Without it, a city is free to serve outsiders on any terms it can exact in unrestrained bargaining. The fact that it may take its exaction in the form of an easement or profit on electric sales rather than in a higher rate per gallon seems irrelevant. And when the city seeks to exact such things as promises to be annexed, the impropriety is even greater. Where a state makes annexation dependent upon petition by the residents of the annexing community, it would seem to have declared thereby that the decision to annex is a political one to be determined by the persons affected, and is to be made voluntarily; where a city with strong bargaining power based on its water affluence forces that decision, it is simply circumventing the state policy against involuntary annexation. Similarly, where a city uses its water position to extend its zoning laws or building code (however desirable) beyond the geographic area authorized by the legislature, it is again undermining or avoiding by indirection an established state policy. Each of these issues, whether annexation or the scope of municipal legislative authority, ought to stand on its own merits. The effectiveness of an existing state policy should not depend upon how much excess water a given city has or does not have.

9. It may well be that no mere procedural rules, however favorable, will be sufficient to help nonresidents through the tangle of rate regulation litigation. Perhaps nothing short of regulation by a public administrative agency will be adequate, as some writers have intimated. See Sengstock, *op. cit. supra* note 1; Kneier, *State Supervision Over*

differential does not, as the courts have indicated, seem a sufficient basis for shifting the traditional burden of proof that rests upon plaintiffs.

A workable solution may be found in maintaining the burden of proof of discrimination on the nonresident plaintiffs, but imposing upon the defendant cities a duty of compiling and producing the cost data for each item which is utilized in determining the rates. The suggestion here, of course, is not especially unconventional; it is merely that the defendants bear, as they do under modern discovery rules, a burden of production of the evidence in their possession. It goes beyond the bare discovery principle only in suggesting that defendants not be permitted merely to "open the files" at large, but that they be required to compile the relevant data indicating precisely how the rate differential was calculated.

This sort of discovery rule would make a remedy for nonresidents a much more practicable possibility. But what of the defendant's likely claim that such a procedure does in effect shift the burden in that it requires him to prove the plaintiffs' case for them by undertaking what may be a very heavy burden of economic analysis before there is any evidence whatever of wrongdoing? There are two good answers to any such claim:

First, such a rule does not shift the traditional burden; it merely particularizes the burden of production, which the defendants already bear under modern discovery rules. It is still incumbent upon the plaintiff, if he is going to win, to persuade the court or jury that the differential rates are discriminatory, either because the figures are erroneous, the method of economic analysis is improper, or because the facts do not support the rates allegedly based on them.

Second, and most important, if the defendant city has acted properly, it should already have this information at hand; indeed, if it does not, that fact alone should be evidence of impropriety in the rate structure. We have already said that the courts which recognize a rule of reasonableness have interpreted that rule to mean that the only rate differentials which are proper are those based on legitimate economic considerations. If this is the case, then a city which has a lawful rate differential must have based that differential on an economic analysis of the relative situations of residents and nonresidents

Municipally Owned Utilities, 49 Colum. L. Rev. 180 (1949). This comment, however, is written in light of the reality that for many states public regulation of municipal utilities is still far in the future, if it is ever to come. In the meantime, the only hope of relief for outsiders is an adequate judicial remedy.

as to cost of service, financing, etc. Thus, if a city has a legitimate differential in rates, it must already have compiled the information which plaintiffs seek, since a legitimate differential can only be based on such information. If the city already has such information, analyzed and calculated, it should have no objection to turning that information over to plaintiffs in a lawsuit. On the other hand, by hypothesis, if the city has not made such an economic analysis, it cannot have a legitimate basis for a rate differential. The presence of a differential in the absence of such data is itself adequate to make a prima facie case of unlawful rate discrimination, and it then is sufficient even under the most traditional approach to shift responsibility to the defendant to show that its differential is in fact justifiable.

Differential water rates have been among the most exacerbating issues in the always delicate area of city-suburban relations. Charges of city profiteering and economic coercion have generally been matched by allegations of suburban tax irresponsibility. Perhaps the ideas set out here will help to suggest a workable basis for litigation which can fairly and comprehensively settle the differences over this particularly troublesome issue.