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*55 RAISING LOCAL GOVERNMENT REVENUE THROUGH UTILITY FRANCHISE CHARGES: IF THE **FEE FITS,** FOOT IT [FNa]

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I. Introduction

MUNICIPAL GOVERNMENTS in the United States have in recent years been placed under a variety of increasing fiscal pressures. On the one hand, revenues have steadily dried up. Changes in the economic base of many municipalities have adversely affected the ability of local governments to raise revenue from the three generally recognized broad-based taxes: property tax, general sales tax, and earnings tax. [FN1] In addition, federal funds to local governments have been virtually eliminated. [FN2]

Even while revenues are less, however, the financial demands on local governments are greater. City officials overwhelmingly see monumental problems such as public transportation, unemployment, water and sewer treatment, energy, social services, low-income housing, and the condition of streets, roads, and sidewalks needing to be met with ***56** decreasing revenue bases. [FN3] In addition, cities are being called upon more and more to shoulder new burdens such as financing incentives for local economic development. [FN4] Finally, expenditures simply to maintain and replace basic infrastructures are expected to double from 1985-1990. [FN5]

As a result, municipalities are seeking new means to deal with their financial obligations. Reducing expenses is always one mechanism available. [FN6] Approaching the problem from a revenue perspective is another. [FN7] The key with revenue measures, analysts say, is to 'raise revenues without raising taxes.' [FN8] One mechanism available for cities to accomplish that task is to exact charges for the use of municipal property by public utilities.

Under most state statutes, cities may grant a franchise to a public utility for the right to erect, maintain, and operate their systems. [FN9] With that grant, the utility may acquire the right to use and occupy the streets and ***57** public grounds of the city. [FN10] Under this franchise system, states may regulate the rates and services of a public utility; it is the cities, however, that grant the basic right to operate within municipal boundaries and it is the cities that establish the conditions which govern that operation. [FN11]

Today, utility franchise agreements are coming to term. [FN12] As a part of the renegotiation process, cities are beginning to reevaluate these agreements to determine whether and under what circumstances they should be renewed. Some cities have sought to impose fees that have not been exacted before. The resulting questions of how to design and collect such a fee involve not only issues of municipal finance, but of public utility regulation as well.

Cities, however, are not without statutory restrictions on revenue- raising measures. The power of cities to tax, for example, is strictly limited. [FN13] So, too, is the power to enact a 'license fee.' [FN14] As cities consider ways to exact compensation from utilities, therefore, it is well to understand the distinctions between these revenue raising measures so as to avoid potential pitfalls. In short, as cities seek new sources of funds, the notion of including rental or user fees as part of new local utility franchise agreements merits examination. [FN15]

In addition to questions as to the power of a city to collect such fees, the exaction of compensation from a utility will raise utility ratemaking questions as well. Assuming that a municipally imposed fee is deemed to be a reasonable operating expense for ratemaking purposes, [FN16] questions will arise as to who will be required to pay

the fee in question. The Iowa Supreme Court, for example, in 1979, held that a utility may ***58** charge back a franchise fee to the residents of the city which imposes it. [FN17] For rental fees, however, that process should not be followed.

This article will undertake three tasks. First, it will consider the power of a municipality to collect fees from utilities and recommend a scheme for such collection. The article will urge cities to require a utility to pay rent for the use of municipal lands in the construction of its transmission and distribution system (or the equivalent infrastructure for a telephone or telegraph company). It will conclude that a city has broad powers to exact rental charges. Second, the article will examine how the local government should set the level of the fee. It will posit that one rational means of collecting such fees is through an imposition on gross receipts. Finally, the article will examine how the utility paying such a fee should allocate that expense among ratepayers. It will conclude that such fees should be considered general operating expenses to be passed on to all ratepayers. Before looking at these specific issues, however, it is best to gain an understanding of the grant of a utility franchise by a municipality in the first instance and how the exaction of a rental **fee fits** within that context.

II. The Utility Municipal Franchise: Its Uses and Origins

The initial era of public regulation of utility companies [FN18] brought in the local utility franchise. Under this system, for a utility to operate within a municipality, it was first required to obtain a franchise. The grant of a municipal franchise was in all respects a contract, with the exchange of consideration by each side. [FN19] On the one hand, this arrangement granted the utility two public privileges. [FN20] It permitted the company to operate, and it granted the right of eminent domain. [FN21] On the other hand, in exchange, cities were granted the right to regulate rates and services. [FN22]

During the early days of municipal regulation, exclusive franchises, ***59** whereby but one utility was permitted to operate within a territory, were the exception rather than the rule. [FN23] Two primary reasons existed for the non-exclusive franchise. First, there was no concept at that time that a regulated monopoly might be desirable (even within the public utility industry); if a city was dissatisfied with the performance or rates of an existing utility, it would simply charter a new and competing company. [FN24] Second, the granting of exclusive franchises was, in most places, either unconstitutional or at least contrary to statute. [FN25] This persisted well into the twentieth century

Eventually, however, a number of shortcomings in the use of franchises as a means to regulate public utilities became too burdensome to ignore. [FN26] Franchises, for example, were rarely beneficent to the city. On the one hand, due to the inexperience of local government officials, franchise agreements were frequently poorly written; on the other hand, where the agreement was well-drafted, it was generally because the document had been written by company attorneys and then presented to the city for a perfunctory review and approval. [FN27] Second, as discussed above, a franchise was in the nature of a contract. [FN28] Accordingly, both parties [FN29] had to agree to any changes, with the company resisting any downward adjustment in rates and the city resisting any upward adjustment. In the situation of an exclusive franchise, [FN30] therefore, the city retained neither the ability to regulate through the adjustment of rates and services nor the ability to promote competition through the charter of other companies. [FN31]

Eventually, state regulation replaced franchise agreements as the primary means of 'economic regulation' of the public utility industry. The first public utility commissions were created in Wisconsin and New ***60** York in 1907. [FN32] By 1920, more than two-thirds of the states had utility regulatory commissions. [FN33] Today, each state has a public utility commission and city franchises are generally viewed as having been 'changed . . . into little more than a permit to use the streets.' [FN34]

III. The Powers of a Municipality to Exact Compensation

Notwithstanding this prevailing view of city powers, franchise agreements can be used to benefit the city and its residents. Through a franchise, for example, the city may exact revenues. [FN35] These monies can either be used to develop specific energy-related programs for local residents [FN36] or they can be funneled into the general fund.

Before structuring a charge to impose on utilities, however, it is important to understand what a city may not do.

A. Franchise Fees

Local governments must be careful in how they structure franchise fees and in articulating the role which these fees play. If included as part of a 'licensing' program designed to exert some local regulatory authority over the utility, for example, the fees generally must be scaled to meet only the local costs of regulating the utility. [FN37] Similarly, if designed as an 'inspection fee,' the charge must compensate the city for the costs of inspection and no more. [FN38]

In these circumstances, a city may not directly seek to raise revenue from a public utility in the form of a straight 'franchise fee' designed to raise general revenues as well as to pay for the local regulation of the ***61** utility. [FN39] Franchise fees that are openly designed to be revenue raising in nature within this context have been successfully challenged. [FN40]

These limits need not necessarily be faced, however. A franchise is a valuable right provided by the city and cities unquestionably have the authority to levy franchise fees today so as to be compensated for the grant of that right. [FN41] Moreover, where the utility consents or acquiesces to the imposition of the fee, it may not later challenge it. In Illinois Broadcasting Co. v. City of Decatur, [FN42] for example, General Electric Cablevision attacked the imposition of certain franchise charges. [FN43] The Illinois appellate court rejected the argument that the fee was an unlawful tax. 'That Decatur could not have exacted many of these conditions is immaterial. Exactions agreed to . . . are not exactions.' [FN44] On this and other challenged regulations, too, the court found that the cable television company had foregone the right to challenge when it accepted the franchise. The court noted:

> these conditions are self-imposed. They are not imposed by Decatur. If General agrees to be so regulated who can complain. If General accepts a condition to pay a sum certain who cares. . . . If General discovers later on that some of the conditions it agreed to are onerous, it can assuage itself with the thought that surcease is but fifteen years away--a condition, too, that it agreed to. [FN45]

The Missouri Supreme Court laid out a more technical basis for the same result in St. Louis Public Service Co. v. City of St. Louis. [FN46] In that case, a bus transportation company challenged a municipal operating tax equal to 5 percent of the annual gross receipts arising from the operation of buses within the city. [FN47] The Missouri court rejected that challenge, holding: 'the rule is well settled that one voluntarily proceeding under a statute or ordinance, and claiming benefits thereby conferred, will not be heard to question its validity in order to avoid its burdens.' [FN48] ***62**

Stating that 'the designation used in referring to this rule or doctrine is obviously unimportant,' the court noted that it is at times referred to as involving the rule against assuming inconsistent positions, and involves the principles of waiver, election, and ratification as well as estoppel. [FN49]

What limits that do exist on the use of a municipal franchise fee as a city revenue raising measure stem from two different boundaries on local authority. First, there are strict limits on the power of a local government to tax. Second, this tax limitation cannot be sidestepped through the imposition of 'license fees' that are found to be 'taxes' in disguise. Each of these limitations deserves closer attention.

B. Taxes

Local governments must constantly be vigilant about not imposing an unauthorized 'tax' on a public utility in the guise of a franchisee fee. Not being a sovereign unto itself, a local government has no inherent power to tax. Rather, any such power may only be derived from a grant of authority from the state. [FN50] Moreover, any grant of taxation power to cities is to be narrowly construed. [FN51] Accordingly, if the existence of the power is doubtful, the doubt is to be resolved against the local government. [FN52]

Often, the restriction against local taxes is placed in the form of an explicit prohibition. In Iowa, for example, the legislature has expressly provided that 'a city may not levy a tax unless specifically authorized by state law.' [FN53]

In addition, beyond such total limitations, there are often procedural prerequisites such as requirements that the tax not be imposed without a referendum or other public affirmation. [FN54] Finally, there are also frequently statutory and/or constitutional restrictions on the rates of local government taxation even where the power to tax unquestionably has been granted. Most of these restrictions come in the form of ***63** limitations to specified maximum rates, articulated in terms of dollars of assessed value [FN55] or in percentage of annual increase. [FN56] As is apparent, the articulation of the principles controlling taxation are easy. It is the application that is difficult.

Generally, a 'tax' is a charge to pay the cost of government without regard to special benefits conferred. [FN57] The intent of the city is most important in resolving any dispute. If the primary intent is to raise revenues, a measure is more likely to be considered a 'tax.' [FN58] If the level of the fee is totally divorced from any cost-basis, it is more likely to be deemed a 'tax.' [FN59] Finally, if the charge is not for a particular service, it is more likely a 'tax.' [FN60]

C. License Fees or Regulatory Measure

In contrast to local government taxation, a local government may, in general, charge a fee associated with the issuance of 'licenses.' The principle of strict construction that applies to taxation does not apply in this context. A city, in other words, is to be given latitude in setting the level of a license fee and all doubt is to be resolved in favor of the reasonableness of the fee. [FN61] The courts have held that so long as the fee is 'reasonably related' to the cost, it need not be calculated with 'mathematical exactitude.' [FN62]

Licenses are considered to be an exercise of the police power of the state. [FN63] This attribute acts to expand as well as to contract what a city may do under its auspices. On the one hand, it is expansive in that the power to collect license fees need not be expressly granted. A local government that has been granted the power to regulate by license is generally held also to have been granted, at least impliedly, the right to collect a fee to cover the costs of such regulation. [FN64] On the other hand, it is restrictive in that, as a regulatory measure, a license or permit scheme ***64** must serve only to regulate the standard of operations. Accordingly, the revenue from the fees must not be 'disproportionate to the cost of issuing the license, and the regulation of the business to which it applies.' [FN65]

Local regulation of utilities under a franchise scheme is not unlike other common regulatory programs for which license fees have been approved. Regulatory schemes that involve licenses for which a fee may be charged involve measures which serve to further the police powers of the city. [FN66] As such, fees for the regulation of utilities through franchise agreements have been expressly approved by the courts. [FN67]

Whether the local government requires a building permit or a utility franchise, the price of the license may not exceed the cost of administrating the program. [FN68] If the dollar exaction materially exceeds the cost of administrating the program, the otherwise permissible 'license fee' becomes an unlawful revenue raising 'tax.' [FN69]

One of the leading cases in determining when a 'license fee' is in reality a 'tax' is the Michigan case of Merelli v. St. Clair Shores. [FN70] In Merelli, the Michigan Supreme Court considered the validity of a fee ***65** associated with certain 'building permits.' [FN71] These fees were imposed as a response to the near tripling of the city's population over a five year period. In Merelli, the city argued that it would be 'unfair and inequitable to expect local residents to bear the cost of special service' [FN72] to be provided to the new residents. In contrast, the developer challenging the fees argued that the 'cost for providing police protection, fire protection and the taking care of the streets' could not be collected from the purchaser of a new home by indirectly adding to the purchaser's 'building cost.' [FN73]

It is the purpose of the revenue measure which determines whether or not it is a 'tax,' according to the Michigan court. While revenue may be raised from a license fee, the revenue must be 'incidental to the accomplishment of the primary purpose of guarding the public.' [FN74] To impose a 'license fee' that is grossly disproportionate to the expenses of the licensing program, the court concluded, is to use 'the police power . . . as a subterfuge to enact and enforce what is in reality a revenue raising ordinance.' [FN75]

In sum, while cities have expansive powers today, there nevertheless still remain specific limitations on the

imposition of financial burdens on persons within their boundaries. A municipal government has no inherent power to tax and is thus restricted solely to what the legislature permits in that regard. Neither may the city avoid this limitation by exacting a 'tax' in the guise of a 'license fee.' It is within this context that the collection of charges for the use of city property is examined.

IV. Municipal Charges for the Use of City Land

Including rental fees as part of new local utility franchises allows local governments to raise revenues while avoiding the problems associated with both taxes and license fees. Conceptually, the exaction of a rental ***66** charge for the use of municipal property by utilities holds no problems. [FN76] Cities hold public property in trust for their citizens and for the use by the general public. [FN77] The grant of property rights to a utility is incompatible with the use of that property by the general public. Accordingly, public utilities should pay to gain that portion of the property right. The basis for this conclusion goes back nearly 100 years.

As the United States Supreme Court noted in 1893, the use of public property easements 'effectually and permanently dispossesses the general public' of property being used so that cities, as trustees of the city property, have a right to compensation for that dispossession. [FN78] In 1884, the city of St. Louis enacted an ordinance requiring each telegraph and telephone company [FN79] to pay a fee of five dollars per pole for each pole 'erected or used' by the company in the 'streets, alleys and public places' of the city. [FN80] In sustaining the right of the city to impose that fee against a challenge by Western Union Telegraph Company, the Supreme Court distinguished the charge from a 'tax.' According to the Court, the St. Louis fee 'is more in the nature of a charge for the use of property belonging to the city--that which may be called rental.' [FN81] The Supreme Court expressly held that 'the revenues of a municipality may ***67** come from rentals as legitimately and as properly as from taxes.' [FN82]

In Western Union, the Supreme Court made a distinction between the city of St. Louis acting in a 'proprietary' and in a 'sovereign' capacity. [FN83] 'A tax,' the Court said, 'is a demand of sovereignty; a toll is a demand of proprietorship.' [FN84] This distinction is particularly important in the debate over whether a charge is a franchise fee or a rental, [FN85] which in turn is important in deciding whether the exaction can be surcharged back to residents of the city. [FN86] In Western Union, the Supreme Court concluded that St. Louis had not acted in its capacity as a government imposing a tax, but rather 'ha d attempted to make the telegraph company pay for appropriating to its own and sole use a part of the streets and public places of the city. It is seeking to collect rent.' [FN87]

In this regard, a rental fee is to be contrasted to a 'license fee.' There is no question but that a rental fee is not intended to be a regulatory measure in any way. The fee is not proposed as a police power measure to regulate either the use of the easements or the operating standards of the utility. Neither is the fee designed to compensate the city for the costs of inspection or licensing. The fee merely entails a charge for the use of the city's land. The city's police power to regulate the use of the streets is not being offered as the city's quo for the rental fee quid.

It is important, in other words, to connect what is occurring conceptually with what is occurring legally when cities seek to exact a charge for the use of municipal property pursuant to a public utility franchise. As noted in Western Union, in such a situation, the city is charging the public utility for the use of the property. Strictly speaking, the city is not collecting a 'franchise fee' at all.

***68** A. Franchise Fees Versus Rents

Two lines of analysis lead to the conclusion that a rental charge is not a 'franchise fee' in disguise. First, in general, the difference between a 'lease' and a 'franchise' is well-recognized in the law. Second, with public utility franchises in particular, courts distinguish between the right to use municipal property for utility purposes and the actual acquisition of that property.

1. PAYMENT FOR A FRANCHISE OR A LEASE

A utility's franchise and a utility's lease of municipal real estate have unique properties that permit clear distinction. [FN88] A franchise is a special privilege granted by the government. [FN89] Not all privileges qualify, however. A franchise must meet several further tests. A franchise is a right or preference that may be granted only by the sovereign; [FN90] the permission must arise from the power of the government to bestow. [FN91] As one California appellate court noted: 'If the privilege is one that any individual may enjoy without a permit from the government, or if it is a right which one individual may grant to another without approval of the government, it is not a franchise.' [FN92]

As is thus apparent, 'it is not . . . every privilege or permission granted by a state or city to occupy or to use public rivers, highways, or streets that rises to the dignity of a franchise.' [FN93] Most such grants are mere leaseholds. [FN94] A lease is a contract for the possession and profits of ***69** property in consideration of rent. [FN95] If the purpose of the agreement at issue is to gain compensation from the grantee for the occupation and use of municipal property, the arrangement is a lease, not a franchise. [FN96]

The West Virginia Supreme Court noted the distinction between a lease and a franchise in Green Line Terminal v. Martin. [FN97] In Green Line Terminal, the court considered a challenge to property taxes assessed against a municipally owned, but privately operated, public wharf. If held under a lease, the wharf was taxable; if operated under a franchise, the wharf was tax exempt. The West Virginia Court found the wharf was subject to taxation. In so finding, the court stated that a franchise was 'a branch of the sovereign power of the State, subsisting in a person or a corporation by a grant from the State.' [FN98] In contrast, according to the court, a lease was simply 'a letting out of property for use during a definite period. . . .' [FN99]

It is thus crucial to distinguish precisely the 'item' for which a city seeks compensation. If the city is charging for the grant of the franchise itself, it may be subject to the strictures on the collection of license fees. [FN100] This occurs, for example, if the city is seeking compensation for overseeing the right to operate or the power of eminent domain. [FN101] In contrast, the use of municipal property by a public utility will generally involve only a lease accompanied by the collection of rents. Since the grant of an easement to a public utility is 'such a letting as a private individual might make of similar property, the result should be considered a leasehold and not a franchise.' [FN102] The California courts considered this very issue in 1971. In holding that the grant of the exclusive right to use certain municipal property for recreational purposes was not a 'franchise,' the California court held that the 'city was acting in its capacity as owner of the land and granted nothing a private landowner could not grant upon his own property.' [FN103]

Because of the nature of a rental charge there is really no basis for ***70** restricting the use of the income from the rental fee to the administrative costs or to the costs of reasonable wear and tear on the streets. While such restrictions apply to the use which regulatory permit revenues can be put, they do not apply where the fee is instead levied as a rental charge. This conclusion is consistent with the treatment of a municipality's right to earn a profit on its proprietary activities in general. Some states distinguish, for example, between fees and user charges. [FN104] In those states with the distinction, even though adhering to the limitations on fees and on special assessments, [FN105] a local government is permitted to make a profit on the proprietary provision of goods and/or services. [FN106] Thus, for example, a community can make a profit on the sale of electricity (or sewer service). [FN107] Making a similar profit on the proprietary activity of renting land has no legal difference. [FN108]

2. PAYMENT FOR A RIGHT vs. A PROPERTY RIGHT

A second line of analysis looks specifically at the right of a public utility to acquire property under a franchise contract. Under a municipal utility franchise, a public utility is given the right to use city rights-of-way for its lines, poles, gas lines, and the like. [FN109] One need determine, however, whether once granted the right to use city property, a utility may be charged additional fees for the exercise of that right. In examining this issue, the right to do a particular thing should not be confused with the results achieved in the exercise of the right. [FN110] When the utility acquires the right to occupy city streets, it acquires a franchise. When that same utility actually occupies the municipal property, it is acquiring an easement. Such an easement is simply another property right, the acquisition ***71** of which is likely best done through a lease. [FN111]

The United States Supreme Court first addressed this issue in City of St. Louis v. Western Union Telegraph Co.

[FN112] In that early case, the Supreme Court found that the existence of a franchise creating a right to use the streets did not deprive the city of the power to thereafter collect an additional rental fee for the subsequent exercise of that right. A franchise from the federal government to construct interstate roads, the Court said, for example, would not authorize the corporation receiving such a franchise 'to enter upon the private property of an individual and appropriate it without compensation.' [FN113] The principle is the same, the Court continued, when a corporation 'assumes to enter upon property of a public nature. . . .' [FN114] Under a franchise, the occupation of the streets by a utility cannot be denied; 'all that the city can insist upon is, in this respect, reasonable compensation for the space in the streets thus exclusively appropriated.' [FN115]

A number of state courts have also addressed this distinction between the right to acquire and interest in municipal lands and the actual act of acquisition. The Texas Supreme Court considered, for example, whether a railroad franchise could be taxed apart from the easements underlying its railway. In Texas and Pacific Railway Co. v. City of El Paso, [FN116] the Texas court held that 'there exists a clear distinction between a franchise and an easement.' [FN117] According to the Texas court:

> The grant of a franchise does not carry with it an interest in land. It is a privilege which may be granted and acquired without involving the ownership of land. On the other hand, an easement is essentially an interest in land. It is a dominant estate imposed upon a servient estate. [FN118]

The court then reached its ultimate conclusion. 'The privilege of using the streets for railway purposes is a franchise. The actual occupation of the streets for railroad purposes by virtue of ordinances is an easement.' [FN119]

It becomes clear, therefore, that cities may exact compensation for ***72** different things. If the local charge is for the right to use city streets, it is a franchise fee. If, in contrast, the charge is for the actual occupation of the streets, it is a rent for an easement or lease. As will become apparent below, the distinction is important.

B. The Power to Exact a Rent

Even assuming that a municipal charge is a rent, it has not always been assumed that a city could impose it. The idea of demanding compensation for the use of municipal lands is not new to the 1980s. Ordinances imposing such rental fees were proposed early on, only to be struck down by the courts. In Village of Lombard v. Illinois Bell Telephone Co., [FN120] for example, the Illinois Supreme Court held invalid a rent based on a percentage of gross receipts. No authority had been granted by the Illinois General Assembly, the court said, 'to lease or let public streets for a rental based on gross receipts or otherwise. . . .' [FN121] Since no legislative authority had been granted, 'the village had no power to exact a rental charge for the use or permission to use the streets and alleys of the village of Lombard.' [FN122]

The other early court decisions disapproving rents adopted this same reasoning. An Ohio appellate court, for example, held that the city of Cincinnati could not 'grant rights in the streets of the city to a public utility company, exact as provided by law.' [FN123] Since no statutory authority existed, the court concluded, Cincinnati had no right 'to collect rental from a public utility company for the use of the streets.' [FN124] So, too, was an Iowa Supreme Court decision disapproving utility rental charges predicated upon the lack of express statutory authority for the city to impose such charges. [FN125]

The powers of cities in the past, however, and of contemporary local governments are much different. Not only do cities have broader powers in general today, but they have greater flexibility to engage in ***73** innovation and local experimentation. [FN126] While cities previously labored under the strictures of 'Dillon's Rule,' denying them all power not expressly granted by the state, [FN127] today's home rule cities [FN128] generally have all powers not explicitly denied. [FN129] Today, the grant of authority to impose rental fees need not come in express statutory language. As one Texas court put it: 'It is now settled that a city has the authority, where authorized by its own charter, to make a street rental charge as consideration for granting a franchise.' [FN130]

In sum, should cities seek to include revenue raising measures in new franchise contracts for public utilities, they should structure such provisions as a rental fee for the use of municipal property. Charging for the use of city property would be construed as a rental since the right to use the property and the actual acquisition of particular

property interests in particular parcels of land are separate acts. Accordingly, limitations on the city's taxing power are avoided as are limitations on the right of a city to charge fees in excess of actual costs.

Given this discussion of municipal powers, it is important, next, to examine how the exaction of a rental fee for the use of city property should be collected.

***74 V. Collection of the Rental Fee**

Even once a city is found to have the power to collect a franchise fee, it must develop a method to generate the funds. One particular alternative available to the city is to impose a fee based upon a percentage of the gross revenues of the utility. [FN131] Basing a rental charge upon a percentage of gross revenues is a rational and reasonable course of action.

Typing rental fees to a percentage of gross revenues is one means to take into account the current market value of property. [FN132] In the market place, rents are based not merely upon area occupied, but upon the fair market value of the property, as well, as determined by the income derived from that property. As a result, a smaller parcel may be more highly valued than a larger parcel where the smaller parcel is capable of producing a higher return.

Charging for the use of municipal land through an income-based fee can take many forms. [FN133] The most common is one tied to gross receipts. There is no question but that these income-based charges are nevertheless considered 'rents' by the courts.

Rents calculated as a basis of gross receipts have been commonly made a part of local utility franchise contracts and accepted as valid. In City of San Diego v. Southern California Telephone Corp., [FN134] the California Supreme Court considered how to determine the amount of rent due under a charge on the utility's gross receipts. No question existed but that the gross receipts exaction was for the use of city property. [FN135] As the court expressly stated: 'The payment required is not a tax upon the property of the corporation, nor a license charge for the privilege of operating its business. It is a compensation for the use of the portions of the highway covered by the franchise easement. . . .' [FN136]

The recognition of the gross receipts charge as a rent, however, carried its own limitations in California. Only the gross receipts attributable to the use of the city property was subject to the gross receipts exaction. ***75** [FN137] In one case, for example, the California court directed that the percentage of a gas company's earnings attributable to the use of the utility's properties located on private property be eliminated from the city's charges. [FN138] Another case considered the operation of a wharf, part of which was on city property and part of which was on private property. [FN139] In that case, the court rejected an award to the city of a percentage of the total revenues, holding that the city could not collect for the occupancy of property not owned by it. [FN140] The San Diego decision, while applying the same principles, concerned the apportionment of revenue for a telephone company, which posed its own unique problems. [FN141]

The California Supreme Court acknowledged, however, that the apportionment of revenue between public and private property is not inherent in the imposition of a user charge based on gross receipts. Indeed, that court asid the entire gross receipts of a company might normally be subject to a percentage charge on the whole. A familiar concept in public utility regulation, the court said, is 'that the gross receipts of a utility arise from all of its operative property and not exclusively from any one part thereof.' [FN142] In the case of the telephone company, therefore, the court said, 'the franchise, in common with all other operative property of the company, contributes to its total gross receipts.' [FN143] It was the specific language of the California statute at issue that required an apportionment. [FN144]

In Texas, the recognition of the legitimacy of using a percentage of gross receips as a basis for rental charges comes in an obtuse manner. Texas authorizes its cities to make a reasonable charge 'for the use of . . . streets, alleys, and public ways by a public utility in the conduct of its business. . . .' [FN145] As the Texas court stated, however, 'the power of cities in Texas to levy and collect rental from public utilities of the class of Gulf State for the use of their streets was limited to two percent of their gross receipts.' [FN146] The court thus recognized the power of a city to ***76** base a rental on gross receipts, [FN147] but invalidated the fee to the extent that it exceeded the statutory

maximum. [FN148]

The Tennessee Supreme Court, too, has upheld a gross receipts charge imposed upon a public utility as rent. In Nashville Gas and Heating Co. v. City of Nashville, [FN149] the city had imposed a 5 percent gross receipts charge above and beyond its basic franchise charge. [FN150] The gross receipts fee was considered 'compensation required by the City to be paid for the use of its streets, i.e., a rental payment or payment in the nature of rental. . . .' [FN151] The Tennessee court upheld the charge against the challenge that it was in fact a tax. [FN152]

The Texas Supreme Court made the same distinction from taxes. In Fleming v. Houston Light and Power Co., [FN153] the Texas court faced a challenge to a gross receipts charge imposed upon the Houston utility. That charge was argued to violate the state's statutory proscription against a city imposing 'by virtue of its taxing power, police power or otherwise' any 'occupation tax or charge of any sort for the privilege of doing business. . . .' [FN154] The Texas court categorically rejected that challenge, stating the ordinance did not impose a charge for the privilege of doing business. According to the court, the ordinance 'imposed a charge in the nature of a rental. . . . The authorities recognize a distinction between a rental charge and a tax or charge for the privilege of doing business.' [FN155] It is thus readily clear that income-based rental fees are not uncommon and not out-of-favor with the courts.

Not all courts, however, have approved the gross receipts fee for purposes of determining a franchise fee. In City of Chicago Heights v. Public Service Co., [FN156] the Illinois Supreme Court, in dicta, [FN157] criticized fees based upon gross receipts as having no relation to the amount of space in ***77** a street used by a given company. Under the court's reasoning, charging a fee based upon gross receipts rather than the amount of property occupied by the utility 'is wholly lacking in uniformity, and is purely arbitrary and discriminatory in nature.' [FN158]

According to the Chicago Heights court, 'it must be at once seen that a fee or imposition based upon gross receipts has no relation to the amount of space in a street used by wires or poles of a given company.' [FN159] The court based its argument on the observation that 'one company may be engaged in an enterprise in which the product sold is exceedingly valuable, and a small amount of space will produce a large amount of gross revenue, while another company may have a larger number of poles and wires, and produce a comparatively small revenue. . . .' [FN160]

What the Chicago Heights court misses, of course, is that rents are not to be determined as a function of the size of the property, but rather as a function of the value of the property. The existence of 'transportation corridors' is one example of a common application of this principle. In this instance, small narrow strips of land, useless for the most part, may attain great value. In particular, when when a group of such parcels can be put together, synergism results. The value of the land in this case lies not in the size of the land, but in its ability to connect two points. These transportation corridors, while small, 'enjoy special value characteristics.' [FN161]

Income is often used to value property. If, for example, the property used by a utility was owned by the company, there is little question but that one reasonable method of valuing that property would be through the use of the capitalization of income methodology. [FN162] Similarly, the value of the property for purposes of setting a fair market rent to a utility can reasonably be calculated by assessing how much income it produces. [FN163] ***78** If a property used by a utility produces for it only a small income, the value of that rented property is much less than if it served a larger consumption base and was thus capable of participating in the production of greater revenue for the utility. Basing rental fees on gross receipts thus is one rational means to tie the level of the rent with the 'value' of the property to the utility.

Developing rental fees as a percentage of gross receipts has the advantage, also, of being responsive to current market movement. Since, for example, utility rates may move upward to reflect the rate of inflation, if the city is to avoid a deterioration in the constant dollar value of the rental fee, the fee also must be upwardly mobile with the rate of inflaction. [FN164] A rental fee based on gross receipts would track property values--up or down.

VI. Ratemaking Treatment of a Franchise Rental Charge

The difference between a rental charge and a franchise fee is significant in the consideration of what ratemaking treatment should be accorded the municipal charges recommended in this article. In the past, city franchise fees

have been surcharged back to ratepayers of the city which levied them. [FN165] However, to treat a rental charge in a manner similar to a franchise fee in this respect would be inequitable and illogical.

The Iowa Supreme Court decision in City of Des Moines v. Iowa State Commerce Commission [FN166] is one of the seminal decisions in approving the surcharge of franchise fees back to the ratepayers of the community ***79** that levied them. [FN167] In City of Des Moines, the Iowa court engaged in a two-pronged analysis of the franchise fee. The first prong looked at who 'benefitted' from the franchise fee. The secound looked at who (or what) 'caused' the utility expense which the fee represented. The Iowa Supreme Court approved a state utility commission holding that 'it would be discriminatory to impose those (franchise) fees on nonresidents of the City who did not benefit from City services.' [FN168] The court further approved of the commission finding that it was justifiable to assign 'identifiable costs' to the residents of Des Moines. [FN169]

The imposition of rental charges raises an entirely different analysis, however. If the reasoning of this Des Moines decision is applicable to a rental situation, should the owner of land charge a utility for the use of her land, she would faced with a corresponding increase in her gas or electric bill [FN170] when the utility recovers the identifiable cost. As a result in this situation, the landowner, in effect, receives nothing in the bargain except the loss of the use of her land.

Where the franchise fee analysis breaks down with regard to rents is in its benefits analysis. When a landowner receives rents from a utility as compensation for the use of her land, the benefits the owner obtains from the expenditure of the rental money are incidental to the transaction. The rental money, in fact, is not a benefit at all. Rather, it is a reimbursement to the landowner for something she has lost in the transaction--the full and free ownership and use of her property. While all other customers on the utility system do not partake in the benefits derived from the collection of the rental charge, neither have those other customers partaken in the loss for which the rent constitutes a reimbursement.

Theoretically, the landowner could have refused to rent right-of-way to the utility and instead insisted that the company purchase that part of his land which the utility required. In this case, no serious contention could be made that the purchase price of the land could be surcharged back to the owner as an identifiable cost. Neither would the purchase price be surcharged back on the theory that the revenue from ***80** the sale went only to benefit the owner and not to benefit ratepayers other than the owner. A rental fee is no different from a purchase price in this regard. Indeed, the rental fee could be viewed as simply the price for purchasing the utility right-of-way for a term of years rather than in fee simple. The landowner gives up a part of her fee simple title and receives rental revenue as a compensation for that loss.

Other courts considering the surcharge issue have relied upon reasoning similar to the Des Moines decision. They hold generally that a franchise charge is a revenue raising measure that stands in lieu of taxes. They conclude that it would be unreasonable to require a contribution to the tax revenue of a city from ratepayers systemwide. [FN171] Without a surcharge, the courts reason, a municipal government has effectively spread the tax burden of supporting its municipal services artificially over all ratepayers of the utility. In a similar vein, the courts have held a franchise fee is imposed by a city primarily to support city services. They further reason that since ratepayers systemwide do not receive the benefits of city services supported by revenue generated through a franchise fee, they should not be required to help generate that revenue. [FN172]

Here, too, the difference between a franchise fee and a rental charge must be considered. Whatever validity this city services analysis has in a franchise situation, it is inapplicable when a rental fee is involved. When a municipal government exacts rent for the use of its property, it is acting in a quasi- private, proprietary capacity as a landholder. [FN173] The fact that it is also a government which provides services to its residents is incidental to the role it is performing as a lessor. Indeed, the Supreme Court has held, the fact that the landowner happens to be a city rather than an individual has no significance whatsoever. [FN174]

If a rental fee is accepted for what it is, a charge for the use of the streets of the city, the inapplicability of the reasoning of the cases approving of the surcharge of franchise fees back to the residents of the city imposing them is apparent. The rental fee is not a benefit to the city, which benefit is then denied to all persons not residents of the city. It is instead, merely compensation for the loss the city suffers when the utility ***81** acquires part of the city's streets to use as right-of-way for its infrastructure. [FN175]

The Colorado Supreme Court used a line of reasoning similar to this in City of Montrose v. Public Utilities Commission. [FN176] In that case, the Colorado court was faced with a fee set at 2 percent of the gross receipts of Rocky Mountain Natural Gas Company. [FN177] The Colorado commission directed Rocky Mountain to compute its rates without including the cost of the franchise fee and then to surcharge the rates of municipal residents with the cost. The Colorado Supreme Court reversed, however, finding that the franchise fee was 'merely a change in the form of assessing the costs of doing business. . . .' [FN178] The court noted that 'incident' to the franchise was the acquisition of 'right-of-way to create a line within the municipality without having to condemn land each time and pay damages therefor and the right to make repairs without having to compensate the city.' [FN179] The purpose of the franchise, the court said, was 'to substitute the agreed franchise charge for the actual cost to Rocky Mountain of carrying on its business.' [FN180] The utility president testified that he would prefer to pay the franchise charges than to go through the expense and inconvenience of condemnation and payment for damages. [FN181] This theory of whether the charge was merely a 'substitute method' for calculating the 'actual cost of carrying on the utility's business' has been used, also, in rental fee surcharge cases. The Washington Supreme Court considered the precise issue of whether rental expenses imposed by a city could be surcharged back to the city's residents in State ex rel. Pacific Telephone and Telegraph Co. v. Department of Public Service. [FN182] In that case, the court decided:

If respondent desired to use some available city property, it might well negotiate a lease and pay a rental therefor. If the use of the property were necessary in the conduct of respondent's business, such rental would undoubtedly be considered by the rate making authority a proper operating expense.

* * *

It might well be that respondent would find it convenient to procure an easement over private property outside the municipal limits for the purpose of placing its poles and ***82** wires. Money paid for such an easement would certainly be properly classed as an operating expense. It seems reasonable that payment of a certain proportion of respondent's gross income collected from rate payers within the city limits be considered as compensation for use of the streets, if no other provision has been made for the payment for the privilege. Such franchise payments, if considered as compensation for the use of the streets, would be properly classed as a general operating expense. [FN183]

This is not to say that a city has unfettered discretion to set the value of the rental fee and expect it all to be passed on indiscriminately to general ratepayers. As the Washington court noted: 'if the payments called for by a franchise appear excessive or out of proportion to the privilege accorded to the utility to use city property, the rate regulating authority would have power to fix the proper proportion of the payment to be allocated to operating expense.' [FN184]

This holding is consistent with that of the Colorado Public Utilites Commission. [FN185] In a case involving Mountain States Telephone and Telegraph Company, the Colorado commission found that some municipal charges [FN186] are designed to compensate the municipality for the use of its streets and alleys by the utility. [FN187] A problem arises, however, the commission said, when these charges 'exceed the bounds of reasonableness and become solely a method for raising revenue for municipal purposes.' [FN188] The Colorado commission then set a limit of 3 percent of gross revenue that could be collected as compensation for the use of a city's streets. It held that only that portion of a city's charges that exceeded the 3 percent limit 'should be surcharged to the customers located within such municipality. . . .' [FN189]

In considering this issue, the ratemaking implications of gaining compensation for the use of city streets, is a distinctly different issue from the authority of the city to exact compensation. As discussed earlier, there is little question but that since the city is acting in its proprietary capacity when it charges a rent for its streets, it has the authority to impose ***83** a rent sufficient to reap a profit. [FN190] This is thus not like the license fee cases which state that if the charge exceeds the cost of administering the program, it constitutes an unlawful tax. The cases involving excessive rental fees hold only that in the situation where an excess rent might exist, the excess over reasonable market rent may be surcharged back to residents of the city in their rates.

The analysis set forth in the Washington and Colorado cases is appropriate for the most part. It recognizes the difference between a utility obtaining the right to use a city's streets and that utility taking actual physical possession of those streets. It recognizes that a city is entitled to compensation, through rental charges, for its loss of the use of

its streets. It recognizes that rental fees paid to a city for the use of streets do not differ from the rental fees paid to a private landholder for the use of private lands. It finally recognizes that rental charges are general operating expenses whether they be paid to a private landholder or to a municipal government.

Only one problem arises in the Washington and Colorado decisions: having recognized the municipal charges for what they were in the first instance in these cases--rental fees--it is difficult to understand why, then, these courts abandoned this framework in the subsequent ratemaking analysis. Under traditional ratemaking, if a utility is found to have incurred an excessive or improvident expense, the remedy for the respective state regulatory commission is to disallow that expense, at least to the extent of the excess. [FN191] It is not for the state utility commission to remake the bargain of the franchise rental fee. [FN192] Ratepayers who happen to reside in the geographic limits of a city which might be imposing unreasonable rental charges are no less entitled to regulatory ratemaking protection because of their residency status. In a rental situation, therefore, there is no rational basis to surcharge the excess rent back to city residents.

***84 VII. Conclusion**

As municipal governments seek out new sources of income, they should consider imposing rental charges on public utilities for the use of city streets pursuant to a franchise agreement. These rental charges are to be distinguished from the traditional franchise fees. While those fees might be designed to compensate the city for the grant of the right to use city streets (or might alternatively be designed to reimburse the city for local expenses incurred in regulating the utility or inspecting its facilities), the rental charges instead represent compensation for the actual physical occupation of the streets, for the property interest in the streets obtained by the utility. These rental charges do not constitute franchise fees any more than they constitute taxes or license fees.

The most rational method for collecting a rental charge for use of the city streets is through a percentage imposition on the gross receipts of the utility. While this imposition may have limits--it may be limited, for example, to gross receipts associated with use of the city property--it has multiple advantages. It accurately seta a rental charge based upon the value of the property. It protects the city against a loss in real dollar terms attributable to inflation.

Once assessed, the rental charges should be treated for ratemaking purposes as a general operating expense that does not differ from the rental charge imposed by any private landholder as compensation for the use of land. If reasonable, the charge should be included in rates to be paid by all customers. Whatever the efficacy of decisions to surcharge franchise fees back to the residents of the city imposing them, [FN193] those decisions are inapplicable to municipal rental charges. In contrast, if the rental charge is found to be excessive or unreasonable or improvidently incurred, the ratemaking remedy is to disallow the charge as a cost rather than to surcharge the excess back to the residents of the city imposing it.

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[FN1]. Bradbury & Ladd, Changes in the Revenue-Raising Capacity of U.S. Cities, 1970-1982, N.E. ECON. REV. 20 (April 1985). Bradbury and Ladd found that 30 percent of the major United States cities experienced a decling in their ability to raise local revenues. For an excellent general review of the changing nature of local economies, see T. NOYELLE & T. STANDBACK, THE ECONOMIC TRANSFORMATION OF AMERICAN CITIES (1984). For a discussion from the perspective of state governments, see generally Kozub, Measuring the Fiscal Capacity of

the States, 8 MUN. FIN. J. 145 (1987).

[FN2]. See Lawson & Benker, Significant Features of Fiscal Federalism (Advisory Commission on Intergovernmental Relations 1985).

[FN3]. Cities' Problems Intensify, GOV'T FIN. REV. 5 (April 1986). These problems were identified in a survey of local elected officials conducted by the National League of Cities in December 1985. Twenty-eight percent of the 487 respondents were mayors with the remaining 72 percent being city council members. Id.

[FN4]. See, e.g., Lind & Duwe, Who Pays? Who Benefits?, The Case of the Incentive Package Offered to the Diamond-Star Automotive Plant, GOV'T FIN. REV. 19 (Dec. 1986); Gunyon, The Minneapolis Development Account, GOV'T FIN. REV. 7(June 1986).

[FN5]. Infrastructure Expenditures Expected to Double, GOV'T FIN. REV. 4 (Aug. 1985) (a survey of municipal officials found that those officials expected to double their 1980-1985 infrastructure expenditures from 1985- 1990). See generally, Pagano, How the Public Works: Major Issues in Infrastructure Finance (National League of Cities 1986).

[FN6]. Kemp, Retrenchment Management: Coping with Fewer Tax Dollars, 11 CURRENT MUN. PROB. 270 (1984); see also Flynn, The 'Creative' Revolution in Municipal Finance, 11 CURRENT MUN. PROB. 460 (1984).

[FN7]. See, e.g., Kemp, Financial Productivity: Beyond Cutbacks to Creativity, 7 MUN. FIN. J. 361 (1987) [hereinafter cited as BEYOND CUTBACKS]; see also Kemp, Economic Development: Raising Revenue Without Raising Taxes, 8 MUN. FIN. J. 145 (1987).

[FN8]. Local governments across the nation are finding it
difficult to make financial ends meet. As the public's expectations increase and inflation and limited revenues shrink tax dollars, balancing the annual budget is becoming a difficult task. . . . Reducing costs, increasing productivity, finding new revenue sources, and raising revenues without raising taxes are new standard activities of local governments.
Beyond Cutbacks, supra note 7, at 123.

[FN9]. MCQUILLAN, THE LAW OF MUNICIPAL CORPORATIONS, 34.01 (3d ed. 1986) ('One thing should be kept constantly in mind, and that is that the rules of law governing franchises to use the streets do not depend, except to a very limited extent, on whether the grantee of the franchise is a gas company, or a water company, or an electric light company, or a telegraph or telephone company, or a street railway company, or any other public service company.').

[FN10]. Id. ('Formerly, the right to grant franchises to use the streets was to a large extent withheld from municipalities and vested in the legislature that could grant the use of streets without the consent of the municipality or its citizens and inhabitants, and even without compensation; but the tendency of modern legislation is to delegate to the local authorities the exclusive dominion over the streets of the respective municipalities, and the value of local self-government in this respect is self-evident. . . .' (emphasis added)).

[FN11]. See infra notes 18-31 and accompanying text.

[FN12]. For an excellent discussion of the history of municipal utility franchise agreements, see generally R. HAHNE, G. ALIFF & D. HASKINS, ACCOUNTING FOR PUBLIC UTILITIES, 2.05 (1987).

[FN13]. See generally infra notes 50-60 and accompanying text.

[FN14]. See generally infra notes 61-75 and accompanying text.

[FN15]. Whether a city may impose a rental fee in mid-franchise, however, is beyond the scope of this article.

[FN16]. Utilities are under an obligation to operate with reasonable efficiencies and to provide least-cost service consistent with adequate reliability. Only costs meeting with these standards are subject to recovery. K. HOWE & E. RASMUSSEN, PUBLIC UTILITY ECONOMICS AND FINANCE 73-74 (1982).

[FN17]. City of Des Moines v. Iowa State Commerce Comm'n, 285 N.W.2d 12 (Iowa 1979).

[FN18]. This included all types of utilities: telephone, natural gas, and electric companies. See generally M. GLAESER, PUBLIC UTILITIES IN AMERICAN CAPITALISM ch. 4-5 (1957).

[FN19]. Trustees of Dartmouth College v. Woodward, 4 U.S. (Wheat.) 518, 643 (1819).

[FN20]. For a discussion of the relationship of franchises and privileges, see infra notes 89-103 and accompanying text.

[FN21]. See generally GARFIELD & LOVEJOY, PUBLIC UTILITY ECONOMICS 28 (1964).

[FN22]. GARFIELD & LOVEJOY, supra note 21, at 28. They state: 'The franchise served as the most important method of regulation through much of the latter half of the nineteenth century and into the period which ended with World War I.' Id. at 29.

[FN23]. 'Between 1882, when Edison opened his Pearl Street station in New York, and 1907, nonexclusive, competitive electric franchises were granted freely, often as a means of forcing down rates that cities considered too high.' A. KAHN, II THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS, 117 (1971).

[FN24]. A. KAHN, supra note 23, at 117-18. 'Competition, or at least laissez-faire, represented the general national policy and there had not yet emerged a general acceptance of the notion that in certain industries regulated monopoly might produce a better performance.' See generally B. BEHLING, COMPETITION AND MONOPOLY IN PUBLIC UTILITY INDUSTRIES (1938).

[FN25]. B. BEHLING, supra note 25, at 23.

[FN26]. For a general discussion of the 'weaknesses of franchise regulation,' see GARFIELD & LOVEJOY, supra

note 21, at 31.

[FN27]. C. PHILLIPS, THE REGULATION OF PUBLIC UTILITIES, 113 (1984).

[FN28]. See supra note 19 and accompanying text.

[FN29]. These would include the city and the utility.

[FN30]. This was a common--indeed perhaps the most common--situation.

[FN31]. B. BEHLING, supra note 24, at 24.

[FN32]. Welch, The Effectiveness of Commission Regulation of Public Utility Enterprise, 49 GED. L.J. 639, 643 (1961).

[FN33]. See generally R. CUSHMAN, THE INDEPENDENT REGULATORY COMMISSIONS 19-41 (1941); I. BARNES, THE ECONOMICS OF PUBLIC UTILITY REGULATION 173-75 (1942).

[FN34]. GARFIELD & LOVEJOY, supra note 21, at 31.

[FN35]. MCQUILLAN, supra note 9, at 34.37. The city may also require the utility to undertake certain tasks such as repairing streets and the like.

[FN36]. Such programs might include, for example, a private fuel fund to assist low income persons in paying energy bills; a fund from which to finance conservation improvements in public buildings; or a fund from which to finance conservation and weatherization improvements for citizens of the community.

[FN37]. Memphis v. Postal Tel. Co., 145 F. 602 (6th Cir. 1906); City of Pensacola v. Southern Bell Tel. Co., 49 Fla. 161, 37 So. 820 (Fla. 1905); Union Elec. Co. v. City of St. Charles, 352 Mo. 1194, 181 S.W.2d 526 (1944); Wejr v. Kansas City, 356 Mo. 882, 204S.W.2d 268 (1947).

[FN38]. See, e.g., Minneapolis Street Ry. Co. v. City of Minneapolis, 40 N.W.2d 353, 359 (Minn. 1949) (citations omitted).

[FN39]. See generally ANTIEAU, LOCAL GOVERNMENT LAW, 29.17 (Supp. 1987).

[FN40]. See, e.g., Chicago Heights v. Western Union Tel. Co., 406 Ill. 428, 94 N.E.2d 306 (1950).

[FN41]. See, e.g., Chesapeake & P.T. Co. v. Morgantown, 144 W. Va. 149, 107 S.E.2d 489 (1959); see generally McQUILLAN, supra note 9, at 34.37 ('A municipal corporation, having entire control of its streets and the power to impose conditions on granting a franchise to use the streets, may require compensation for their use by public

service companies, as a condition of the grant of the right to use them, unless forbidden by statute, or contrary to public policy.') (citations omitted).

[FN42]. 238 N.E.2d 261 (Ill. App. Ct. 1968).

[FN43]. Id. at 265.

[FN44]. Id.

[FN45]. Id.

[FN46]. 302 S.W.2d 675 (Mo. 1957).

[FN47]. Id. at 876.

[FN48]. Id. at 879; accord, Tri-State Elect. Coop. v. City of Blue Ridge, 77 S.E.2d 547, 550 (Ga. 1953).

[FN49]. Id. The court continued: 'Regardless of the name or principle designated, the result is clearly the same. It precludes one who accepts the benefits from questioning the validity of the accompanying obligation.' (Citations omitted.)

[FN50]. See, e.g., Hackleburg v. Northwest Ala. Gas Dist., 120 So. 2d 899 (Ala. 1965); Walker v. Morgantown, 71 S.E.2d 60, 63 (W. Va. 1952).

[FN51]. Pepin v. Danbury, 171 Conn. 74, 368 A.2d 88, 94 (1976).

[FN52]. See, e.g., Consolidated Diesel Elec. Corp. v. Stamford, 238 A.2d 410, 411-12 (Conn. 1968).

[FN53]. IOWA CODE 364.3(4) (1987). This particular statute is an amended version of an earlier statute, IOWA CODE 368.2 (1966), which provided that 'cities and towns shall not have the power to levy any tax, assessment, excise, fee, charge or other exaction except as expressly authorized by statute.' (Emphasis added.) In amending the statute, the legislature clearly excluded 'assessments, excises, fees, charges or other exactions' from the restrictive condition of requiring express statutory authority.

[FN54]. See generally ANTIEAU, supra note 39, at 23.14.

[FN55]. Id. at 23.07 (citing U.S. Advisory Commission on Intergovernmental Relations, State Limitations on Local Taxes and Expenditures 12, 16-17 (1977)).

[FN56]. Id.

[FN57]. See, e.g., Newman v. City of Indianola, 232 N.W.2d 568, 573 (Iowa 1975).

[FN58]. See, e.g., Cotton States Mutual Ins. Co. v. DeKalb County, 304 S.E.2d 386 (Ga. 1983); but see infra notes 104-08 and accompanying text.

[FN59]. City of Little Rock v. Cash, 644 S.W.2d 229 (Ark. 1982), cert. denied, 462 U.S. 1111 (1983).

[FN60]. City of North Little Rock v. Graham, 647 S.W.2d 452 (Ark. 1982).

[FN61]. Commonwealth of Pennsylvania v. Winfree, 182 A.2d 698, 703 (Pa. 1962).

[FN62]. See, e.g., Silco Automatic Vending Co. v. Puma, 261 A.2d 674, 676 (N.J. 1970).

[FN63]. Merrelli v. City of St. Clare Shores, 96 N.W.2d 144, 148 (Mich. 1959).

[FN64]. See, e.g., Vermont Salvage Corp. v. State Johnsbury, 34 A.2d 188, 194 (Vt. 1943).

[FN65]. Id.

[FN66]. If a fee is imposed under the police powers, however, there must be some exercise of that power. In City of Chicago Heights v. Western Union Tel. Co., 94 N.E.2d 306 (Ill. 1950), the Illinois Supreme Court invalidated a license fee. While the city claimed the fee to be part of its right to regulate utilities, the court found:

> a closer scrutiny of the ordinance under attack discloses that there are no other essential features there ordained, except the collection and payment into the general treasury of the city of the fees therein provided for and consent to the erection and maintenance of any poles and wires by the city council. No standards or specifications are prescribed. No inspection or supervision is required. No disposition is made of the fees to be paid thereunder, except that they be paid to the city clerk and presumably into the general fund of the city. The ordinance in no sense attempts to regulate.

Id. at 309.

[FN67]. McQUILLAN, supra note 9, at 34.37.

[FN68]. Similar issues arise regarding the propriety of special assessments. Special assessments are exactions that are based on property value and are designed to pay for public facilities which provide a special or local benefit on a defined set of property owners. Common public improvements subject to financing by a special assessment include street paving, sidewalks, and sewer lines.

As with fees, whether a particular exaction is a special assessment or a tax is important in determining whether statutory or constitutional limitations on the amount of taxation have been exceeded. See, e.g., State ex rel. Frese v. City of Normandy Park, 392 P.2d 207 (Wash. 1964); see also Lipscomb v. Lenon, 276 S.W. 367 (Ark. 1925).

As, too, with fees, a special assessment may equal, but not exceed, the actual cost of the improvement plus necessary expenses. See, e.g., Garcia v. Falkenholm, 198 A.2d 660 (R.I. 1964); see also Los Angeles v. Offner, 358 P.2d 926 (Cal. 1961).

[FN69]. Nitkin v. Administrator of Health Servs. Administration, 399 N.Y.S.2d 162 (N.Y. 1975); Opinion of the Justices, 290 A.2d 869 (N.H. 1922); see also Brackman v. Kruse, 199 P.2d 971 (Mont. 1948).

[FN70]. 96 N.W.2d 144 (Mich. 1959).

[FN71]. Included were permits for electrical, plumbing and other work generally associated with construction. 96 N.W.2d at 145.

[FN72]. Id. at 146.

[FN73]. Id.

[FN74]. Id. at 150. For example, the court noted, 'electrical circuits must conform to stated standards in order that the threat of fire or personal injury be minimized. Plumbing installations must conform to standards imposed in the interest of public health.' Id.

[FN75]. Id. In Merelli, the court found that 'here, the testimony of the various city officials in support of the schedule of amended fees makes it clear that what was sought to be defrayed was . . . 'the general cost of government under the guise of reimbursement for the special services required by the regulation and control of new buildings'.' Id. at 150.

[FN76]. See, e.g., Postal Tel. Cable Co. v. City of Richmond, 249 U.S. 252 (1918) ('although the occupation of its streets by a telegraph company engaged in interstate commerce . . . cannot be denied by a city, yet since the use of its streets for its poles by such a company is necessarily, in a measure, permanent and exclusive in character, and different in kind and extent from that of the general public, and since such use imposes contingent liabilities upon a city, it is competent for it, in the exercise of its police power, to exact reasonable compensation 'in the nature of rental.' . . .' Id. at 259.

In addition, a Texas appellate court has held that whether a local government can impose street rental charges depends upon whether the power to exact such charges exists under state law and whether the fee is reasonable. City of Corpus Christi v. Southern Community Gas Co., 368 S.W.2d 144 (Tex. Civ. App. 1963).

[FN77]. See, e.g., City of St. Louis v. Western Union Tel. Co., 148 U.S. 92, 98-99 (1893); accord Cowin v. City of Waterloo, 21 N.W.2d 705, 707 (Iowa 1946).

[FN78]. The use which the (utility) makes of the streets is an

exclusive and permanent one, and not one in common with the general public. The ordinary traveler, whether on foot or in a vehicle, passes to and from along the streets, and his use and occupation thereof are temporary and shifting. The space he occupies one moment he abandons the next to be occupied by any other traveler. This use is common to all members of the public, and is a use open equally to citizens of other states and with those of the state in which the street is situate. But the use made by the (utility) is, in respect to so much of the space it occupies with its poles, permanent and exclusive. It as effectually and permanently dispossesses the general public as if it had destroyed that amount of ground.

City of St. Louis v. Western Union Tel. Co., 148 U.S. 92, 98-99 (1893).

[FN79]. Or at least each such company not taxed on gross income for city purposes.

[FN80]. Id. at 93-4.

[FN81]. Id. at 97.

[FN82]. Id. The Court rhetorically posited: 'Supposing the city of St. Louis should find its city hall too small for its purposes, or too far removed from the center of business, and should purchase or build another more satisfactory in this respect; it would not thereafter be forced to let the old remain vacant or to immediately sell it, but might derive revenue by renting its various rooms.' Id. at 97.

[FN83]. See New Jersey Bell Tel. Co. v. State Board of Taxes, 280 U.S. 338 (1930) ('The franchise tax upon gross earnings does not purport to be, and is not claimed as, a charge or rental for the use of property belonging to the state or any of its subdivisions. . . . Clearly the state, when passing the act making the assessment, acted not as a proprietor demanding compensation for the use of its property, but as a sovereign imposing a tax for the support of government.') Id. at 347 (citing City of St. Louis v. Western Union Tel. Co.).

[FN84]. Id. The Court queried: 'Now when there is this permanent and exclusive appropriation of a part of the highway, is there in the nature of things anything to inhibit the public from exacting a rental for the space thus occupied? Obviously not.' City of St. Louis v. Western Union Tel. Co., 148 U.S. 92, 99.

[FN85]. See City of Oakland v. Hogan, 106 P.2d 987, 994 (Cal. 1940); see also infra notes 90-9 and accompanying text.

[FN86]. See infra notes 173-89 and accompanying text.

[FN87]. City of St. Louis, 148 U.S. at 98.

[FN88]. See generally Mac Amusement Co. v. Washington Dept. of Revenue, 95 Wash. 2d 963, 633 P.2d 68, 71 (1981) (with citations).

[FN89]. St. Louis Terminals Corp. v. City of St. Louis, 535 S.W.2d 593, 595 (Mo. Ct. App. 1976).

[FN90]. Inland Waterways Co. v. City of Louisville, 13 S.W.2d 283, 285 (Ky.Ct.App. 1929). A grant from the sovereign is essential to a franchise. Schisler v. Merchants Trust Co., 94 N.E.2d 665, 667 (Ind. 1950); Department of Highways v. Southwestern Elec. Power Co., 243 La. 564, 145 So. 2d 312, 315 (1962); In re Algonquin Gas Transmission Co., 176 N.Y.S.2d 868 (N.Y. 1958).
Moreover, a franchise must be a grant of a right that without the sovereign's express imprimatur, the grantee could not otherwise do. Washington Water Power Co. v. Rooney, 101 P.2d 580, 583 (Wash. 1940); Artesian Water Co. v. State Dep't of Highways and Transp., 330 A.2d 432, 440 (Del. Super. Ct.), aff'd, 330 A.2d 441 (Del. 1974); Dunman Inv. Co. v. Northern Natural Gas Co., 85 Neb. 400, 176 N.W.2d 4, 6 (1970).

[FN91]. City of Oakland v. Hogan, 106 P.2d 987, 994 (Cal. 1940) ('Originally, a franchise was considered as a royal privilege or prerogative emanating from the king.'); Greene Line Terminal Co. v. Martin, 10 S.E.2d 901, 903 (W. Va. 1940); see also Inland Waterways v. City of Louisville, 13 S.W.2d 283, 285 (Ky. Ct. App. 1929).

[FN92]. City of Oakland, 106 P.2d at 994.

[FN93]. McPhee & McGinnity Co. v. Union Pac. R. R. Co., 158 F. 5, 10 (8th Cir. 1907).

[FN94]. See infra notes 102-03 and accompanying text.

[FN95]. St. Louis Terminals v. City of St. Louis, 535 S.W.2d 595, 595 (Mo. Ct. App. 1976).

[FN96]. Id.; accord Inland Waterways v. City of Louisville, 13 S.W.2d 283, 286 (Ky. Ct. App. 1929).

[FN97]. 10 S.E.2d 901 (W. Va. 1940).

[FN98]. Id. at 903 (citations omitted).

[FN99]. Id.

[FN100]. See supra notes 61-75 and accompanying text; but see infra notes 104-08 and accompanying text.

[FN101]. Granting to a private corporation the right to exercise eminent domain is one example of an attribute of a franchisee. It is, in other words, a power that may only be given by the sovereign.

[FN102]. Greene Line Terminal, 10 S.E.2d at 903.

[FN103]. Copt-Air v. City of San Diego, 93 Cal. Rptr. 649, 652 (Cal. Ct. App. 1971).

[FN104]. See, e.g., Pinellas Apartment Ass'n v. City of St. Petersburg, 294 So. 2d 676, 678 (Fla. Dist. Ct. App. 1974) ('There is nothing inherently wrong with the city's making a modest return on its utility operation or certain portions thereof, providing the rate is not unreasonable. . . .'). On the other hand, an unreasonable reliance on utility revenue does amount to 'imposing upon (ratepayers) unfair tax burdens.' Mitchell v. City of Mobile, 13 So. 2d 664, 667 (Ala. 1943).

[FN105]. For a general discussion of 'special assessments,' see supra note 68.

[FN106]. See, e.g., Orr Felt Co. v. City of Piqua, 2 Ohio St. 3d 166, 443 N.E.2d 521 (1983); accord Kliks v. Dalles City, 335 P.2d 366 (Or. 1959); H. P. Higgs Co. v. Borough of Madison, 184 N. J. Super. 355 446 A.2d 193 (N.J. Super Ct. App. Div. 1982).

[FN107]. See, e.g., Town of Spring Hope v. Bissette, 287 S.E.2d 851 (N.C. 1981).

[FN108]. To pocket a profit from the rental of city streets and alleys, however, may have implications as to the recovery of these rentals through rates. See infra notes 184-90 and accompanying text.

[FN109]. See supra notes 9-11 and accompanying text.

[FN110]. 36 AM. JUR. 2d Franchise, 3 (1943).

[FN111]. 'The right to occupy streets is a franchise; the actual occupation of them in that way, pursuant to a franchise, is the exercise of an easement. A distinction must be marked between the right to do the thing and the interest acquired in the soil by the exercise of that right.' Id.

[FN112]. 148 U.S. 92, 97 (1983).

[FN113]. Id. at 101.

[FN114]. Id.

[FN115]. Id. at 105.

[FN116]. 855 S.W.2d 245 (Tex. 1935).

[FN117]. Id. at 249.

[FN118]. Id.

[FN119]. Id. See also State ex rel. Northwestern Elec. Co. v. Clark County Superior Court, 183 P.2d 803, 809 (Or. 1947).

[FN120]. 405 Ill. 209, 90 N.E.2d 105 (1950) (with citations).

[FN121]. 405 Ill. at 214, 90 N.E.2d at 110.

[FN122]. Id.

[FN123]. City of Cincinnati v. Union Gas & Elec. Co., 49 Ohio App. 166, 195 N.E. 488 (1934).

[FN124]. Id.

[FN125]. City of Pella v. Fowler, 244 N.W. 234, 738 (Iowa 1932).

Appellant also insists that cities and towns have the right to recover rental, under the circumstances of this case, for the streets and public places. It is well settled in this state . . . that cities and towns exercise only such power and authority in such cases as are conferred upon them by legislative enactment. . . . Our attention is called to no statute in whcih the Legislature has conferred authority upon cities and towns to demand rent or compensation for the use of the streets and alleys thereof.
Accord City of Des Moines v. Iowa Tel., 162 N.W. 323 (Iowa 1917).

[FN126]. See generally SANDS & LIBONATI, LOCAL GOVERNMENT LAW, 4.01. Herein, the authors state, however:
The concept of home rule as a more or less independent source of municipal power has faired (sic) poorly in the 1980's at both the federal and state court level. . . . In sum, home rule appears to be 'on the ropes' and strict construction on the rise. Only with clear constitutional and/or legislative authority can local governments clearly be said to have the power to engage in the activities of governance for which they were created.
Id. The authors continue on to posit that: 'the specific holdings concerning the scope of home rule are resistant to generalization and sometimes in hopeless confusion even in a single transaction. . . .' Id. at 13.03.

[FN127]. Dillon's Rule states that: it is a general and undisputed proposition of law that a municipal corporation possesses and can exercise the following powers and no others: First, those granted in express words; second, those necessary or fairly implied in or incident to the powers expressly granted; third, those essential to accomplishment of the declared objects and purposes of the corporation,--not simply convenient but indispensable.' DILLON, COMMENTARIES ON THE LAW OF MUNICIPAL CORPORATIONS, 443-49 (5th ed. 1911).

[FN128]. Home rule for a city may take many forms: constitutional home rule versus legislative home rule, home rule provisions that are self- executing, and those that are not. For a discussion of the various types of home rule, and their implications, see SANDS & LIBONATI, supra note 126, at 4.02-.07.

[FN129]. SANDS & LIBONATI, supra note 126, 4.03. 'Under self-executing grants of home-rule powers, the only 'control' to which local governments are subject is that which results from the doctrine of judicial supremacy, through which courts construe the constitution.'

[FN130]. City of Corpus Christi v. Southern Community Gas Co., 396 S.W.2d 144, 147 (Tex Civ. App. 1963) (citations omitted).

[FN131]. See, e.g., City of Richmond v. Chesapeake & Potomac Tel. Co., 205 Va. 919, 140 S.E.2d 683 (1965).

[FN132]. The term 'value' is illusive at best. On the one hand, it may be judged on an objective basis, considering what price the property would command on the open market in an arms length transaction. On the other hand, there is a subjective concept of value. This looks at what a particular property is worth to a particular individual.

[FN133]. Courts have, for example, approved requirements for a utility to pay a certain percentage of its net earnings or a certain percentage of declared dividends as a rental charge. See McQUILLAN, supra note 9, at 34.37 and notes 4-6.

[FN134]. 266 P.2d 14 (Cal. 1954).

[FN135]. Id. at 21.

[FN136]. Id. at 20 (quoting County of Tulare v. City of Dinuba, 188 Cal. 664, 206 P. 983, 986 (1922)).

[FN137]. Id. at 20-21.

[FN138]. City of Monrovia v. Southern Counties Gas Co., 296 P. 117 (Cal. Dist. Ct. App. 1931).

[FN139]. Ocean Park Pier Amusement Corp. v. City of Santa Monica, 104 P.2d 668, 679 (Cal. Dist. Ct. App. 1949).

[FN140]. Id. at 679.

[FN141]. 266 P.2d at 22-26.

[FN142]. Id. at 24 (citations omitted).

[FN143]. Id. at 22, 24.

[FN144]. Id.

[FN145]. City of Beaumont v. Gulf States Utilities Co., 163 S.W.2d 426, 428 (Tex. Civ. App. 1942).

[FN146]. Id. (emphasis added).

[FN147]. Beaumont sought to impose a 4 percent gross receipts charge. Id.

[FN148]. Id. at 428-32.

[FN149]. 152 S.W.2d 229 (Tenn. 1941).

[FN150]. Id. at 230.

[FN151]. Id. at 233.

[FN152]. Id. at 233-34.

[FN153]. 143 S.W.2d 923 (Tex. 1940).

[FN154]. Id. at 924.

[FN155]. Id. at 924 (citing City of St. Louis v. Western Union Tel. Co. 148 U.S. 92 (1983)). So, too, did a New York court find that a fee set at a rate of 5 percent of the gross receipts of a cable television company was 'really in the nature of rent or a rent charge.' Teleprompter Manhattan CATV Corp. v. City New York, 420 N.Y.S.2d 544, 546 (N.Y. App. Div. 1979).

[FN156]. 408 Ill. 310, 97 N.E.2d 268 (1951).

[FN157]. The court expressly based its rejection of the fee on the same grounds that it based its rejection of the franchise fee in Village of Lombard. See supra notes 120-22 and accompanying text. This basis was unrelated to the fact that the fee was based on a percentage of gross revenues.

[FN158]. 97 N.E.2d at 272.

[FN159]. Id.

[FN160]. Id.

[FN161]. Dolman & Seymour, Valuation of Transportation/Communication Corridors, APPRAISAL J. 509, 515 (Oct. 1978).

[FN162]. The use of an income-based valuation method for calculating rents is consistent with the use of a capitalized income approach to valuing property for property tax appraisal purposes. See, e.g., In re James Madison Houses, 234 N.Y.S.2d 799, 803 (N.Y. 1962); see also People v. Tax Comm'n of N.Y., 233 N.Y.S.2d 501, 506 (N.Y. 1962). See generally J. BONBRIGHT, 1 VALUATION OF PROPERTY 257-58 (1937).
The net income approach to valuing property is concerned with the present worth of future benefits of a property. The income over a property's remaining useful life is estimated and then capitalized to an estimate of value. City of New Brunswick v. State of New Jersey Div. of Tax Appeals, 39 N.J. 537, 189 A.2d 702, 706-07 (1963); cf., Aetna Life Ins. Co. v. City of Newark, 89 A.2d 385, 388 (N.J. 1952). See also 1 J. BONBRIGHT, VALUATION OF PROPERTY 257-58, (1937). Indeed, one New York court has held that net income is 'usually the surest indication of value.' Elmhurst Towers v. Tax Comm'n 309 N.Y.S.2d 680, 682 (N.Y. 1970). See generally Gifford, Should Replacement Cost Impose a Ceiling on Real Property Tax Assessment, 26 J. OF TAXATION 314 (1967).

[FN163]. For example, the California Department of Transportation annually earns about $6 million, in addition to saving landscaping and maintenance costs, by leasing the airspace beneath and adjacent to its freeways. Ranging from parking and storage space to a Hilton Hotel, the department enters into leases based on a percentage of sales with a guaranteed minimum. Airspace Leasing, GOV'T FIN. REV. 4 (Aug. 1986). See also 93 A.L.R.2d 1136, 5(c) (basing license fee or occupation tax for persons renting real estate on percentage of sales is appropriate).

[FN164]. Cities would not have the opportunities, in other words, to periodically adjust a fee included in a franchise agreement. See supra notes 28-31 and accompanying text.

[FN165]. See, e.g., Treatment of Franchise Fees, 12 PUB. UTIL. REP. 4th 278, 294-95 (Fla. PSC 1975) (with

citations); but see City of Montrose v. Colorado Public Utils. Comm'n, 590 P.2d 502 (Colo. 1979).

[FN166]. 285 N.W.2d 12 (Iowa 1979)

[FN167]. The Iowa court, it should be noted, did not mandate that the franchise fee be surcharged back to city residents. Rather, it was acting in an appellate capacity in reviewing a decision of the state public utility commission. In performing its limited appellate review, the court found that the commission's decision to surcharge the fee back to the city's residents was not contrary to law and was supported by substantial evidence. Id. at 16.

[FN168]. Id.

[FN169]. Id.

[FN170]. This is, however, applicable to whatever type of utility requires the use of the right-of-way. See supra note 9.

[FN171]. See, e.g., State ex rel. Pacific Tel. & Tel. Co. v. Department of Pub. Serv., 142 P.2d 495, 535 (Wash. 1943); Newport News v. Chesapeake & Pacific Tel. Co. of Va., 96 S.E.2d 145 (Va. 1957); City of Scotts Bluff v. United Tel. of the West, 106 N.W.2d 12 (Neb. 1960).

[FN172]. See, e.g., Village of Maywood v. Illinois Commerce Comm'n, 178 N.E.2d 345 (Ill. 1961) (citing Elmhurst v. Western United Gas & Elec. Co., 1 N.E.2d 489 (Ill. 1936)). Ogden City v. Utah Pub. Serv. Comm'n, 260 P.2d 751 (Utah 1953).

[FN173]. See New Jersey Bell Tel. Co. v. State Board of Taxes, 280 U.S. 338, 347 (1930)); see also City of Oakland v. Hogan, 106 P.2d 987, 994 (Cal. 1940).

[FN174]. City of St. Louis v. Western Union Tel. Co., 148 U.S. 92, 101 (1893).

[FN175]. The loss referred to here does not include the expenses, e.g., street repair, for which they city may wish reimbursement. It instead looks only at the loss of the complete and untrammeled ownership and use of its property.

[FN176]. 590 P.2d 502 (Colo. 1979).

[FN177]. The charge was concededly a 'franchise fee' and was treated as such. Id. at 504.

[FN178]. Id. at 505.

[FN179]. Id. at 504-05.

[FN180]. Id. at 505.

[FN181]. Id.

[FN182]. 142 P.2d 498 (Wash. 1943).

[FN183]. Id. at 536.

[FN184]. Id.

[FN185]. The Colorado commission apparently treated franchise fees and rental charges differently.

[FN186]. The commission characterized the exaction as a tax. Although it probably erred in failing to do so, the commission simply did not distinguish between taxes, fees and rents. Colorado Mun. League v. Public Utils. Comm'n, 473 P.2d 960, 973 (Colo. 1970).

[FN187]. Id.

[FN188]. Id.

[FN189]. Id. The Colorado supreme court refused to rule one way or the other on the surcharge in the posture that it was presented. Id. at 974. The Virginia Supreme Court, however, disapproved a percentage limit it found to be too low. See New Port News v. Chesapeake & Pacific Tel. & Tel. Co. of Va., 96 S.E.2d 145 (Va. 1957).

[FN190]. See supra notes 104-08 and accompanying text.

[FN191]. See supra note 16 and accompanying text.

[FN192]. Indeed, the Kansas Corporation Commission recently held that it lacked jurisdiction to review franchise agreements in that state. The commission staff had argued in the proceeding that franchise fees should be cost-based and that the commission should, during a rate proceeding, conduct a 'prudency review' of a utility's franchise agreements. The commission held, however, that it had only limited power to ensure that the terms of the franchise were consistent with the utilities' tariffs and that the terms did not adversely affect the utility's provision of ervice. NARUC Bulletin, at 9- 11 (Mar. 28, 1988).

[FN193]. This article does not consider the propriety of this surcharge one way or the other.