THE SUPREME COURT OF ARKANSAS HOLDS IMPOSITION OF STORMWATER UTILITY FEE TO BE REASONABLE MUNICIPAL CONDUCT NOT CONSTITUTING AN ILLEGAL EXACTION OR REQUIRING VOTER APPROVAL AS A TAX

In *Morningstar v. Bush*,[1] the Supreme Court of Arkansas upheld a municipal ordinance adopted by the City of Hot Springs that placed a levy on its municipal utility accounts in order to raise funds necessary for compliance with federal and state regulations over the area's stormwater treatment facility.[2] According to local residents, the city of Hot Springs (the "City") had fashioned what was actually an "illegal-exaction tax," into what only appeared to be a service fee for the continuance of municipal stormwater services.[3] In a matter of statutory construction, substantial public interest, and development of the law, the court ruled that the service fee was reasonable, that it was validly set in place pursuant to authorizing legislation, and that it was not an illegal tax as the City's residents proclaimed it to be.[4]

In the early 2000's, the Environmental Protection Agency (EPA) and Arkansas Department of Environmental Quality (ADEQ) found Lake Hamilton and its surrounding areas in violation of environmental-pollution standards. In 2004, the City was required to obtain a National Pollution Discharge Elimination System Permit (NPDES) pursuant to the Clean Water Act,[5] which enables the City to discharge storm and wastewater from its municipal storm-system facility.[6] According to the EPA, the NPDES permit is designed to promote environmentally efficient methods of discharging and treating storm/wastewater that can harm the environment by carrying pollutants through run-offs and streams into surrounding bodies of water or other municipal stormwater systems.[7] Specifically, the City's NPDES permit designated its treatment site as a regulated small Municipal Separate Storm Sewer System (MS-4).[8] The two agencies promulgated a number of regulations that apply specifically to small MS-4s.[9] The City had until May

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1. 2011 Ark. 350, at 1, ___ S.W.3d at ___.
2. *Id*. at 1–2, ___ S.W.3d at ___.
3. *Id*. at 2, ___ S.W.3d at ___.
4. *Id.* at 9, ___ S.W.3d at ___.
5. Clean Water Act of 1972 § 208, 33 U.S.C. § 1288.
6. *Morningstar*, 2011 Ark. 350, at 2, ___ S.W.3d at ___.
7. *Id*. at 3, ___ S.W.3d at ___.
8. *Id.* at 2, ___ S.W.3d at ___. For additional information regarding small MS-4s in Arkansas, see http://www.adeq.state.ar.us/water/branch_permits/general_permits/stormwater/ms4.htm#B2.
9. *Morningstar*, 2011 Ark. 350, at 2, ___ S.W.3d at ___.

of 2009 to complete the system improvements required by these unfunded mandates.[10]

Until 2008, the City used revenues from its general-purposes fund to finance the storm water system at an average of $90,000 per year.[11] However, the City suggested that in 2007 it became aware that complying with its 2009 regulation deadlines would be unfeasible without securing additional revenue.[12] The City's Board of Directors thereafter adopted Ordinance No. 5629, which established a stormwater utility fund, and imposed the previously mentioned utility fees pursuant to Arkansas Code Annotated section 14-235-223(a)(1).[13] The fees applied to all resident-owned, municipal-utility-account statements on file with the City, except for those of property owners who used both wells for water and septic tanks for sewage and owners of freestanding parking lots in the City's downtown area.[14] Once levied, the fees were deposited into the City's designated utility fund to be used solely for purposes of operating the stormwater system.[15]

The ordinance fixed a monthly charge of $3 for residential utility accounts and $6 for industrial and commercial accounts;[16] however, it did not impose charges, in any amount, on utility-account holders residing outside the City's corporate limits, although such customers were still allowed use of and benefit from the City's stormwater system.[17] Incidentally, only sixty-percent of the City's utility customers maintained property within its territorial bounds, thus exempting forty-percent of the system's service base from financial contribution toward the operating costs of the water-treatment program.[18]

Somewhat surprisingly, at least from the viewpoint of the paying residents, revenues collected attendant to the levy were almost doubled the operating costs of the project—notwithstanding the non-payment for nearly half of the stormwater services provided by the City.[19] For the reporting year of 2008, the City's costs for the water system totaled $414,698, while it col-

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10. *Morningstar*, 2011 Ark. 350, at 2, ___ S.W.3d at ___. The regulations require implementation of the department's minimum control standards within five years of the permit's effective date, *supra* note 7, which represent the core functions of the EPA's comprehensive "Stormwater Management Program" for MS-4s. For a description of these standards, see *Stormwater Phase II Final Rule*. http://www.epa.gov/npdes/pubs/fact2-0.pdf at 2.
11. *Morningstar*, 2011 Ark. 350, at 2–3, ___ S.W.3d at ___.
12. *Id*. at 2-3, ___ S.W.3d at ___.
13. *Id*. at 3, ___ S.W.3d at ___.
14. *Id*., ___ S.W.3d at ___.
15. *Id*. at 4, ___ S.W.3d at ___.
16. *Id*. at 1, ___ S.W.3d at ___.
17. *Morningstar*, 2011 Ark. 350, at 1, ___ S.W.3d at ___.
18. *Id*. at 3, ___ S.W.3d at ___.
19. *Id*. at 4, ___ S.W.3d at ___.

lected $634,009 in service fees.[20] In fact, of all revenues collected by the City from then until the following October, not even half were used in operating/maintaining the storm water facility.[21] As a result, 15,000 customers paid $1,115,667 toward the use of $621,469 in less than a two-year period.[22] This left the remaining 10,000 system users with access to free stormwater services and the City with an abrupt surplus of $534,198. Moreover, use of the levy released approximately $160,000 back into the City's general-purposes fund during this timeframe, totaling an estimated growth in City assets of $694,198, which exceeded the total costs in operating the storm-water system during the same period--$621,469.[23]

A number of Hot Springs residents brought an unsuccessful class-action suit on behalf of themselves and others similarly situated against the City in the Garland County Circuit Court. On appeal, the residents contended that the circuit court's ruling was clearly erroneous for three distinct reasons, each of which was addressed by the Supreme Court of Arkansas. First, the residents asserted that the fee constituted an illegal exaction, and that the City adopted Ordinance No. 5629 in violation of the authorizing provisions set forth in Arkansas Code Annotated section 14-235-223.[24] Next, the residents claimed that the user fee was in reality a tax that was imposed against the stormwater customers to supplement the City's general-use funds, which would require approval via a public vote in order to be a lawful exaction.[25] Finally, the residents argued that, even if the charge were a fee, it was unlawfully assessed and applied because it generated a surplus.[26]

The court first noted that an exaction is illegal when it is contrary to law or unauthorized under law.[27] Further, municipalities are inherently bound to the powers conferred on them by the legislature or constitution.[28] According to Ordinance No. 5629's authorizing statute, a municipality "shall have power, and it shall be its duty, by ordinance to establish and maintain just and equitable rates or charges for the use of and the service rendered by the works, to be paid by each user of the sewerage system of the

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20. *Id*., ___ S.W.3d at ___.
21. *Id*., ___ S.W.3d at ___.
22. *Id*., ___ S.W.3d at ___.
23. *See* Laurie Reynolds, *Taxes, Fees, Assessments, Dues, and the "Get What You Pay for" Model of Local Government*, 56 FLA. L. REV. 373, 413 (2004) (contending that the value of the services rendered, rather than the benefits conferred upon the fee-payer should be the source of scrutiny for the courts).
24. *Morningstar*, 2011 Ark. 350, at 5, ___ S.W.3d at ___.
25. *Id*. at 7-9, ___ S.W.3d at ___; ARK. CODE ANN. § 26-73-103(a) (Repl. 2008).
26. *Morningstar*, 2011 Ark. 350, at 9, ___ S.W.3d at ___.
27. *Id*. at 5, ___ S.W.3d at ___; *see also* ARK. CONST. art. XII, § 4 ("[n]o municipal corporation shall be authorized to pass any laws contrary to the general laws of the state").
28. *See* Jones v. Am. Home Life Ins. Co., 293 Ark. 330, 335, 738 S.W.2d 387, 389 (1987).

municipality."[29] That section goes on to declare that all revenues collected pursuant to its provisions are revenues of the "works,"[30] which include the following items, also cited by the court:[31]

(1) The structures and property as provided in § 14-235-203;

(2) Storm water management;

(3) The creation and operation of a storm water utility;

(4) The creation and operation of a storm water department; and

(5) Other like organizational structures related to the disposal or treatment of storm water by municipalities.[32]

Rejecting the residents' contention that the phrase, "to be paid by each user of the sewerage system of the municipality" required that the City charge its fee to non-resident users of the municipality's system as well, the court broadly construed the term "each user."[33] That is, according to its interpretation, the statute "does not state that the fee must be paid by any beneficiary, whether intended or unintended, of the sewerage system[.]"[34] Therefore, where the legislature provides, "*it shall be its duty*." for a municipality to charge fees to *each user* of its works,[35] the state's high court showcased its reluctance to abrogate a municipality's discretion in charging fees to its system's users or in charging fees to some of its system's users, according to whether the municipality "intends" for that particular group of users to benefit from the use of its systems.[36] The court then mentions that the City "contends" its stormwater-system permit does not give it the authority to charge fees to customers outside the City's corporate boundaries;[37] however, the court did not make its own finding of such.[38] Section 14-235-

29. ARK. CODE ANN. § 14-235-223(a)(1) (Repl. 1998).

30. *Id*. § 14-235-223(c).

31. *Morningstar*, 2011 Ark. 350, at 5-6, ___ S.W.3d at ___.

32. *Id*. (citing ARK. CODE ANN. § 14-235-201 (Supp. 2011)).

33. *Morningstar*, 2011 Ark. 350, at 6, ___ S.W.3d at ___.

34. *Id*., ___ S.W.3d at ___.

35. ARK. CODE ANN. § 14-235-223(a)(1) (Repl. 1998) (emphasis added).

36. *See* Rogers Group, Inc. v. City of Fayetteville, Ark., 629 F.3d 784 (8th Cir. 2010) (applying Arkansas law) (determining that ordinances should be sustained so long as enacted pursuant to authorizing law, and so long as the enabling authority is substantially complied with).

37. *Morningstar*, 2011 Ark. 350, at 6, ___ S.W.3d at ___.

38. According to EPA literature produced to educate operators of small MS-4's, creating a "utility fee" as the City has done here to be charged to all its users is one of the agency's most highly recommended methods of funding MS-4s. The funding information states that only those customers *not* benefitting from the system, while *within* the municipal bounds, should be exempt from paying the utility fee. *See Funding Stormwater Systems*. http://www.epa.gov/npdes/pubs/region3_factsheet_funding.pdf at 1-2.

203(c) states that, "For all purposes of this subchapter, all municipalities shall have jurisdiction for ten (10) miles outside their corporate limits."[39]

In similar fashion, the court then noted that section 14-235-223 does not define "sewerage system," leaving it unable to distinguish between wastewater sewerage systems and stormwater sewerage systems.[40] Under section 14-235-203, cited by the court and incorporated by reference into section 14-235-201(1),[41] "works" are also to include:

[A] municipal waterworks system or a municipal sewer system or both may extend its service lines beyond its corporate limits for the purpose of giving water service, sewer service, or both, to adjacent areas where the demand for service is sufficient to produce revenues that will retire the cost of the service lines.[42]

Giving significant deference to the legislature, the court, in essence, stated that the circuit court had ample evidence before it to make a sound decision and chose not to elaborate on the differences among wastewater sewerage systems, stormwater sewerage systems, municipal waterworks systems, municipal sewer systems, and municipal separate stormwater sewer systems.[43] Thus, because the court held that Ordinance No. 5629 was not enacted in violation of Arkansas Code Annotated section 14-235-223, it concluded that the user fee was a legal exaction, regardless of the percentage of utility customers paying, or not paying, toward the operating costs of the stormwater system.[44]

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39. ARK. CODE ANN. § 14-235-203(c) (1987); *cf. id.* § 14-234-110(a)-(b)(3) (giving municipalities owning waterworks systems the authority to extend services beyond their boundaries, and charge rates, whether disparate or not, to outside users when doing so).

40. *Morningstar*, 2011 Ark. 350, at 6, ___ S.W.3d at ___ (interpreting ARK. CODE ANN. 14-235-223(a)(1) (Repl. 1988)).

41. *Id*. at 5-6, ___ S.W.3d at ___.

42. ARK. CODE ANN. § 14-235-110.

43. *Morningstar*, 2011 Ark. 350, at 6, ___ S.W.3d at ___. The permit given to the City was for a municipal separate stormwater sewer system. *Id*. at 2.

44. *Id*. at 6, ___ S.W.3d at ___; *see* Medlock v. Leathers, 311 Ark. 175, 179, 842 S.W.2d 428, 430 (1992) (stating that determinations concerning discriminatory measures should be made by local legislative entities rather than by the courts). Other courts have approached this issue differently. For example, the Supreme Court of Michigan ruled that a user fee levied by local ordinance to fund a wastewater treatment facility was characteristic of an illegal tax requiring a vote, where roughly twenty-five percent of customers paying the fee were actually receiving the full benefit of treatment services. Bolt v. City of Lansing, 459 Mich. 152, 165, 587 N.W.2d 264, 271 (1998). It warned against the dangers inherent in liberal use and interpretation of user fees: The danger to the taxpayer of this burgeoning phenomenon [the imposition of mandatory user fees] is as clear as are its attractions to local units of government. The "mandatory user fee" has all the compulsory attributes of a tax, in that it must be paid by law without regard to the usage of a service, and becomes a tax lien of the property. However, it escapes the constitutional protections afforded voters for taxes. It can be increased any time without limit. *Id.* at 169, 587 N.W.2d at 273 (quoting Headlee Blue

Next, the court looked to the true nature of the exaction in ruling the utility fee a valid exercise of the municipality's police powers, rather than relying on the particular label conferred by the City.[45] As a preliminary matter, the fee must truly be a tax and not a fee in order for the court to invalidate it as an "illegal tax" under an "illegal-exaction" claim.[46] If the exaction is determined to be a tax, it is automatically an illegal exaction, as municipalities must gain voter approval before implementing taxes, accordant with the Arkansas Constitution.[47] The court distinguished between the two by writing, "government imposes a tax for general revenue purposes" of its locality; on the other hand, "a fee is imposed in the government's exercise of its police powers,"—i.e., providing a specific service, or funding a regulatory scheme.[48]

In particular, the court found three factors determinative of the fee's non-tax status. First, the only substantiated evidence before the court suggested the City levied the user fee only in response to its monetary needs in complying with the promulgated mandates of the EPA and ADEQ.[49] The services sought through engagement of the MS-4 permit had the specific and narrow purpose of promoting waste-management services accordant with the regulations of these two environmental agencies.[50] Second, the Arkansas Legislature had delegated the specific and direct authorization needed for local municipalities such as Hot Springs to adopt ordinances aimed at providing the necessary funding for the Wastewater Management Program.[51] Last, and perhaps most important to the court, all revenues generated by the fee were placed in a designated utility fund that the City main-

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Ribbon Commission, A Report to Governor John Engler, Executive Summary § 5, pp. 26-31 (September 1994)).

45. *Morningstar*, 2011 Ark. 350, at 6-7, ___ S.W.3d at ___.

46. *Id*. For an on-point comparison of fees vs. taxes in local government, see Reynolds, *supra* note 21, at 385-96.

47. *Morningstar*, 2011 Ark. 350, at 7, ___ S.W.3d at ___; *see* ARK. CONST. art. 12, § 4.

48. *Id*. quoting *Harris v. City of Little Rock*, 344 Ark. 95, 105, 40 S.W.3d 214, 221 (2001) (internal citations omitted). For a more thorough look at the process of distinguishing between taxes and fees, and the practical effects arising from those distinctions, see Eben Albert-Knopp, *The California Gas Charge and Beyond: Taxes and Fees in A Changing Climate*, 32 VT. L. REV. 217, 231-42 (2007).

49. *Morningstar*, 2011 Ark. 350, at 8, ___ S.W.3d at ___.

50. *Id*. at 8–9; *cf.* City of N. Little Rock v. Graham, 278 Ark. 547, 647 S.W.2d 452 (1983) (invalidating a $3 monthly "public service fee" as an illegal tax, where the fee was charged to North Little Rock residents' water bills and being used to increase salaries of the city's policemen and firemen, a "traditional governmental operation").

51. *Morningstar*, 2011 Ark. 350, at 8-9, ___ S.W.3d at ___; *see* Arkansas County v. Burris, 308 Ark. 490, 825 S.W.2d 590 (1992) (invalidating an ordinance as an illegal exaction that required property owners to show proof of payment of county waste fees before they could pay their property taxes because such a provision was not found in the authorizing legislation).

tained separate from its general revenue accounts, and could be used only for expenditures pertaining to that program.[52] The court's references to, and reliance on, this last factor sheds light on its belief that fees being kept separate from general revenues give rise to the presumption that they are not being used, and will not be used in the future, to serve municipal functions traditionally provided with by tax dollars.[53]

After distinguishing the utility charge as a fee, the court finalized its validity by finding that it was fair, that is was reasonable, and that it bore sufficient relationship with the benefits it bestowed on the beneficiaries of the stormwater services.[54] The residents made a final and unsuccessful attack against the fee based on the dissociation between the revenues collected under its authority and the adequate requirements to achieve its purpose. Yet, the court maintained its consistent deference to the legislative processes at work in this case, acknowledging but giving no effect to the disparity, "as the scope of the services is still within the purposes of the authorizing legislation."[55]

Because the user fee was levied pursuant to authorizing legislation[56] and because the ordinance established a utility fund to be managed separate from the City's general-purpose revenues, the court was thoroughly satisfied that the charge was not an illegal exaction.[57] It did not matter that the customers had already been receiving the stormwater services prior to adoption of the ordinance; further, it did not matter that the fee as set occasioned amassed surpluses in revenues to the City, because the rate for the fee was set reasonably in relation to the typical needs of like facilities.[58]

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52. *Morningstar*, 2011 Ark. 350, at 9, ___ S.W.3d at ___. The court reaffirmed the standard it used in *City of Marion v. Baioni*, proscribing commingling of general-purpose funds and revenue generated from regulations: "This fund restriction distinguishes this case from those situations where municipalities have imposed fees to underwrite the costs of a special service to a new development but instead the monies benefited the general public." 312 Ark. 423, 428, 850 S.W.2d 1, 3 (1993).

53. *See* Albert-Knopp, *supra* note 46, at 234-35 (discussing the ultimate uses of tax and fee revenues).

54. *Morningstar*, 2011 Ark. 350, at 9, ___ S.W.3d at ___.

55. *Id*. *But see* White County v. Cities of Judsonia, Kensett & Pangburn, 369 Ark. 151, 155, 251 S.W.3d 275, 279 (2007) ("any substantial doubt about the existence of a power in a municipal corporation must be resolved against it"); Reynolds, *supra* note 21, at 413 (claiming that some states have found it appropriate to, through the use of objective indicators, provide judicial relief where the costs for the services greatly exceed the benefits received).

56. *See* ARK. CODE ANN. § 14-235-223(a)(1) (Repl. 1998).

57. *Id*. at 8 n.1, ___ S.W.3d at ___; *see generally* Mark N. Halbert, *Municipal Law-Utility Franchise Fees-True Nature of Levy Immaterial When City Possesses Statutory Authority*, 18 U. ARK. LITTLE ROCK L.J. 259, 273 (1996).

58. *Morningstar*, 2011 Ark. 350, at 8-9, ___ S.W.3d at ___; *see* Rogers Group, Inc. v. City of Fayetteville, Ark., 629 F.3d 784 (8th Cir. 2010) (applying Arkansas law) (stating that so long as an ordinance does not conflict with state law, a court's opinion as to its reasonableness should be irrelevant). *But see* Taylor, Cleveland & Co. v. City of Pine Bluff, 34 Ark.

Morningstar v. Bush will likely increase flexibility in municipal governance via use of ordinances, which may now, more so than in past years, harness the numerous municipal benefits of adopting "user," "impact," or "service" fees, rather than dealing with the traditional stringencies associated with creating revenue through direct taxation.[59] The court's opinion lends the impression that it truly did not want to invalidate the City's ordinance; hence the consistent deflection to principles that are not absolute in their application. Without concrete evidence of municipal misbehavior, citizens will have difficulty challenging the legality of local ordinances that establish regulatory fees; the court will not speculate, regardless of the likelihood of truth a speculative argument may encompass.

** J. Andy Marshall*

603, 608 (1879) (suggesting that courts should have authority to reapportion municipal fees that result in excesses: "the police power is too vague, indeterminate and dangerous to be left without control[,]"). The court based its decision, in part, on testimony procured during trial. *Morningstar*, 2011 Ark. 350, at 9, ___ S.W.3d at ___. The City called an expert in wastewater facility management who stated that the ordinance's $3 utility charge was typical among like facilities in other jurisdictions. *Id*. at 4, ___ S.W.3d at ___.

59. *See* Albert-Knopp, *supra* note 46, at 221 (distinguishing the heightened requirements for imposing taxes, whereas fees can be imposed independently and, in some circumstances, free from political backlash).