ALAN WILSON
ATTORNEY GENERAL

May 23, 2019

The Honorable John Richard C. King
S.C. House of Representatives
P.O. Box 11555
Rock Hill, SC 29731

Dear Representative King:

You have requested an opinion from this Office regarding the legality of the City of Rock Hill's policy of transferring utility revenues to its general fund when it lacks sufficient reserves. In your request letter, you inform us that pursuant to City of Rock Hill Budget 2017 – 2018, "Appendix," FP 6, the City of Rock Hill has instituted the following policy on transfers:

> Section 1. **Franchise Fees.** The City shall budget annually a franchise fee from the Utility Fund that equals the franchise fee that would have been paid had electric, water and sewer services been provided by an investor-owned utility. The franchise fee shall be calculated by multiplying all gross revenues of the electric, water and sewer systems made within the City's corporate boundaries by the current franchise fee the City charges to private utility providers. The franchise fee shall be reported as an expense of the electric, water and sewer system and as a revenue of the General Fund.
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> Section 2. **Payment in Lieu of Taxes.** The City shall budget annually a payment in lieu of taxes from the electric, water, and sewer systems to the General Fund that approximates the amount of ad valorem taxes that would have been paid had utility services been provided by an investor-owned utility. The payment in lieu of taxes shall be calculated by multiplying the gross fixed assets of the system reported in the City's most recent audited financial statements by the appropriate assessment ratio and then by the City-wide tax rate included in the City's most recent budget ordinance. The resulting product shall be multiplied by the estimated percentage of electric, water and sewer fixed assets that are located within the City's corporate boundaries. The payment in lieu of taxes amount calculated under this section shall be reported as an expense of the electric, water and sewer system and as a revenue of the General Fund.
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> Section 3. **Payment in lieu of Rate of Return.** The City may budget annually a payment in lieu of a rate of return on the gross operational

> revenues of the electric, water, and sewer systems. The rate of return will be based on 5% of the gross utility revenues and may be adjusted by City Council to meet the current utility business environment. The payment in lieu of a rate of return calculated under this section shall be reported as an expense of the electric, water and sewer system and as revenue of the General Fund.
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> **Exceptions:** The amount to be paid from the electric, water and sewer system under the resolution may be increased or reduced upon approval of the City Council as long as the amounts actually paid do not exceed amounts reasonably necessary to cover a portion of the General Fund which are incurred to support City General Fund obligations and costs related to the utility system services, or as otherwise allowed by applicable law.

You have provided us with the following information:

> The 2015 through 2017 audited financial statements of the City show that the unrestricted reserve in the City's electric, water and sewer system is insufficient, starting at $76,564, which represents .06% of the annual operating expenses of $126,293,658 and is less than one day of operations for 2015. This is largely due to the City transferring $7,198,877 to the General Fund of the City in 2016. Even after that transfer, the City's Unassigned General Fund balance was only $264.3 thousand, representing about two days of reserves, so one must ponder whether the current transfer policies benefit either the bondholders, the rate payers, or citizens of Rock Hill. Lastly, those figures slightly improved in the ensuing years of 2016 and 2017.

You are requesting that our Office answer the following questions:

1. Does the transfer policy that the City of Rock Hill has in place meet the requirement of either S.C. Code Ann. § 6-1-300(6) or S.C. Code Ann. § 6-21-440 if the City has not established all the reserve funds required by 6-21-440?

2. If the City's policy does not meet the requirements of both S.C. Code Ann. § 6-1-300(6) and S.C. Code Ann. § 6-21-440, may the City continue to transfer funds from the Utility Fund to the General Fund?

LAW/ANALYSIS:

As we have stated in many prior opinions, this Office is not empowered to make factual findings.[1] However, we can provide you with the applicable law. In order to determine if the City of Rock Hill's transfer of revenues from its electric, water, and sewer systems to its general fund is lawful, you can petition a court for a declaratory judgment, "as only a court of law can interpret statutes and make such determinations."[2]

We will begin with a general discussion of the law that is pertinent to your questions. Municipalities are granted certain powers by the Legislature, including the power to "make assessments, and establish uniform service charges relating to them . . . ." S.C. Code Ann. § 5-7-30 (1976 Code, as amended) (emphasis added). Section 6-1-330 provides the process or procedure by which a municipality imposes a new service or user fee:[3]

> (A) A local governing body, by ordinance approved by a positive majority, is authorized to charge and collect a service or user fee. A local governing body must provide public notice of any new service or user fee being considered and the governing body is required to hold a public hearing on any proposed new service or user fee prior to final adoption of any new service or user fee. Public comment must be received by the governing body prior to the final reading of the ordinance to adopt a new service or user fee. A fee adopted or imposed by a local governing body prior to December 31, 1996, remains in force and effect until repealed by the enacting local governing body, notwithstanding the provisions of this section.
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> (B) The revenue derived from a service or user fee imposed to finance the provision of public services must be used to pay costs related to the provision of the service or program for which the fee was paid. If the revenue generated by a fee is five percent or more of the imposing entity's prior fiscal year's total budget, the proceeds of the fee must be kept in a separate and segregated fund from the general fund of the imposing governmental entity . . . .

S.C. Code Ann. § 6-1-330 (1976 Code, as amended) (emphasis added). As used in section 6-1-330, a "service or user fee" means:

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[1] See Op. S.C. Atty. Gen., 1989 WL 406130 (April 3, 1989) ("[b]ecause this Office does not have the authority of a court or other fact-finding body, we are not able, in a legal opinion, to adjudicate or investigate factual questions.")

[2] Op. S.C. Atty. Gen., 2016 WL 7425912, at *3 (Dec. 2, 2016) (citing S.C. Code § 15-53-20 (1976 Code, as amended)).

[3] See Op. S.C. Atty. Gen., 2012 WL 3875116 (Aug. 23, 2012) ("Section 6-1-330 of the South Carolina Code (2004 & Supp. 2011) provides the procedure for imposition of a new service or user fee within a municipality . . . .").

> a charge required to be paid in return for a particular government service or program made available to the payer that benefits the payer in some manner different from the members of the general public not paying the fee. 'Service or user fee' also includes 'uniform service charges.'

S.C. Code Ann. § 6-1-300(6) (1976 Code, as amended).

Our understanding from your letter is that the City of Rock Hill has issued bonds pursuant to the Revenue Bond Act for Utilities, S.C. Code Ann. § 6-21-5 et seq. (1976 Code, as amended). Under the Revenue Bond Act for Utilities, a municipality is permitted to issue revenue bonds "[f]or the purpose of defraying the cost of purchasing, constructing, improving, enlarging, extending or repairing any system or project of any character mentioned in § 6-21-50[4]. . . ." S.C. Code Ann. § 6-21-190 (1976 Code, as amended). The revenue bonds are secured by a statutory lien on the system or project financed. S.C. Code Ann. § 6-21-330 (1976 Code, as amended).

The principal and interest on the bonds are paid solely from the revenues derived from the operation of the system or project for which they are issued. S.C. Code Ann. § 6-21-220 (1976 Code, as amended). The service or user fees must be sufficient to pay the interest and principal on the bonds and the expenses of operation and maintenance of the utility, as well as to build up a reserve for depreciation and a reserve for improvements and extensions. S.C. Code Ann. § 6-21-390 (1976 Code, as amended). Each of these sums must be segregated into a separate fund. S.C. Code Ann. § 6-21-440 (1976 Code, as amended). If there is a surplus after these amounts are paid and set aside, it "shall be disposed of by the governing body of the borrower [the municipality] as it may determine from time to time to be for the best interest of the borrower." Id. One of our prior opinions explained that "[t]here is some latitude for the use of these revenues [the surplus], assuming that all required funds have been adequately funded as required . . . ." Op. S.C. Atty. Gen., 1989 WL 508567, at *4 (July 17, 1989) (citing City of Spartanburg v. Blalock, 223 S.C. 252, 75 S.E.2d 360 (1953)).

In your request letter, you directed our attention to Azar v. City of Columbia, 414 S.C. 307 (Sept. 9, 2015). In Azar, the plaintiffs brought an action against the City of Columbia, alleging that it was unlawfully transferring water and sewer revenues to its general fund as well as using the revenues for economic development purposes. Although the State Supreme Court reversed and remanded to the trial court because of "genuine issues of material fact as to whether the City's expenditures of water and sewer revenues were lawful,"[5] the Court examined the relationship between sections 6-1-330 and 6-21-440, which were discussed above.

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[4] Section 6-21-50 is entitled "Authorized public works which may be purchased or constructed," and provides that "[a]ny municipality of this State may purchase or construct a waterworks system, water supply system, sewer system, . . . light plant or system, . . . power plants and distribution systems . . . ." S.C. Code Ann. § 6-21-50 (1976 Code, as amended).

[5] Id. at * 308.

After the City admitted that its water and sewer revenues fell within the definition of "service or user fee" as defined under section 6-1-300(6), the Court explained the limitation contained in section 6-1-330(B)[6]:

> the statute [section 6-1-330(B)] requires that revenues *must* be spent on costs 'related to' the City's provision of water and sewer services. Indeed, the plain and ordinary meaning of the language in section 6–1–330(B) requires some nexus—some commonality—between the underlying purpose of the expenditure and the City's provision of water and sewer services.

Id. at * 312.

The parties conceded the applicability of section 6-21-440 of the Revenue Bond Act for Utilities. The Court made it clear that all of the expenses and set-asides provided for in section 6-21-440 had to be satisfied before the surplus revenues could be used:

> It is only after the utility system's operating and maintenance expenses and bond principal and interest expenses have been paid and the statutorily required set-asides have been made in the depreciation and contingent funds that "[a]ny surplus revenues thereafter remaining" may be used for unrelated purposes at the local government's discretion.

Id. at * 314.

The Court found that the "surplus revenues" provision of section 6-21-440 could be reconciled with the requirement of section 6–1–330(B) that all service or user fees be used to pay for "related" costs:

> [w]e find the 'surplus revenues' provision of section 6–21–440 is a limited exception to the general rule in section 6–1–330(B)–an exception that allows disposition of surplus funds *if* the specific preconditions set forth in section 6–21–440 have been met.

Id. at * 315.

Ultimately, the Court determined that in order to be lawful, the City of Columbia's transfers and expenditures of the utility revenues must constitute either "surplus revenues" under section 6-21-440 or have a sufficient nexus to the provision of water and sewer services that they would be considered "related" expenditures or transfers under section 6-1-330. The Court opined: "[s]imply put, the statutes do not allow these revenues to be treated as a slush fund." Id. at * 320.

The Azar decision shows that a municipality's transfer of its utility revenues to its general fund is lawful if it constitutes either "surplus revenues" pursuant to section 6-21-440 or "related" costs under section 6-

[6] The key language of section 6-1-330(B) states: "[t]he revenue derived from a service or user fee imposed to finance the provision of public services must be used to pay costs related to the provision of the service or program for which the fee was paid . . . ." S.C. Code Ann. § 6-1-330(B), supra.

1-330(B). To qualify as "surplus revenues," the municipality must have issued bonds pursuant to the Revenue Bond Act for Utilities.[7] The utility revenues must be used to pay the interest and principal on the bonds and the expenses of the operation and maintenance of the utility. The utility revenues must also be used to build up reserves for both depreciation and for improvements and extensions. The municipality cannot utilize the utility revenues as surplus funds to be spent at its discretion unless all of these expenses and reserves have been funded.

If the transfer of the utility revenues does not constitute "surplus revenues," then it must be "related" costs pursuant to section 6-1-330(B). In order to be "related" costs, the utility revenues must be used to pay costs sufficiently related to the provision of the utility services. If the transfer of the utility revenues does not constitute "surplus revenues" or "related" costs, a court would most likely find the transfer to be illegal.

CONCLUSION:

In summary, section 6-21-440 of the Revenue Bond Act for Utilities[8] mandates that bonded utility revenues must fund certain expenses and reserves before those funds can be used at the municipality's discretion. Pursuant to Azar v. City of Columbia, 414 S.C. 307 (2015), a municipality's transfer of its utility revenues to its general fund is lawful if it constitutes either "surplus revenues" pursuant to S.C. Code Ann. § 6-21-440 or "related" costs under S.C. Code Ann. § 6-1-330(B). In order to be "related" costs under section 6-1-330(B), the utility revenues must be used to pay costs sufficiently related to the provision of the utility services. If those mandatory reserves have not been met as required by law, and the expenditure or transfer of the utility revenues does not constitute "surplus revenues" or "related" costs as permitted by law and discussed in Azar, then a court would most likely find the transfer of those funds to be unlawful.

However, such a determination is highly fact-specific and cannot be undertaken by this Office in an opinion. For this reason, we can only discuss the applicable law in the abstract here. We suggest that the proper venue for a resolution of this question may be in the courts either in the form of a declaratory judgment or a taxpayer lawsuit.

Sincerely,

Elinor V. Lister

Elinor V. Lister
Assistant Attorney General

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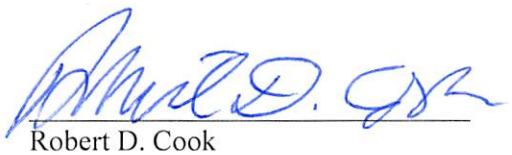
[7] S.C. Code Ann. § 6-21-5 et seq., supra.

[8] S.C. Code Ann. § 6-21-5 et seq., supra.

REVIEWED AND APPROVED BY:



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