Municipal Fees
Legal Issues
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Introduction:

If your city is like ours, fees are an important source of funds to pay for various programs. At times you may find that you are on the wrong end of a lawsuit regarding your fees. You may be fortunate enough to have your client contact you before they set or raise a fee to find out if there are any legal requirements of which they must be mindful. The purpose of this paper is to give you the general legal framework for analyzing whether a fee meets the requirements set out in the law (and hopefully avoid, or successfully defend against, future lawsuits).

Please note, I represent a home-rule municipality. Therefore, my review looks mainly toward the authority of a home-rule municipality. However, where legal authorities have spoken to the limits on general law cities, I try and will provide that information in this paper.

The opinions expressed in this paper are my own, not an official opinion of the City of Austin or its City Attorney. As you think through your revenue needs in your city, one of your resources should be the TML Revenue Manual for Texas Cities. This handbook is clearly worded and is a helpful starting place in analyzing the legal issues relating to sources of funding for your city.

General Legal Framework:

Cities assess a variety of fees and it is legal to charge these fees.

While there are many types of fees, the most common that I work with are user fees and regulatory fees. Examples of user fees are garbage collection fees, pool fees, recreation center fees, and pet adoption fees. Examples of regulatory fees are building permit fees, parking meter fees, billboard fees, and drainage fees.

When fees are in excess of the amount needed for regulation, they are referred to as "unauthorized occupation taxes" by the courts. The Texas Constitution Article XI, Section 5 provides that "cities may levy, assess, and collect such taxes as may be authorized by law or by their charters" but "no tax for any purpose" shall exceed 2 ½% of the taxable property of the city (effectively $2.50 for each $100 worth of value). Similar language appears

in Texas Constitution Article XI, Section 4. Additionally, there is specific language regarding "occupation taxes" in the Texas Constitution Article VIII, Section 2. Specifically, that provision requires that all occupation taxes must be equal and uniform upon the same class of subjects within the limits of the authority levying the tax.

Home rule cities may take actions authorized by the city charter and not specifically prohibited or preempted by the Texas Constitution, state, or federal law. Cities may also regulate a range of local activities to promote the general welfare of the city's residents. Thus, in general, using the home rule police power gives us the authority to assess a fee if the fee is regulatory and the amount is based on the cost of regulating. General law cities are more limited in their authority.

First Rule for Fees: fees should return only what it costs to run the program and no more.

Fees that generate revenue in excess of what a city needs to operate the program for which the fee is charged can be found by a court to be unauthorized taxes. When fees are struck down in this manner, courts often call these fees "occupation taxes."

For home rule municipalities, if a fee bears a reasonable relationship to the cost of providing the service or regulating the behavior being regulated, and there is no legal prohibition against charging the fee, generally, the city can charge the fee.

For general law cities, the fee must bear a reasonable relationship to the cost of providing the service or regulating the behavior, and there must be authority to levy the fee. *See, e.g., Vance v. Town of Pleasanton,* 261 S.W. 457, 458 (Tex. Civ. App. – San Antonio 1924 aff'd Comm'n of Appeals of Texas, Section A, 277 S.W. 89, 1925).

Second Rule for Fees: The purpose for which the fee is charged must be a public purpose.

The purpose for which the fee is charged must also be a public purpose. The definition of a public purpose has evolved in the case law over time. One of the first cases to analyze this question is *Davis v. City of Taylor*, 67 S.W. 2d 1033 (Tex. 1934). In this case the City of Taylor

assessed a tax for a Board of City Development to use to advertise the city. The Court quoted *McQuillin on Municipal Corporations* and recognized that there is no precise definition of public purpose although it must be beneficial to the inhabitants of the city and directly connected with the local government. (*Davis* at 1034). The Court questioned whether there was clear authority for the city to spend money on advertising, but noted that the city was a home rule city and advertising itself was could reasonably be part of its purpose and powers as a city, plus there was language in its charter that arguably gave it the power to tax for this purpose. Therefore, the Court deferred to the legislative discretion of the city. Note: on the same day, the Court decided *Anderson v. City of San Antonio*, 67 S.W. 1036 (Tex. 1934). In that case, the city had no authority, either in its charter or elsewhere, to support the levy of a tax to be used to advertise the city. The Court concluded that without any authority to support the levy of this tax, it could not approve the tax. *Id.* (Shortly after this, San Antonio amended its charter to address the issue).

Third Rule: Charge too much and pay for too many unrelated things, and you've got a tax.

The fees that are described below are examples of cases in which the particular fee was found by a court to be in excess of the cost to provide the service or regulate the behavior.

(A) Billboard fees:

An association of billboard owners and operators brought a case challenging the City of Houston's billboard fees. The plaintiffs alleged that the fees brought in more money than it cost to regulate the billboards and therefore the fees were an occupation tax. *City of Houston v. Harris County Outdoor Advertising Association*, 879 S.W. 2d 322 (Tex App. Houston [14th Dist.] 1994), *writ denied, cert. denied*. The evidence in this case was that the fees were approximately $120 per permit for a six year period, when the fee should have been $40 a permit. (*Outdoor Advertising* at 326). The court noted that the State did not have an occupation tax for billboards. While the court noted that the ordinance was prima facie valid and presumed to be reasonable, the trial court's finding that there was no direct relationship between the fees and the receipt of service would not be overturned by the appellate court. (*Outdoor Advertising* 326-327).

Houston had based its fee on a fee study that recommended this fee for activities that included impoundment of illegal stick and paper signs that were unrelated to the billboards (among other city actions). (*Outdoor Advertising* at 328). The court also found no reason to overturn the trial court's finding that there was no direct relationship between the payment of fees and the services received by the billboard owners and operators. Rather, the permit fees for these particular signs subsidized the sign enforcement program for the city as a whole. (*Outdoor Advertising* at 330).

For those of us assisting our clients in evaluating fees, it is important to note that the court not only found against the City, but upheld the request by the plaintiffs to have the fees paid back, and awarded attorneys' fees.

(B**): Fire Safety Fees:**

In the case of *Lowenberg v. City of Dallas*, (261 S.W. 3d 54, Tex. 2008), owners and operators of commercial buildings challenged Dallas' fire registration fee. Dallas instituted a fee on commercial buildings to generate funds for fire protection. Failure to pay the fee carried a criminal fine of up to $2,000. Although the fee was intended to offset administrative costs relating to fire safety in commercial buildings, the fee also was intended to raise enough revenue to fund all costs of fire prevention in commercial buildings as well as fire prevention for the general public. Additionally, the court notes that the "revenue greatly exceeded any regulatory cost." The court upheld the award against the city – both a refund of fees and attorneys' fees.

Regulatory Fees (discussed in case law):

Cases that look at fees for regulating an activity follow a similar path to those that look at user fees. First, they examine whether the City has the lawful authority to regulate the activity. Next they review whether the fee bears a reasonable relationship to the cost of regulating the activity.

(A) Guidance on What It Means to Regulate: Although not a municipal fee case, the case of *Creedmoor Maha Water Supply Corp. v. Barton Springs-Edwards Aquifer Conservation District*, (784 S.W. 2d 79, Tex. Civ. App. – Austin 1990), *writ denied*, has some helpful language to explain what it means to regulate and thus what costs can be included in the cost of regulation. The court distinguishes cases

where fees were found to be in excess of the cost needed to regulate because the fees were being spent on activities relating to controlling the activity (e.g. marketing Texas citrus fruits), versus actually controlling the activity. In this case, the court found that controlling the wells and the use of the underground water were activities that were reasonably considered "regulating" and within the purpose of the water conservation district and it upheld the charges as fees, not taxes. (*Creedmoor* 83-84).

Another helpful case regarding what it means to regulate is *City of Fort Worth v. Gulf Refining Co., et. al.* (83 S.W. 2d 610, Tex. 1935). In this case, Fort Worth charged a fee of $23 to license gas stations. Gasoline was known to be a hazardous substance that caused fires. The stations used the public streets and sidewalks which created traffic hazards for pedestrians and vehicles (*Fort Worth at 611)*. The City put on testimony from its land development staff, fire marshal, weights and measures inspector, and police to establish what each did in regards to the establishment and operation of the gas stations. The City also introduced its ordinances; one that created the zoning and land use requirements for the gas stations, and the other that had findings relating to the need to ensure safety of the stations and that set the fee. The Court states: "It is a part and parcel of the city's regulatory system, and unless the charge is unreasonable, its validity must be sustained . . . the sum levied cannot be excessive nor more than reasonably necessary to cover the costs of granting the license and of exercising proper police regulation . . . The nature of the business sought to be controlled and the necessity and character of police regulations are the dominating elements in determining the reasonableness of the sum to be imposed." (*Id. 618-619).* Cities may find it helpful to refer to the conclusion of the court that the burden in these cases is for the plaintiffs to prove that the charge is unreasonable. *(Id. at 619).* Moreover, the fact that the funds went into the general revenue of the city did not mean that this fee was to raise revenue instead of paying for the costs to regulate the activity. *(Id.).*

(B) Parking:

There are a couple of cases from the 1930's that looked at whether a city could charge for parking. *Harper v. City of Wichita Falls*, 105 S.W. 2d 743 (Tex. Civ. App. - Fort Worth 1937) *writ ref'd*; and *Ex. Parte Harrison*, 122 S.W. 2d 314 (Tex. Crim. App. 1938) are two of these cases. In both of

these cases, the courts concluded that a city has a right to grant the use of a street or sidewalk to a person for private use and to charge a fee if the license or grant of use will not interfere with the use by the general public of the sidewalks and streets in question. (*See, e.g., Harper* at 753). Thus, establishing meters to control the flow of cars parking along the streets was a public purpose. The courts also reviewed the amount of the fee and compared it to the costs of running the meter program. The *Harper* court cited with favor various treatises and cases that reviewed these types of fees and determined that the amounts were reasonable if the revenues are not in excess of the costs of operating the meters, paying expenses related to the operation of the meters, and inspecting and regulating traffic to control its flow along the streets within the city. ((*Harper* at 755).

(C) Health Inspections: Another case reviewed whether a city could charge for inspections. That case is *Producers Assoc. of San Antonio v. City of San Antonio,*326 S.W.2d 222 (Tex. Civ. App – San Antonio, 1959) *writ ref'd n.r.e.* In this case the milk producers challenged San Antonio's authority to assess a fee for inspecting dairy farms. The fee was based on the cost of inspection plus a mileage fee. This case is helpful because the court explains what is meant by the word "revenue" in reviewing a fee. The court noted that the rule for determining whether a fee is an illegal tax is whether the primary purpose of the fee is to raise revenue, not regulate an activity. The court states as follows: "The word 'revenue' . . . means the amount of money which is excessive and more than reasonably necessary to cover the cost of regulation, and not that which is necessary to cover the cost of inspection and regulation." (*Producers* at 224, citations omitted). Since the fee generated less money than it cost to perform the inspections the court found the fee did not illegally raise revenue and was not a tax.

The *Producers* court also recognized that the State and the Federal government had laws relating to milk production. Those laws did not preempt the City's inspection regime adopted by ordinance.

Finally, the dairy farmers challenged the ordinance because the mileage charge was the same whether you were a small or large diary. The court rejected a challenge to this method of calculating the fee. It said "[w]e think it is elementary that an ordinance may establish a classification so long as the classification is reasonable and applies equally to all person who fall within the class." (*Producers* at 226).

Fees in State Law (discussed in statutes):

If a state statute includes language that grants authority for a specified fee, and your city is following the statute, then your city may assess the fee. The list below is a sample of some statutes that provide for fees – fees are being added and changed each legislative session, so this list is not exhaustive.

(A) Solid Waste Disposal Service Fee:

Texas Health and Safety Code Section 364.034 states that a city may:
(1) Offer solid waste disposal service to persons in its territory;
(2) require the use of service by those persons;
(3) charge fees for the service; and
(4) establish the service as a utility separate from other utilities in its territory.

(B) Concession Fee:

The Texas Local Government Code 331.006 permits a city to lease concessions or privileges for amusements, stores, gas stations, or other concerns consistent with the operation of a public park.

(C) Municipal Court Fees:

There are numerous fees that municipal court can charge – these are set by statute. Examples include the following: building security fees (used to fund security needs of the building that houses municipal court – *see* Tex. Crim. Proc. Code Ann. Section 102.017), child safety fees (different fees apply to cities under 805,000 in population and cities over that – *see* Tex. Crim. Proc. Ann. Section 102.014), court technology fees (for technology needs of city courts – *see* Tex. Crim. Proc. Code Ann. Section 102.0172), and juvenile case manager fees (*see* Tex. Crim. Proc. Code Ann. Section 102.0174).

(D) Impact Fees:

An impact fee is a charge or assessment imposed against new development to generate revenue for funding or recouping the costs of capital improvements or facility expansions necessitated by and attributable

to new development. *See*, Tex. Loc. Gov. Code Chapter 395. There are many rules relating to impact fees – you need to read the statute very carefully and follow the rules before implementing this type of fee.

(E) Utility Rates:

There are 4 types of utilities that cities generally have.

Water and wastewater
Electric
Solid waste (garbage collection)
Drainage.

- The Texas Water Code, Chapter 13, has the standards and requirements for water and sewer rates.
- The Public Utility Regulatory Act (PURA) regulates the rates of electric utilities (as well as gas and telecommunications).
- Both the Water Code and PURA allow customers who receive service but who are outside the city limits to appeal a city's rate decision to the appropriate regulatory entity.
- Water and sewer rates and electric rates can be appealed by the outside of city users to the Public Utility Commission (PUC). Also, both statutes, in general, prescribe the requirements for setting rates. Rates must provide for payment of debt service and the cost of service, and may provide for a reasonable rate of return on invested capital used and useful in providing utility service.
- Rates for a drainage utility must be spent as set out in state law (*See Section 552.041 et. seq. Texas Local Government Code*).
- Solid waste rates and drainage utility rates are set by the city. There is no state agency that regulates these rates.

(F) Charges for operating vehicles for hire:

- Texas Transportation Code Section 502.003(b) authorizes cities to license and regulate vehicles for hire in the city limits to impose a permit fee or street rental charge for the operation of each motor vehicle used to transport passengers for compensation, other than certain federally licensed vehicles. The fee may not exceed two percent of the annual gross receipts from the vehicle. In *City of Waco*

v. Reed, 223 S.W. 2d 247, 255 (Tex. Civ App Waco 1949 - writ ref'd), Waco instituted this fee at 2% and said it was for licensing. They had evidence of what it cost to regulate. The evidence in that case showed that the cost exceeded the amount that Waco would collect under the fee. The fee was upheld.

Franchise Fees:

Franchise fees are different from user and regulatory fees. The Texas Constitution prohibits cities from giving away city property. (*See,* Texas Const. Art. III, Sec. 52). Your city charter may contain similar prohibitions. Use of city streets, right of way, or the grounds of the city are all city property that can be controlled by the city by granting a franchise to use the property in question.

A franchise is a special privilege conferred by government on an individual or organization. Franchises are generally granted to utilities or other monopolies that exist to further the public interest. Texas cities therefore charge franchise fees for use of city property, such as streets and the public right of way to deliver service to customers.

State and federal law often preempt most city regulation of franchises such as cable television, video services, and telephone service. Despite this, cities can still charge for use of right of way and city property. The regulations in these areas change often, so consult with TML or an expert if you need to before enacting fees and regulations for utilities using your property.

Risks when the City is Sued:

If your city is challenged on a fee, the general claim will be that the city is raising revenue in excess of the costs needed to regulate or the provide services.

If a challenge is successful, plaintiffs will generally seek injunctive relief (to stop your city from charging the fee), repayment of what they allege are overcharges, and attorney's fees.

Defenses:

(A) Standing:

Of course, it is important to review the case carefully to make sure that the plaintiff has properly established standing for the relief sought. Ask your client contacts carefully about the plaintiff and his or her payment of fees. Some people who are angry about a fee may not have paid it. Some may claim to represent a class of similarly situated persons, but be unable to establish this.

(B) Voluntary Payment:

A number of cases have not allowed recovery of fees paid in the past. This issue often turns on a review of whether the fee was paid "under duress." What is duress? *Lowenberg*, cited above, noted that the threat of criminal prosecution for non-payment can be duress. The court noted that a person who pays a tax voluntarily and without duress does not have a valid claim for repayment if the tax is later held to be unlawful. *Lowenberg* at 58. The court went on to note that failure to pay the fee in question in this case could result in prosecution for a Class C misdemeanor. Therefore, the court found that this fee was paid "under duress." *Lowenberg* 58-59.

Similarly, plaintiffs can allege "business compulsion" or "economic duress." In one Houston case, for example, a company paid off a city lien that it believed to be extinguished because it could not sell its property without paying this lien. The company noted on its payment that it was made under duress. Later, the company sued the city. The court held that payment of illegal or improper government fees and taxes, coerced by financial penalties, loss of livelihood, or substantial damage to a business can constitute business compulsion or duress and thus give rise to a proper claim for the amounts previously paid to the government. *Saturn Capital Corp. v. City of Houston,* 246 S.W. 3d 242, 248 (Tex. App. Houston [14th Dist.] 2007, pet. den.).

One case that reviews the contrast between voluntary payment and payment made under duress is *Dallas County Comm. College Dist. v. Bolton*, 185 S.W. 3d 868 (Tex. 2005). In this case, the community college assessed a technology fee against the students. Although the students asserted that they could not take classes if they did not pay the fee, the court noted that the fee was on a sliding scale, and there was a mechanism to request a waiver. Therefore, the court found the fee was voluntary. *Bolton* at 881. The case is useful because it gives the justification for the voluntary

payment rule, as well as explains the history of the "business compulsion" exception to that rule.

(C) Documenting Reasonableness of Fees:

Mindful of the law and the risks associated with charging fees in excess of the amount allowed by law, it can be helpful to evaluate the cost to the city of a given program before instituting a fee, or raising a fee.

If you can hire an expert, that is great. And, if you are in court, you may find yourself in need of an expert. But, we advise our departments to use a cost of service analysis in fee setting.

Cost factors generally include:
1) Employees whose direct labor is used in the activity for which the fee is charged. Employee costs include both salary and benefits.
2) Direct costs such as materials, contracts, and supplies used in providing the service or regulating the activity.
3) Internal indirect costs such as administration of the program in question.
4) External indirect costs such as central services like city-wide budget, finance, and human resources – based on budgetary analysis from your city's budget office if possible.

These costs can be divided by the number of units in a twelve month period (e.g., permits issued, tickets given out, citations issued, number of people who used the pool or after-school program) to get the average fully loaded cost that should be attributable to each fee. Round down to be conservative.

I've attached a sample of a billboard registration fee study that was done for the City of Austin in a recent case.

Fee Waivers:

To be legally defensible the fee waiver must not be made in an arbitrary and capricious manner, and must have some standards and controls tied to the fee waiver.

As a general rule, a gratuitous donation or gift by a city is prohibited by the Texas Constitution. Article XVI, Section 50 of the Texas Constitution

prohibits lending the credit of the state, and Article III, Section 52 prohibits the Legislature from authorizing political subdivisions to lend their credit or to grant public money. The clear purpose of the constitutional provisions is to prevent the gratuitous application of public funds for private use. *Brazoria County v. Perry*, 537 S.W. 2d 89 (Tex. Civ. App.- Houston [1st. Dist.] 1976, no writ); *Edgewood Indep. v. Meno*, 893 S.W. 2d 450, 473 (Tex. 1995).

On the other hand, the Constitution does not invalidate an expenditure that incidentally benefits a private interest if it is made for the direct accomplishment of a legitimate public interest. *Byrd v. City of Dallas*, 118 Tex. 28, 6 S.W. 2d 738, 740 (1928). If the city determines that a particular expenditure accomplishes a valid public purpose, and despite the fact that one or more individuals or corporations might incidentally benefit, the expenditure will still be valid.

The key question is whether a valid public purpose is being directly accomplished by the expenditure. *City of Corpus Christi v. Bayfront Assoc. Ltd.*, 814 S.W.2d 98 (Tex. App. – Corpus Christi 1991, writ den.) (Cities may not expend public funds simply to obtain for the community the general benefits resulting from the operation of the corporate enterprise). What constitutes a public purpose cannot be answered by any precise definition other than to state that, if an object is beneficial to the inhabitants and directly connected with the local government, it could be considered a public purpose. *Davis v. City of Taylor*, 67 S.W.2d 1033, 1034 (Tex. 1934). The governing body of the city must make the determination of whether a certain expenditure meets the public purpose test, and must also place sufficient controls on the transaction to ensure that the purpose will be carried out. Additionally, the City taxpayers should receive a benefit that is roughly equivalent to what is being spent (or what is not being received). Thus, for example, a city might waive a fee for an event if the event is providing marketing for the City that would be roughly equivalent to the cost of the fee. The document evidencing the waiver (whether it is a resolution, ordinance, or contract), should articulate this framework to establish that the waiver meets these requirements.

CONCLUSION

Cities cannot charge unauthorized taxes. Fees that bring in more money than it costs to regulate an activity or provide a service can be found by a court to be unauthorized taxes.

As a best practice, determine the cost to provide the service or regulate the activity, and use that cost as the basis for calculating the city's fee before charging it. Have a process to communicate the requirements with city staff who work with fees to make sure they understand the requirements and know who to come to if they have questions. If you have a study or other report to document the fee change, including that information in what is provided to council as back-up for their decision on the fee change can be helpful as evidence of what council considered in changing the fee.

If your City is waiving fees, it is best to do so in a manner that speaks to what the City purpose is, what benefit there is to the taxpayers, and that provides some basis for finding that the benefit is at least roughly equivalent to the fees being waived.

If your fee is challenged in court, review the risks noted above to help you evaluate the city's potential liability in court.