by Catherine D. Reischmann

Up *Allen's Creek* Without a Paddle: Can Cities Leverage Utility Service for Annexation?

Cities should beware because even 20 years after it was decided, *Allen's Creek Properties, Inc. v. City of Clearwater*, 679 So. 2d 1172 (Fla. 1996), continues to raise questions about the legality of municipalities compelling county property owners to annex into a city to obtain that city's utilities.[1] Hailed as a victory for cities, the Florida Supreme Court decision held that cities can require landowners in unincorporated areas to execute "voluntary" annexation petitions in return for access to city utilities.[2] But the decision brings up many troubling issues familiar to those in local government, such as judicial interference in the operation of local government, cities' ability to control growth on their borders through annexation, and the right to leverage annexation for utilities.

Cities are often looking to expand their boundaries because annexation results in increased revenue and lower tax rates in the future. Specifically, annexation helps spread the costs of constructing and operating municipal utility systems to all customers, not just city residents. Although hardly perfect, tending to create pockets of incorporated areas, by mandating annexation petitions from county property owners for utility service, a city addresses the public policy concern of county residents on cities' borders reaping the benefits of city life tax-free.

The Florida Supreme Court recognized that annexation solves the widespread problem of county residents enjoying urban city life, including city utilities, without paying city taxes and fees, as described in the article by Michael Sittig and Harry Morrison, Jr., with John T. Wark, *The Annexation Riddle*, Quality Cities, March/April 2011 at 17:

> State policies continue to encourage Floridians to live and develop property in unincorporated areas where rural land remains available for a relatively inexpensive price and taxes are likely to be lower because urban services are not available — yet. Meanwhile, county residents on a city's fringe, those who do not want to be annexed, go on enjoying the fruits of city life — tax-free. They can drive to a nearby city to do business, enjoy restaurants and parks and nightlife, or participate in cultural and sports activities. And they can do so without sending a dime of their property taxes to city government to support the infrastructure of roads, sewage plants, water systems and police protection that these restaurants, cultural organizations, sports teams and businesses depend on.
>
> County residents or business owners are often not motivated to voluntarily annex into a city because of the increased financial burden that comes along with annexation, sometimes without any additional perceivable benefit because of the ready availability of municipal services to these nonresidents. Cities, then, are faced with a Hobbesian choice. Either the cities accept that those on their borders can use their benefits, including their utilities, and disrupt their land use plans, without paying city taxes; or cities must look for ways to force or, at a minimum, incentivize county residents and businesses to annex.

Further aggravating this dilemma for cities is the impact of *Allen's Creek*. At first blush, it appears that the decision is highly favorable to cities seeking to annex more territory, since the Florida Supreme Court found a city could require a utility customer located outside the city to sign an annexation petition as a condition of receiving city utility service. The court sided with the City of Clearwater in its quest to force nonresident utility customers into the city. In doing so, the court pointed out that annexation is a legitimate condition for obtaining utility service. Provision of utility service to nonresidents is a proprietary, rather than governmental function, stated the court, which means that in most cases a city has no duty to furnish any service to nonresidents, and so a city can refuse to serve the customer absent the customer acquiescing to a utility related condition such as annexation.[3] The decision also seems to establish the autonomy of government owned utilities to operate outside their borders without judicial interference, absent discrimination.

In *Allen's Creek*, a noncitizen of Clearwater demanded sewer service. The city required him to sign an annexation petition to obtain that service. He argued he should not have to sign an annexation petition because he claimed Clearwater, as the exclusive sewer service provider to his property under an interlocal agreement with Largo, should provide him service unconditionally. The Supreme Court disagreed, stating that the agreement with Largo merely allowed but did not require Clearwater to provide sewer service to the property,

and the city could condition provision of utility service on annexation.

Upon closer examination, the decision adds a lot of uncertainty. The court mentioned two exceptions when a city would have an unconditional duty to serve a nonresident, and in those cases, the city could not condition service at all.[4] Under *Allen's Creek*, cities are required to provide utilities unconditionally: 1) when the city has "held itself out as a public utility" or "expressly manifested" a desire to serve; and 2) when there is a contract or law mandating service between a customer or a group of customers in an area, and the city.[5] In both categories, stated the *Allen's Creek* court, a city has a duty to serve the nonresident, which cannot be conditioned on annexation. Because of some dicta describing these two exceptions to the annexation rule, the decision makes uncertain municipalities' power to condition utility service to nonresidents, to use their utilities to require annexation, and ultimately to collect their fair share of taxes and fees from non-residents on the edge of city life.

The owner in *Allen's Creek* argued both the exceptions applied there, but the court disagreed. The city was not "holding itself out as a public utility," in part because the city only provided utilities to a limited area outside the city. Nor did the city have an unconditional contractual duty to provide utilities to all the unincorporated land within the owner's service area under either Clearwater's interlocal agreement with the City of Largo establishing each city's service area, or a "201 Plan."[6] The court held that neither of those was a contract binding Clearwater to serve the Allen's Creek property.

The fallout from *Allen's Creek* is that a city must embark on a difficult multi-step analysis to determine if it can require utility customers to annex. The city must consider whether it has an obligation to serve a property based on a contract, such as an interlocal agreement; by operation of law; or through its conduct. A review of the public policy justifications offered by the court to support the holding in *Allen's Creek* will help clarify the need for an expansion of a city's right to compel annexation, and for a simplification of the test to determine when annexation petitions can be required by a city in exchange for utility service.

Rationale for Requiring Annexation Petitions for City Utility Service for County Residents

• *City's Economic Needs* — The *Allen's Creek* court found that a reasonable justification for the annexation petition requirement is that without the increase in tax revenue from annexation, a city would be unable to ensure continued adequate utility services to its own residents. The court placed city residents' needs above the desires of the nonresident customers to receive city utility service without paying city taxes.[7]

• *Uncontrolled Growth on City Borders* — As required by F.S. Ch. 163, a city's comprehensive plan must include a plan for the city's future land use to make certain that its infrastructure, including its utilities, will keep pace with growth. If a municipality is required to serve unincorporated areas that are developed outside the city's control, and governed by a potentially more permissive county comprehensive plan, a city will be unable to plan effectively for its capital improvements needs.[8] For example, there are escalating costs in operating a water utility for the many communities dependent on groundwater sources that must be budgeted.

Allen's Creek recognized that in order to plan for future improvements, a city must know which properties will be available for annexation in the future. A city must also be able to control how many utility customers it will have and how intensively those customers will develop these properties. Requiring nonresident customers to sign annexation petitions allows the city utility to plan for the water and sewer capacity that needs to be reserved for its future residents, because the city would have control over future development in those unincorporated areas.

• *Annexation is Directly Related to Utility Service* — While a city cannot and should not make individual arbitrary determinations regarding whom it will serve with its utilities, *Allen's Creek* held that a city can place conditions related to utility service on the provision of that service, including requiring annexation petitions. One legislatively sanctioned distinction

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between residents and nonresidents that implicitly recognizes the higher costs to serve nonresidents, is the disparity in charges to customers for utilities inside and outside the city. F.S. §180.191 (2014) allows cities to charge a 25 percent surcharge to nonresident utility customers without conducting a study showing that this 25 percent surcharge represents actual increased costs to serve these nonresidents, although the surcharge is controversial, deemed "taxation without representation" by county residents. The statute even allows cities to charge up to a 50 percent surcharge if a study is done justifying the charge and a public hearing is held.[9]

• *When Operating Outside City Limits, Cities Are Operating in a Proprietary Capacity Offering a Public Service; Contract Law Governs* — A city is not operating as a governmental entity when operating outside its borders,[10] and when operating a business is generally free from judicial scrutiny absent a showing of an abuse of discretion under contract principles.[11] Previously, the Florida Supreme Court has implied that courts do not have jurisdiction over city utilities acting extra-jurisdictionally, but instead that regulations and rates are to be set by contract, at the discretion of the city.[12]

The Fifth District raised the question of who regulates city utilities outside their borders, without answering it, in *City of Winter Park v. Southern States Utilities, Inc.*, 540 So. 2d 178, 180 n.1 (Fla. 5th DCA 1989). That answer might come from Colorado, where the state supreme court ruled that neither the state's public utilities commission nor any other board has the power to regulate city utilities operating extra-jurisdictionally, in *Board of County Commissioners of Arapahoe County v. Denver Board of Water Commissioners,* 718 P.2d 235 (Co. 1986).

Similar to Colorado, the Florida Public Service Commission (PSC) does not exercise regulatory power over a municipal utility, because the legislature decided city residents were adequately protected from abuse by a city utility. Since city residents own the utility, it functions for their benefit, and the residents have elective control over the officials operating the utility.[13] Some argue that if a city is the equivalent of an investor owned utility when operating extraterritorially as a monopoly, a city should be subject to regulation by the PSC outside city limits the same as investor owned utilities, since the nonresident customers do not have a check on the city utility at the ballot box.[14] Based on *Allen's Creek*, it appears the Florida Supreme Court now believes there are instances in which the judiciary should step in the shoes of the PSC to protect nonresident owners from the utility's rules when a city utility is deemed by a court to be a "public utility." As long as *Allen's Creek* remains the law, a primary disadvantage for a city deemed a "public utility" is the city will be prevented from enacting a rule mandating annexation.

• *Powers Granted Municipal Utilities in F.S. Ch. 180*[15]— Although *Allen's Creek* did not mention F.S. Ch. 180, the decision was consistent with an earlier attorney general opinion considering the same issue of whether a city can mandate annexation for utilities.[16] The attorney general pointed to F.S. §180.19(1) (2014) for guidance, which allows a municipality that constructs utilities to permit potential customers to connect to city utilities "upon such terms and conditions as may be agreed between such municipalities, and the owners...," including, presumably, annexation.

Limiting Factors in the Court's Determination that Annexation Is an Acceptable Utility Condition

• *Impracticality in Supreme Court's Reasoning that Nonresident Can Seek Service Elsewhere* — After enumerating many valid public policy reasons for Clearwater's annexation condition, the court claimed that another reason for ruling in favor of Clearwater was that Allen's Creek could obtain sewer service from another government or through a private sewer treatment system. This argument contradicts state policy, which is designed to prevent the overlap of utilities by encouraging monopolies and territorial agreements to provide service at the lowest possible cost with the highest efficiency.[17]

Further, it is often very difficult if not impossible for property owners, especially large property owners, to obtain permits, finance wells, legally use septic tanks, or construct self-contained treatment facilities when city service is available. It is also environmentally unsound.

• *City Service Area Must Be Small* — The court narrowed its ruling considerably by pointing favorably to the fact that Clearwater was not in the "water business," serving only isolated areas outside the city.[18] The court implied that if Clearwater served larger areas outside city limits, that could mean the city would be "holding itself out" as a public utility, and would have a duty to serve all in the "larger" area.

• *City Must Demonstrate Uniformity in the Application of Annexation Condition* — Many cities that require annexation in exchange for its utilities have adopted certain exceptions to the requirement. *The Allen's Creek* court commented favorably on Clearwater's uniform application of "no utilities without annexation" rule,[19] implying that the ruling would not have gone Clearwater's way otherwise.

Two Exceptions to the General Rule That Annexation Is Related to Utility Service

As previously mentioned, absent a duty to serve a property with utilities, the *Allen's Creek* court held that a city can condition service by requiring annexation. But through the ambiguities in the decision, the Florida Supreme Court has reined in cities' power to condition service to nonresidents by the breadth of the two exceptions to the general "no duty to serve" rule, known as the "holding out" exception and the "contract" exception.

1) The Holding Out Exception

The *Allen's Creek* court implied that if Clearwater had a duty to provide service because it was "holding itself out" as being in the water business, it could not condition service on annexation.[20] Under this standard, a city, by its conduct, can morph from

a municipal utility operating under its proprietary powers with no duty to provide service to a "public utility" with an absolute duty to serve and no right to condition service.

• *Use of the Term "Public Utility"* — Under Florida statutory law, the term "public utilities" is applied only to private investor owned utilities governed by the PSC or to a "jurisdictional county," not to government owned utilities. Florida municipalities and county owned utilities, unlike in some other states, are exempt from regulation by the PSC as they are not classified as "public utilities" under the statutes.[21] Despite this clear statutory directive, based on *Allen's Creek*, the courts have changed city utilities' status and converted them to "public utilities," whereby the utilities are subject to some of the same scrutiny as investor owned utilities.

• *"Expressly Manifesting an Intent to Assume Duty to Serve" Precludes the Imposition of the Annexation Condition* — It is not clear from Allen's *Creek* exactly what municipal conduct would constitute "expressly manifest(ing) the desire or intent to assume that duty [to provide service outside the jurisdictional boundary]."[22] Perhaps the city's intent to be considered a public utility may be expressed in its interlocal service area agreements; in a permit or an agreement that mandates service to a particular customer, including a water management district consumptive use permit requiring mandatory hookup; or bond covenants that factor into required service; or a special act defining a city's service area.

There is one certainty from the *Allen's Creek* decision, which is entirely reasonable: a city's creation of a "Chapter 180" district coupled with a mandatory connection ordinance or policy requiring all property owners in a particular area to connect to city sewer means the city must provide "reasonably adequate services for reasonable compensation," and precludes the imposition of the annexation condition in that area.[23]

2) Contract Exception to No Duty to Serve Rule

In some states, the determination of whether a municipal utility that serves customers outside the city is bound to serve all customers unconditionally is based simply on contracts between the city and the extraterritorial consumer. When this contract exception applies, the *Allen's Creek* decision mandates a city must provide efficient service at the lowest possible cost.[24]

• *Contracts Should be in Writing to be Binding* — Absent an express written contract, a property owner seeking utility service in Florida should be barred from claiming a city has an unconditional obligation to serve that customer by virtue of an oral contract, due to cities' sovereign immunity, privity issues, and the statute of frauds. Written contracts define a city's duties, not oral understandings or staff representations.[25] For example, the Ohio Supreme Court, in *Bakies v. City of Perrysburg*, 843 N.E.2d 1182 (Oh. 2006), pointed out the unenforceability of oral contracts with city utilities, rejecting a nonresident's claim that the city had an oral agreement with him to provide utilities without condition, and that the city should not be able to alter unilaterally the terms of that "oral" agreement by requiring annexation mid-stream, so to speak.

• *Some Interlocal Agreements Could Bind Cities to Serve Unconditionally* — Interlocal agreements or franchise agreements between government entities regarding service areas may be a type of contract that could cause a city to fall under the contract exception, per the Florida Supreme Court. Generally these interlocal agreements will recite that they do not benefit third parties, but in *City of Clearwater v. Metco Development Corp.*, 519 So. 2d 23 (Fla. 2d DCA 1987), cited in *Allen's Creek*, the district court found that Clearwater was contractually bound under an interlocal agreement with the county to provide water to an out-of-city customer, in part because the city was already providing water to part of that customer's property when the city demanded an annexation petition for the entire property in exchange for providing water to the balance of the property.[26]

Incentives for Annexation or Carving Out Exceptions to a Mandate as an Alternative to Mandating Annexation

Until further clarification is provided regarding cities' authority to mandate annexation, offering incentives to utility customers to annex is the only safe alternative for municipal utilities. Cities have provided many of the following incentives to try to achieve annexation: a) imposing a high utility surcharge on nonresidents (up to 50 percent under F.S. §180.191(1)(b) (2014)).[27] The risk of this incentive is that the city's study justifying the increased surcharge could be challenged; b) eliminating the 25 percent surcharge after the nonresident executes the annexation petition. The risk here is that nonresidents could claim the imposition of the surcharge is arbitrary; c) requiring customers who do not sign the annexation petition to make impact fee payments and excusing those who do sign annexation petitions. This could put the impact fee program at risk; d) offering other kinds of limited monetary incentives only to commercial properties or those properties that provide contiguity to commercial areas. This incentive leads to a claim of cherry picking only the lucrative areas to annex, often resulting in city limits resembling a jigsaw puzzle piece, with all the resulting inefficiencies in the delivery of government services.

A city could carve out exceptions to the annexation requirement for certain customers, which is also perilous due to the Supreme Court's emphasis on uniformity in *Allen's Creek* and the possibility of creating enclaves and pockets. The exceptions, which are used by municipalities throughout the state, could be for customers: a) who had been served by a private utility that was purchased by the city utility; b) in older subdivisions, which are expensive to provide city services (although that could be deemed discriminatory); c) in residential areas in general (also discriminatory); d) where there is a "legal obligation" to serve those customers, leaving that standard unresolved; or e) where customers can find a practical and environmentally sound alternate source of water and sewer.

Conclusion: The Most Logical Exception

Courts in Florida have pledged to "not interfere with a municipal utility's exercise of its authority as long as the municipality does not arbitrarily discriminate between its customers and can present reasonable justification for its actions."[28] Under the bulk of common law and the relevant statutes, municipalities have full executive and legislative discretion to determine when and if the cities will deliver utility services outside the municipal boundary.[29] In fact, courts in other states have held that in certain instances, compelling a city to furnish utilities to those outside its corporate limits and beyond its taxing powers would violate the due process clause of both that state's constitution and the federal constitution.[30] Additionally, cities, except those deemed "public utilities," are protected by sovereign immunity from suit by a customer for failure to serve, waived only to the extent of an express written contractual obligation.[31]

Cities should only be required to serve an extra-jurisdictional area based on an enforceable service contract, or where the city's ordinances, charter, or a special act, mandate such service. Absent those contractual obligations, municipal utilities should have discretion to deny service unless a customer signs an annexation petition, since annexation is a "utility related" reason for declining service akin to lack of capacity. So long as cities' rules comply with contractual obligations and are rationally related to permissible objectives, such as compatibility of growth, economic development, and the security and safety of its residents, municipal utilities should have the option to leverage annexation for utilities.❑

[1] Cities operate utilities outside their boundaries because they construct utilities, as authorized by FLA. STAT. §§159.07, 180.03 and 180.06 (2014); or purchase utility systems from private providers, under the Revenue Bond Act, FLA. STAT. §159.05 (2014). Cities' power to operate utilities outside their boundaries generally comes from portions of the Revenue Bond Act, FLA. STAT. §§159.03, 159.05, and 159.07 (2014); the Public Works Statute, Ch. 180; their charters, and special acts.

[2] Generally annexation must be voluntary, or it is very difficult to achieve. Involuntary annexation is less burdensome in some situations, such as for enclaves (FLA. STAT. §171.046 (2014)); when there are limited numbers of registered voters residing on property (FLA. STAT. §171.0413 (2014)); and when the county and a city enter into a Service Boundary Agreement under FLA. STAT. §171.203, or a Joint Planning Agreement for annexation planning under FLA. STAT. §163.3171 (2014).

[3] *See also Edris v. Sebring Utilities Commission*, 237 So. 2d 585, 586 (Fla. 2d DCA 1970); 11 MCQUILLIN, THE LAW OF MUNICIPAL CORPORATIONS, §31:18; 64 AM. JUR 2d., *Public Utilities* §7.

[4] A city can usually refuse service if it lacks capacity, however. *See generally*, PAUL GOUGELMAN, *Moratoria and Interim Growth Management*, FLORIDA ENVIRONMENTAL AND LAND USE LAW, Ch. 5, §3 (1994).

[5] *Allen's Creek*, 679 So. 2d at 1176.

[6] The 201 Plan was part of a federal program in which Clearwater was required to delineate service areas to determine facilities needed in the future, but the plan was never implemented. *See* the Second District's decision in *Allen's Creek, City of Clearwater v. Allen's Creek Properties, Inc.*, 658 So. 2d 539, 541 (Fla. 2d DCA 1995).

[7] *Allen's Creek*, 679 So. 2d at 1177.

[8] *Id.* at 1175.

[9] FLA. STAT. §180.191 (2014); *City of Daytona Beach v. Stansfield*, 258 So. 2d 809 (Fla. 1972). The Florida Supreme Court has held rates charged outside city limits are not reviewable by the courts. *State v. City of Melbourne*, 93 So. 2d 371 (Fla. 1957). Further, the court has stated that city utility rule or rate setting is a legislative function that should not be invalidated by the courts except where the legislation is unreasonable or discriminatory. *Mohme v. City of Cocoa*, 328 So. 2d 422, 425 (Fla. 1976).

[10] *Town of Riviera Beach v. State*, 53 So. 2d 828 (Fla. 1951).

[11] *Hamler v. City of Jacksonvillle*, 122 So. 220, 221(Fla. 1929); *City of Winter Park v. Montesi*, 448 So. 2d 1242, 1245 (Fla. 5th DCA 1984).

[12] *State v. City of Melbourne*, 93 So. 2d 371, 372 (Fla. 1957).

[13] *City of Winter Park v Southern States Utilities, Inc.*, 540 So. 2d 178, n.1 (Fla. 5th DCA 1989).

[14] City utilities can always be monitored, however, due to the application of the Sunshine Law and the Public Records Act.

[15] Cities do not need to rely on Ch. 180 for power to operate utilities, especially within their boundaries. *Contractors and Builders Ass'n of Pinellas County v. City of Dunedin*, 329 So. 2d 314, 319 n. 6 (Fla. 1976) (Ch. 180 is "anachronistic").

[16] ATTY. GEN. OP. 86-5 (Jan. 16, 1986).

[17] *See, e.g., Clearwater v. Metco,* 519 So. 2d 23, 24 (Fla. 2d DCA 1987).

[18] *Allen's Creek*, 679 So. 2d at 1176.

[19] *Id.* at 1177.

[20] *Id.* at 1176.

[21] FLA. STAT. §§366.02(1), 366.11(1), 367.021(1) (2014); *Village of Virginia Gardens v. City of Miami Springs*, 171 So. 2d 199 (Fla. 3d DCA 1965).

[22] *Allen's Creek*, 679 So. 2d at 1176.

[23] The city can only mandate connection to sewer within five miles from a city's border per FLA. STAT. §180.02(3) (2014).

[24] *Allen's Creek*, 679 So. 2d at 1175.

[25] The waiver of sovereign immunity found in FLA. STAT. §768.28 (2014), only applies to suits on express approved written contracts. *County of Brevard v. Miorelli Engineering, Inc.*, 703 So. 2d 1049 (Fla. 1997) (oral contracts not enforceable); *see generally Town of Ponce Inlet v. Pacetta, LLC.*, 120 So. 3d 27 (Fla. 5th DCA 2013); *Arenado v. Florida Power and Light Co.*, 541 So. 2d 612 (Fla. 1989). Further, sovereign immunity bars enforcement of an alleged contract against a governmental entity that was never properly approved by that entity. *City of Orlando v. West Orange Country Club*, 9 So. 3d 1268, 1272-3 (Fla. 5th DCA 2009).

[26] Water infrastructure was already installed, making connection to an alternative source extremely expensive. The interlocal agreement in question apparently provided that the city would unconditionally serve Metco, and the county, not the customer, sued to enforce the interlocal.

[27] *Allen's Creek*, 679 So. 2d at 1176.

[28] *Sebring Utilities Com'n. v. Homes Savings Association of Florida,* 508 So. 2d 26, 28 (Fla. 2d DCA 1987), *rev. den.*, 515 So. 2d 230 (Fla. 1987).

[29] Courts have held persons who do not comply with a utility's reasonable rules do not have a property interest in water. *James v. City of St. Petersburg*, 33 F.3d 1304 (11th Cir. 1994); *Burgess v. City of Houston*, 718 F.2d 151, 153 (5th Cir. 1983).

[30] *Bair v. Mayor and City Council of Westminster*, 243 Md. 494, 221 A.2d 643, 645 (Md. 1966); *Crawford v. City of Billings*, 130 Mont. 158, 297 P.2d 292, 295 (Mont. 1956).

[31] *Miorelli*, 703 So. 2d at 1049.

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