Iowa General Assembly

2009 Legal Updates

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LEGAL UPDATE—CITY FRANCHISE FEES
Filed by the Iowa District Court for Polk County
June 3, 2009

Kragnes v. City of Des Moines, Case No. CE 49273

Background Facts and Procedure. This civil class action lawsuit against the City of Des Moines (City) alleges that the franchise fees assessed in the City's franchise agreements for gas and electric power services are illegal. In 2006, the district court granted the plaintiff's motion for summary judgment by finding that the franchise fees were illegal taxes. Later that year, the Iowa Supreme Court held that while "any franchise fee charged by a city must be reasonably related to the city's administrative expenses in the exercise of its police power," there remained "a genuine issue of material fact as to whether all or part of the franchise fees in this case are so related." *Kragnes v. City of Des Moines*, 714 N.W.2d 632, 633 (Iowa 2006). Specifically, the Iowa Supreme Court held that such a fee "needs to be related to the reasonable costs of inspecting, licensing, supervising, or otherwise regulating the activity in order to be permitted under a city's home-rule authority [, otherwise,] it is nothing more than a tax levy, which the legislature has strictly prohibited." *Id.* at 641 (citation omitted). Accordingly, the Iowa Supreme Court reversed the district court's ruling and remanded the case for further proceedings on that issue.

Issue on Appeal. Whether all or a portion of the franchise fees collected from customers as the result of the City's franchise agreements are reasonably related to the City's costs of inspecting, licensing, supervising, or otherwise regulating the franchise?

Analysis. According to the City, the costs and expenses accrued by the City for administering the electric and gas franchises include: lost value of trees; lost opportunity cost; lost property tax; administrative costs; degradation costs; construction costs; operating costs; disruption costs; and the cost of a franchise fee study. The district court addressed each of the claimed costs and expenses and identified those that should not be used in calculating the appropriate amount franchise fees. Based on this determination, the district court declared that $1,575,194 of the electric utility franchise fees are reasonably related to the City's administrative expenses. The district court also declared that $1,574,046 of the gas utility franchise fees are reasonably related to the City's administrative expenses. Accordingly, the district court held that any amount in excess of those costs constituted an illegal tax and unless otherwise provided by law should be disallowed and unenforceable.

In rejecting the plaintiff's request for an injunction, the district court identified the recent legislation enacted by the legislature and signed by the Governor. 2009 Iowa Acts, Senate File 478, provides that a city franchise fee may be based upon a percentage of gross revenues generated from sales of the franchisee within the city not to exceed five percent, without regard to the city's cost of inspecting, supervising, and otherwise regulating the franchise. Senate File 478 also provides that franchise fees collected pursuant to an ordinance in effect on May 26, 2009, and in excess of the amount to inspect, supervise, and regulate the franchise may be used by the city for any purpose authorized by law. However, franchise fees collected pursuant to an ordinance that is adopted or amended on or after May 26, 2009, must be credited to a franchise fee account within the city's general fund and used for certain specified purposes. Senate File 478, however, does not apply retroactively to those fees collected prior to the effective date of the Act.

The district court dismissed the City's various arguments that the plaintiff should not receive a refund. In support of its decision to order a refund of a portion of the franchise fees paid by customers, the district court stated that "the court would be sending a message to all cities in Iowa that as long as the cities use funds from the illegal taxation of its citizens for good and honorable purposes, the taxpayers do not have anything to complain about and have no right to a refund of the funds illegally collected."

Conclusion. Ultimately, the district court ruled that to the extent the electric and gas franchise fees exceeded the City's cost to administer the franchise, the ordinances under which those fees were collected are illegal, during the period from July 27, 1999, through May 26, 2009. The court ordered the City to comply with its orders and with statutory changes relating to franchise fees that became effective May 26, 2009. The district court entered judgment in the amount of all electric and gas franchise fees paid to the City in excess of the amount determined to be legally charged, including appropriate interest. The district court retained jurisdiction to determine the actual amounts to be refunded, the amount to paid to each class member, and the manner and feasibility of refunds.

Update. On September 2, 2009, the district court issued rulings on several posttrial motions filed by both parties. Within those rulings, the district court rejected the City's request to apply the court's previous ruling only to the named plaintiff, Lisa Kragnes, rejected the plaintiff's request to block collections of a new five percent franchise fee, and denied a motion to decertify the class action lawsuit.

LSA Contact: Michael Duster, Legal Services, (515) 281-4800.