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LICENSING AND FRANCHISING SOLID WASTE SERVICES

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North Carolina cities and counties are authorized by statute both to license and to franchise various private providers of solid waste management services. This bulletin discusses the differences between a franchise and a license and then discusses the constitutionality of a grant of an exclusive franchise.

For counties, Chapter 153A, Section 136 of the North Carolina General Statutes (hereinafter G.S.) authorizes the board of commissioners to grant licenses and franchises to the providers of certain solid waste management services, and the statute expressly authorizes the grant of an exclusive franchise. The services for which franchises and licenses may be granted are the commercial collection and disposal of solid wastes. Franchises may be granted for up to thirty years; no time limit is set for licenses. A county may regulate the fees charged by either franchised or licensed providers of services. Pursuant to G.S. 153A-136(a)(3), a county may "set the terms" of any franchise, and presumably this power includes the setting of certain service levels.

For cities, the authority is granted in a more roundabout manner. G.S. 160A-194 provides that a city may license all trades and occupations conducted in the city; no specific authority is given to license providers of solid waste management services. No time limit is set for the duration of licenses, and no authority exists under which a city may regulate the rates charged by a licensee. G. S. 160A-319 authorizes cities to grant franchises to private providers of the public enterprises listed in G.S. 160A-311, and G.S. 160A-311(6) includes in the definition of public enterprises "solid waste collection and disposal systems and facilities." A city may grant a solid waste franchise for up to thirty years. Cities are not given express authority to control the rates and fees charged by franchisees, but that authority appears to exist by virtue of the power given cities by G.S. 160A-319 to grant franchises upon "reasonable terms," which should include some sort of control over rates to ensure that customers of the franchisee are not charged excessive rates. The "reasonable terms" authority also appears to authorize a city to require certain levels of service from a franchisee. Although G.S. 160A-319 does not expressly authorize cities to grant exclusive franchises, it provides that a city

may by ordinance prohibit the operation of an enterprise without a franchise, and the effect of such an ordinance, when combined with the grant of a franchise, would be to make that franchise exclusive.

Local Government Franchises

What is a franchise and how is it different from a license? In his treatise on municipal law, McQuillin defines a franchise this way:

> Generally, a franchise is defined as a special privilege conferred by the government on individuals or corporations and that does not belong to the citizens of a country generally by common right, and it is immaterial whether the grant is made direct by the legislature or by a municipality to whom the power is delegated. . . . Innumerable business activities of a public nature are the proper subject of a franchise, such as the right to supply city inhabitants with natural gas, to collect wharfage and dockage tolls, and to operate a community antenna television service.[1]
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> Municipal franchises are the concrete, definite points of contact between large public and private interests. Franchises have been regarded as special privileges granted by the government to particular individuals or companies to be exploited for private profits. They are coming to be regarded, however, not so much as privileges, but rather as functions delegated to private individuals to be performed for the furtherance of the public welfare and subject to public control.[2]

From the discussion in McQuillin and from the cases cited, it is clear that most franchises granted by local governments share the following characteristics. First, they usually involve the use of city or county property by a private firm. This is the case with water and gas systems that must lay pipe along streets and roads, electric systems that must erect poles and string wires along streets, bus systems that must use the streets, and—most recently—cable television systems that must lay cable along city streets. Second, the franchise is to provide services that are sometimes provided by local governments themselves but are contracted to private firms, usually for reasons of economy or technical expertise. Third, franchises usually involve a substantial capital investment by the franchisee and for that reason are granted for relatively long periods of time—ten to forty years—so that this investment can be recovered. Fourth, franchises are contracts between the local government and the franchisee in which rights and duties flow both ways. For example, certain levels of service may be required by the local government, and it may have the right either to set or approve the rates charged by the franchisee. Fifth, some franchises are by their very nature exclusive, whether or not the grant from the local government so provides. Only one gas company or electric company can provide service to a city or a designated area thereof. Of course, not all franchises are for services that amount to such "natural monopolies." Solid waste collection franchises need not be exclusive, although local governments may wish to grant exclusive collection franchises for reasons of efficiency or to obtain an agreement from the franchisee to provide certain services—recycling, for example. Sixth, a franchise gives the holder certain property rights. If these rights are impaired, the franchisee is entitled to compensation. A license, by contrast, is only permission to conduct a particular activity in the local government's jurisdiction and typically must be renewed annually.[3]

What North Carolina authority there is that describes franchises agrees with McQuillin's definition. In two early cable television cases, the North Carolina Supreme Court was required to determine whether the arrangements the cities had entered into were actually franchises, even though the cities had called them something else. In *Shaw v. City of Asheville*,[4] the city's charter required that before it granted a franchise the matter had to be put to a vote of the city's residents and be approved by a majority vote. However, the city had entered into what it called a "lease-license agreement" with a private firm to provide cable television service to city residents, and it had not put the question of whether to enter into the agreement to a vote. The court declared that the arrangement was a franchise and was invalid because no election had been held. The court defined a franchise this way:

> It is the privilege of doing that which does not belong to the citizens of the country generally by common right which constitutes the distinguishing feature of a franchise.
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> . . .

1. 12 EUGENE MCQUILLIN, MUNICIPAL CORPORATIONS §34.03 (Beth A. Buday & Dennis Jensen eds., 3d ed. 1995).
2. *Id.* § 34.01.
3. *See id.* § 34.05.
4. 269 N.C. 90, 152 S.E.2d 139 (1967).

> A franchise is property, intangible, it is true but none the less property—a vested right, protected by the Constitution—while a license is a mere personal privilege, and except in rare instances and under peculiar conditions, revocable.[5]

In a similar case, *Kornegay v. City of Raleigh*,[6] the city's charter also required an election to approve a franchise. Raleigh granted what it called a "license" to a private firm for the provision of cable television service without holding an election. On the authority of *Shaw*, the court held the arrangement was a franchise and invalid.

Although a franchise in North Carolina is property, if it is a county franchise it is qualified by the possibility that it may be displaced by annexation and the accompanying municipal services. In *Stillings v. City of Winston-Salem*,[7] Forsyth County had granted the plaintiffs exclusive franchises to collect solid waste in designated areas of the county. The city annexed portions of the territories and began providing municipal solid waste collection services. The plaintiffs brought an inverse condemnation action seeking compensation for the loss of their property—the franchise. The court denied compensation. It conceded that a franchise was property but said it was subject to all existing statutory provisions at the time it was granted, one of which was the power of a municipality to annex territory and displace the franchise with municipal services.

Exclusive Franchises

Whether a grant of an exclusive franchise for solid waste services is constitutional turns on whether Article I, Section 34, of the North Carolina Constitution applies to such franchises. The constitutional provision states: "Perpetuities and monopolies are contrary to the genius of a free state and shall not be allowed." An examination of the cases involving franchises in which this constitutional provision has been referred to—it has never been decisive in a case involving a local government franchise for a public enterprise service—and those in which it has not been mentioned, leads to the conclusion that it probably does not bar granting exclusive franchises by local governments for public enterprise services. If an exclusive franchise for solid waste collection or disposal services should be challenged as violating Article I, Section 34, the challenge would most likely be denied on the ground that such a franchise is a "legal monopoly" considered constitutional in other contexts.

Only one case has ever said forthrightly that an exclusive franchise granted by a local government for a public enterprise service was an unconstitutional monopoly. In *Thrift v. Elizabeth City*,[8] the city had granted an exclusive franchise to a private firm for the construction and operation of a water system. As noted above, by its nature such a franchise has to be exclusive, whether or not the franchise states that it is exclusive. The court agreed with the trial judge's decision that the financial arrangements for the water system were unconstitutional because a water system was not a necessary expense within the meaning of the constitution, and this was the only question the court was required to decide. The court then concluded its opinion by stating that, although unnecessary to the decision, it felt called upon to announce that the franchise was also unconstitutional under the "no monopoly" provision. The precedential value of this case is weak for several reasons. First, by the court's own terms the statements about unconstitutionality under the "no monopoly" provision were unnecessary to its decision and therefore dicta. Second, at the time this case was decided no general statute authorized cities to grant franchises for public enterprise services. And finally, the case was decided before *Reid*—the next case discussed—and the public utility cases that followed *Reid*.

This case should be contrasted with *Reid v. Norfolk Southern Railroad Co.*,[9] in which an indirect challenge was made to a railroad company's franchise on the ground that it was in violation of the constitutional provision prohibiting the granting of exclusive or separate privileges or emoluments except in consideration of public service.[10] The court rejected the challenge, stating that franchises granted to public service corporations (in which category it assumed railroads belonged) were in consideration of public service. The "no monopoly" provision was not mentioned, and it was too obvious to state in the opinion that a franchise to one company to build a railroad from A to B excludes all other companies from the same route. As Professor John Orth notes, this case created a major exception to the "no monopoly" provision because there is no practical difference between a grant of exclusive privileges under Section 32 and a monopoly under Section 34, and a grant of exclusive

5. *Shaw*, 269 N.C. at 97, 152 S.E.2d at 145.
6. 269 N.C. 155, 152 S.E.2d 186 (1967).
7. 311 N.C. 689, 319 S.E.2d 233 (1984).
8. 122 N.C. 31, 30 S.E. 349 (1898).
9. 162 N.C. 355, 78 S.E. 306 (1913).
10. N.C CONST. now art. 1, § 32.

privileges is acceptable if it is in consideration of public services.[11] "[O]n this basis public utility companies have been created. By and large, such companies are functioning monopolies. . . ."[12]

The holding of *Reid* is underscored by language in *State v. Felton*,[13] a case in which a county franchise granted to owners of a racetrack, issued pursuant to a local act of the legislature, was declared unconstitutional as in violation of both the "no exclusive emoluments" and "no monopoly" provisions. In distinguishing this case from *Reid*, the court stated:

> It should be noted that grants of well-defined monopolistic rights to regulated *quasi*-public utilities, including the power of eminent domain, under the public law, are upheld as being "in consideration of public service" within the terms of Art. I, sec. 7, of the Constitution of North Carolina. Indeed, such corporations have become known as "public service corporations." . . . Within the exception, *a fortiori*, is a municipal corporation, an agency of the State, created for the benefit of the public.[14]

For this last proposition, regarding municipal corporations, the court cited *Kornegay v. City of Goldsboro*,[15] and that case does hold that municipal corporations share the exemption of public utilities from the strictures of the "no exclusive emoluments" provision. The city's action complained of in that case was the sale of bonds at less than par pursuant to the state's municipal finance act. By extension of the court's reasoning, a city is exempt from the "no exclusive emoluments" provision when it provides public enterprise services such as water, electricity, and solid waste collection to the exclusion of private providers of those services. By further extension, if a city is exempt from the "no exclusive emoluments" provision when it provides public enterprise services itself, it is likewise exempt when it grants a franchise for the furnishing of those services to a private firm.

In *Madison Cablevision, Inc. v. City of Morganton*,[16] the court dealt again with the "no monopoly" and "no exclusive emoluments" provisions in the context of a local government franchise. In that case, Morganton did not renew the franchise of a private firm to provide cable television but rather decided to operate a cable television system itself. Among the constitutional provisions the firm alleged that the city violated were those prohibiting monopolies and exclusive emoluments except in consideration of public services. On the monopoly question, the court held that Morganton had not granted itself a monopoly because it was not the exclusive supplier of cable service. The court's reasoning on this point is difficult to follow. First, it is clear that as long as the city was providing the service, no other person, as a practical matter, would be able to provide the service. Second, the court seems to say that as long as the city has not decided to provide this service indefinitely, no monopoly has been created: "The City expressly left open the possibility that other cable companies could apply for and obtain a franchise in the future and committed itself to review the overbuild [?] situation five years after it issued its decision to operate a municipal system."[17] No matter how the court tried to cast the matter, the city had in fact, for five years, designated itself the exclusive provider of cable television service to its residents.

The court found no violation of the "no exclusive emoluments" provision on two grounds. First, it found the provision inapplicable to a city that provides services pursuant to authority granted by the legislature. Second, it held that even if the provision applied to the city, a city is a public service corporation within the meaning of the *Reid* decision, and therefore any services it provides on an exclusive basis do not violate the provision.[18] The court did not, however, explain how an exclusive provider of services such as cable television is not a monopoly; that is, the court did not reconcile its holdings under the "no exclusive emoluments" provision with its statements about the "no monopoly" provision.

Helpful light can be shed on the question of exclusive franchises by examining the court's attitude toward public utilities that are granted exclusive territorial service rights by a certificate of convenience and necessity. G.S. 62-110 requires that before a public utility[19] conducts business in a particular territory it must receive a certificate of convenience and necessity from the North Carolina Utilities Commission. In most situations these franchises are

11. JOHN V. ORTH, THE NORTH CAROLINA STATE CONSTITUTION: A REFERENCE GUIDE 75–76 (1993).

12. *Id.* at 76.

13. 239 N.C. 575, 80 S.E.2d 625 (1954).

14. 239 N.C. at 585, 80 S.E.2d at 633.

15. 180 N.C. 441, 105 S.E. 187 (1920).

16. 325 N.C. 634, 386 S.E.2d 200 (1989).

17. 325 N.C. at 654, 386 S.E.2d at 211.

18. 325 N.C. at 654–55, 386 S.E.2d at 212. The court cited the *Felton* case for this proposition.

19. Public utilities are gas and electric companies, telephone companies, certain suppliers of water and sewerage services, and certain transportation companies, N.C. GEN. STAT. § 62-3(23).

exclusive; that is, Carolina Power & Light cannot offer electrical services in a territory in which Duke Power Company is already doing business; nor—until very recently—could BellSouth provide local telephone service in an area in which General Telephone is already providing that service. These exclusive public utility franchises have never been invalidated under either the "no exclusive emoluments" or the "no monopoly" provisions. To the contrary, in several cases the court has extolled the virtues of such monopolistic arrangements. In *State ex rel. Utilities Comm'n v. General Telephone Co.*,[20] a case involving the allowable rates to be charged by a telephone company, the court stated: "The State has granted to the utility company a legal monopoly upon a service vital to the economic well being and the domestic life of the people of a large territory."[21] And again, in *State ex rel. Utilities Comm'n v. National Merchandising Corp.*,[22] a case in which the utilities commission's jurisdiction to regulate advertising on telephone directory covers was challenged, the court said: "This State has adopted the policy of granting to a telephone company a monopoly upon the rendering of telephone service within its service area."[23] Neither case mentioned either the "no exclusive emoluments" or the "no monopoly" provision of the constitution.

The court has, however, invoked those provisions when the legislature attempted to grant an exclusive franchise to a business that is not regulated as a public utility. In *In re Aston Park Hospital, Inc.*,[24] the court struck down a statute that required a certificate of need for hospital construction. In finding that such a requirement violated both the "no monopoly" and "no exclusive emoluments" provisions, the court distinguished the certificate of convenience and necessity required by G.S. 62-110 on the ground that the rates and fees charged by hospitals are unregulated. "[I]n those fields [public utilities] the State has undertaken to protect the public from the customary consequences of monopoly by making the rates and services of the certificate holder subject to regulation and control by the Utilities Commission. No comparable power to regulate hospital rates and services has been given to the Medical Care Commission."[25]

The lesson of *Aston Park Hospital* is that if a local government grants an exclusive franchise, it is essential that the terms of the franchise give the government control over the rates to be charged. This may be accomplished by establishing the initial rates to be charged in the franchise and then further requiring that all rate increases must be approved by the city or county governing board. The other essential element of an exclusive franchise appears to be some regulation of the services to be provided by the franchisee. Regarding solid waste collection services, such regulation might require, for example, that all households in the franchisee's territory must be offered the service, that the franchisee also collect white goods and yard waste, or that the franchisee offer curbside collection of recyclable materials.

Other States' Treatment of Exclusive Franchises

Judicial decisions from other states involving exclusive franchises granted by local governments are instructive. In *James Cable Partners, L.P. v. City of Jamestown*,[26] a city's grant of an exclusive franchise to a private firm for cable television service was held not to violate Tennessee's constitutional prohibition of monopolies. In *Ray v. City of Owensboro*,[27] the court upheld a municipality's grant of an exclusive ten-year franchise to a firm for the provision of ambulance services in the city. A competitor had challenged the franchise on the ground that it denied him property rights guaranteed by the Kentucky constitution. In *Bridges v. Yellow Cab Co., Inc.*,[28] a city's exclusive franchise for airport limousine service was upheld when challenged as being in violation of Arkansas's constitutional prohibition against monopolies. And in *Strub v. Village of Deerfield*,[29] a municipal ordinance that limited the number of licenses for garbage collection to two was held not to create a monopoly contrary to the Illinois constitution.

Conclusion

The general assembly has given cities and counties authority to grant exclusive franchises to private firms to perform certain public enterprise services, including solid waste collection and disposal. This authority includes the power to set or approve rates and charges and to regulate levels of service. If a city or county

20. 281 N.C. 318, 189 S.E.2d 705 (1972).
21. 281 N.C. at 335, 189 S.E.2d at 716.
22. 288 N.C. 715, 220 S.E.2d 304 (1975).
23. 288 N.C. at 725, 220 S.E.2d at 310.
24. 282 N.C. 542, 193 S.E.2d 729 (1973).
25. 282 N.C. at 550, 193 S.E.2d at 734.
26. 818 S.W.2d 338 (Tenn. App. 1991).
27. 415 S.W.2d 77 (Ky. 1967).
28. 406 S.W.2d 879 (Ark. 1966).
29. 167 N.E.2d 178 (Ill. 1960).

grants an exclusive franchise and exercises its authority to require the franchisee to furnish a certain level of service and to submit its rates to the governing board for approval, there is nothing in principle to distinguish such a franchise from an exclusive franchise granted to a utility under G.S. 62-110. Both franchises control the rates to be charged by the franchisee and thereby avoid one of the major risks inherent in monopolies. Both arrangements, in the court's terms, are exclusive emoluments granted in consideration of public service and legal monopolies.

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