Community and Economic Development in North Carolina and Beyond Blog: Using Utility Rates as an Economic Development Incentive Tool

By Kara Millonzi


This entry was posted on August 31, 2010 and is filed under Economic Development

Kara Millonzi is a School of Government faculty member.

A county (or municipality) is trying to attract two different commercial entities to locate within the unit. The first is a retail development complex which would be similar in size and function to existing retail development within the unit (ABC Company). The second is a landscaping business with an extensive plant and garden nursery (XYZ Company). There is no similar type of company currently located within the unit. The unit’s governing board is exploring its incentive options to attract either (or both) of the commercial entities. Negotiations with the entities reveal that they are both interested in, among other things, receiving significantly reduced (or even free) water rates, at least for a period of time. This incentive is particularly attractive to the unit’s governing board because the unit would not have to pay for this incentive out of its General Fund. And, the unit’s Water Enterprise Fund currently has a significant surplus so the reduced rates to the two commercial entities would not impact water fees for other customers.

Can the local government offer reduced utility rates to these two commercial entities as part of an economic development incentive package? The answer is no. Having said that, the unit may be able to approximate the same result through other means.

Utility Rate Classifications

North Carolina General Statutes §§ 160A-314 and 153A-277 expressly authorize municipalities and counties, respectively, to charge different rates for different “classes of service,” but the statutes provide little clear guidance on the differentiating factors needed to justify separate rate classifications. Under the common law, different rate classifications may reflect differences in the costs of providing services to certain customer groups. Additionally, rate classifications may be “based upon such factors as . . . the purpose for which the service or the product is received, the quantity or the amount received, the different character of the service furnished, the time of its use or any other matter which presents a substantial ground of distinction.” In other words, courts have upheld classifications for purposes of assessing different utility rates when there is a utility-based reason for the differentiation. However, classifications based on the type—or status—of the customer, or customer group, that do not relate to one of the above-listed purposes are not valid.

For example, a local unit may assess a different rate for water used for irrigation purposes than for household or other commercial purposes (classification based on the purpose for which the water is used), but it cannot charge a different rate to all farmers (classification based on status). A unit may vary its utility rates based on the size of the house or the number of bathrooms (proxies for different costs or capacity demands), but it may not charge a different rate based on customer income levels (classification based on status). Or, a unit may assess a different rate to customers who request service after a certain date (again, proxies for different costs or capacity demands), but it may not charge a different rate to a single business entity solely for purposes of offering an economic development incentive (classification based on status). For more information on lawful (and unlawful) utility rate classifications, see Local Finance Bulletin 33 (October 2006).

Economic Development Incentives

Are there any exceptions to this general rule? There are no explicit exceptions, but there are methods by which a local government may accomplish a similar result to discounting utility rates for economic development incentive purposes.

First, G.S. 158-7.1 provides broad authority for counties and municipalities to appropriate funds “for the purposes of aiding and encouraging the location of manufacturing enterprises, making industrial surveys and locating industrial and commercial plants . . . .” Under this authority, as part of an economic development incentive, a local government may
provide a cash grant to certain perspective commercial or industrial entities that reimburses the entities for all, or a portion, of their utility fees over a period of time. (My colleague, Tyler Mulligan, has blogged about the requirements (and limitations) of providing incentives pursuant to this statutory authority here.) A unit also may fund the extension of utility lines or facilities to serve the entity. The appropriations for such incentive programs must derive from the unit’s General Fund, however, not its enterprise fund(s).

Second, a unit may be able to provide discounted utility rates to one or more commercial entities if it has a valid, utility-based reason for establishing a separate rate classification for the particular commercial entity at issue. As stated above, a unit may create a different rate classification for its commercial customers (as opposed to its residential or industrial customers). It also may create sub-classifications within the commercial classification if, for example, it costs more to serve one or more commercial customers or one or more commercial customers uses the utility services for substantially different purposes.

Take the two commercial entities described above. Could the unit create a separate rate classification for ABC Company or XYZ Company for purposes of charging a different (lower) utility rate? Because the unit already has retail development, it likely could not create a separate rate classification that encompasses only ABC Company. Based on the information provided above, there is no reason to believe that there is a valid, utility-based reason to treat ABC Company differently than the existing retail development in the unit. Thus, the unit likely would have to charge ABC Company the same utility rate as it charges its other retail development.

The unit, however, may very well have a valid, utility-based reason for creating a separate rate classification for XYZ Company. Presumably, XYZ Company will need to use at least some water for irrigation purposes and, because of the nature of its business, also may be a uniquely high-volume customer. Thus, the unit likely is justified in charging a lower utility rate to XYZ Company than it charges to its other commercial entities. (Of course, if another landscape or similar business located within the unit, the unit would have to charge the new business the same rate as it charges XYZ Company.)