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REGULATORY FEES: CAN NONRESIDENTS BE CHARGED MORE THAN RESIDENTS?

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Regulatory fees are fees charged by local governments for the regulatory services they provide, such as issuing building permits, reviewing subdivision plans, or performing building inspections. The general purpose of these fees is to recover some or all of the costs associated with regulatory services, including costs for processing permit applications or conducting building inspections.[1] Regulatory fees are related to, but different from, what are typically termed "user fees." User fees are "charges to those who voluntarily receive governmental services or use governmental facilities."[2] Examples include fees for using public parks or swimming pools and fees for garbage collection.

While local governments in North Carolina can charge both regulatory and user fees,[3] the imposition of such fees is subject to constitutional limitations. In particular, if local governments wish to charge nonresidents higher fees than they charge residents, they must abide by the strictures of the Equal Protection, Privileges and Immunities, and Commerce clauses of the United States Constitution. Many courts have examined this issue in the context of user fees.[4] To date, however, no court has specifically addressed this issue as it applies to

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1. *See* DAVID M. LAWRENCE, LOCAL GOVERNMENT FINANCE IN NORTH CAROLINA § 311(A) (2d ed. 1990).

2. *Id*. at § 309.

3. *Id*. at § 309 and Appendix E (user fees); *see also* discussion of regulatory fees, *infra* p. 2. For example, N.C. Gen. Stat. § 160A-314 (hereinafter G.S.) grants cities the power to charge user fees for services furnished by public enterprises, such as solid waste collection and disposal services. Counties have similar powers.

4. *See, e.g*., Barber v. Hawaii, 42 F.3d 1185 (9th Cir. 1994) (charging higher boat mooring fees to nonresidents upheld as method of equalizing burden of supporting facilities); Borough of Neptune City

regulatory fees. This bulletin examines the constitutionality of imposing on nonresidents higher regulatory fees than those imposed on residents.

North Carolina Supreme Court Has Upheld Regulatory Fees

Local governments in North Carolina have not been explicitly granted the power to impose regulatory fees through enabling legislation.[5] For example, Chapter 160A, Section 296(a)(4) of the North Carolina General Statutes grants cities the power to close streets or alleys but says nothing about whether the city may charge a fee for that service. However, the North Carolina Supreme Court has held that, notwithstanding the lack of explicit statutory authority, local governments do have the power to charge regulatory fees.[6] In a 1994 case, the court found that regulatory fees for things such as commercial driveway permit reviews, subdivision reviews, permanent street closings, and other services amounted to a valid exercise of a city's police power, as the charging of these fees is "reasonably necessary or expedient to the execution of the City's power to regulate the activities for which the services are provided."[7] Cities may impose these fees so long as they are reasonable and the city has the power to regulate the underlying activity.[8] The court did not specifically address whether counties also had this power; however, given the similarity of the statutory provisions relating to city and county powers, they most likely do.[9]

The court found that it was "generally accepted" among other state courts that the power to regulate implied the power to impose a fee "in an amount sufficient to cover the cost of regulation."[10] Fees that are higher than the cost of regulation, whether charged to residents or nonresidents, are presumably invalid.[11] Under the court's reasoning, fees for nonresidents may be higher than fees for residents if the cost of regulation is higher for nonresidents than residents.[12] The court's interpretation also leaves open the possibility that nonresidents may be charged more than residents so long as the charge does not exceed the cost of regulation. For example, a city may charge nonresidents the full cost of regulating an activity, while charging residents a discounted rate based on their contribution to provision of the service through local taxes. This interpretation may be permissible under state law, but it probably violates the United States Constitution.

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v. Borough of Avon-by-the-Sea, 294 A.2d 47 (N.J. 1972) (charging higher beach fees to nonresidents invalidated).

5. *See* LAWRENCE, *supra* note 1, at § 311(A).

6. Homebuilders Ass'n of Charlotte v. City of Charlotte, 336 N.C. 37, 442 S.E.2d 45 (1994). *See also* Brooks v. Tripp, 135 N.C. 159, 47 S.E. 401 (1904) (indicating support for regulatory fees). Note that the *Homebuilders* court does not, for the most part, call these fees regulatory fees. The majority and the city term the fees involved "user fees," though they clearly fit the definition of regulatory fees discussed *supra* p. 1. And at one point, the court does refer to them as "regulatory user fees." *Homebuilders*, 336 N.C. at 45, 442 S.E. at 50. The dissent believes that the fees are not user fees, but are rather the unconstitutional imposition of a tax on a small segment of the population for activities that benefit the entire population. *Id*. at 48, 442 S.E. at 52. Whatever the name of the fee, the majority clearly validated the regulatory fee concept as defined for the purposes of this bulletin.

7. *Homebuilders*, 336 N.C. at 45, 442 S.E. at 50.

8. *Id.* at 46, 442 S.E. at 51.

9. The court relied on G.S. 160A-4 to make its decision, finding that the powers of a city should be broadly construed: "[T]he provisions of this chapter . . . shall be broadly construed and grants of power shall be construed to include any additional and supplementary powers that are reasonably necessary or expedient to carry them into execution and effect. . . ."

For example, the power of the city to require building permits implies the power to charge for their issuance. The analogous provision for counties is G.S. 153A-4, which is worded differently: "[T]he provisions of this chapter . . . shall be broadly construed and grants of power shall be construed to include any powers that are reasonably expedient to the exercise of this power."

The words *additional*, *supplementary*, and *necessary* are missing from G.S. 153A-4. This could provide fodder for the argument that counties do not have as much discretion as cities, and that the power to levy regulatory fees is not "reasonably expedient" to the exercise of the regulatory power and is therefore not within the power of a county. However, a widely accepted interpretation holds that counties do have this power.

10. Homebuilders, 336 N.C. at 42, 442 S.E. at 49.

11. *See id*.; EUGENE MCQUILLIN, THE LAW OF MUNICIPAL CORPORATIONS § 26.32.20 (3d ed. 1996).

12. But it is unlikely that it would cost more to review, for example, the commercial driveway permit of a nonresident than that of a resident.

Discrimination against Nonresidents—Constitutional Issues

Nonresidents clearly can be bound by the regulations of a city or county in which they do not live.[13] Local governments must regulate nonresidents carefully, however, as discriminating against them can raise several constitutional issues. In particular, regulatory fees that are higher for nonresidents than for residents could implicate the federal Constitution's Equal Protection Clause, Privileges and Immunities Clause, and/or Commerce Clause.

Equal Protection Clause

The Fourteenth Amendment to the United States Constitution contains the Equal Protection Clause (EPC), which provides that no state shall "deny to any person within its jurisdiction the equal protection of the laws." States and localities may permissibly classify groups of people, however, and treat those groups differently under their laws, if certain standards are met. The United States Supreme Court[14] uses different levels of review when deciding whether such classifications are permissible under the EPC.[15] Most classifications are judged using the *rational basis* standard of review, which is most deferential to state and local lawmaking bodies: A state/locality law will be upheld by the Supreme Court so long as there is a rational basis for its enactment. Suspect classifications—those based on race, alienage, national origin, or sex—and classifications that infringe on fundamental rights, such as the right to travel, trigger a heightened form of review termed *strict scrutiny*: To pass constitutional muster, laws involving such classifications must be narrowly tailored and backed up by a compelling state interest.[16] Therefore if differential regulatory fees impact a suspect class or infringe on a fundamental right, they will be judged under strict scrutiny. [*Note: Both standards of review are discussed in more detail below*.]

13. MCQUILLIN, *supra* note 11, at § 26.48.

14. Throughout this bulletin, the U.S. Supreme Court is referred to as the Supreme Court or simply as the Court. Reference to the North Carolina Supreme Court or to supreme courts of other states will be explicit.

15. *See generally* LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW § 16 (2d ed. 1988). Intermediate scrutiny, the newest addition to the Court's arsenal, is not applicable to this issue and is not discussed in this bulletin.

16. Nordlinger v. Hahn, 505 U.S. 1, 10 (1992).

Has the Right to Travel Been Infringed, thus Triggering Strict Scrutiny?

Nonresidents have never been found to constitute a suspect class.[17] Therefore for strict scrutiny to be invoked in cases dealing with regulations that treat nonresidents differently, the regulation must infringe on the exercise of a fundamental right. Because the right to travel has been deemed a fundamental right, its infringement will trigger strict scrutiny.[18] But the Supreme Court has offered only a few examples of state or local legislation which actually rose to the level of *infringing upon* the right to travel, and most of these cases involved discrimination against new residents to an area, not nonresidents. The Court distinguishes between "bona fide residence requirements, which seek to differentiate between residents and nonresidents, and residence requirements . . . which treat established residents differently based on the time they migrated into the State."[19] The latter are often unconstitutional, but the former are acceptable as they further "the substantial state interest in assuring that services provided for residents are enjoyed only by residents. . . [Those requirements generally do] not burden or penalize the constitutional right of interstate travel, for any person is free to move to a State and establish residence there."[20]

Differential regulatory fees do not fit neatly into either category. Certainly these fees do not vary based on *length* of residence, and thus are not automatically constitutionally suspect. However, these fees are not exactly *bona fide residence requirements*, since nonresidents can pay a (different) fee and receive the same service as residents; residence is not required to receive a particular service, it just lowers the cost to the

17. *See* Barlow v. Town of Wareham, 517 N.E.2d 146, 150–51 (Mass. 1988).

18. *See Nordlinger*, 505 U.S. 1.

19. Attorney General of N.Y. v. Soto-Lopez, 476 U.S. 898, 904 n.3 (1986) (citations omitted).

20. *Id.* (citing Martinez v. Bynum, 461 U.S. 321 (1983)). Note, however, that at least one state court has found the right to travel to have been infringed when nonresidents were discriminated against. A Texas statute made nonsupport of minor children a misdemeanor for state residents but made it a felony for nonresidents. A state appeals court found that this distinction infringed on the right to travel and ruled that the statute was invalid because the classification wasn't necessary to further the compelling state interest urged in support of the statute (extradition). *Ex parte* Boetscher, 812 S.W.2d 600 (Tex. Crim. App. 1991).

consumer.[21] The question of whether there is a "substantial state interest in assuring"[22] that services are provided for everyone but enjoyed at low cost only by residents has never been squarely addressed.[23]

Thus it is not clear whether the Supreme Court would find that differential regulatory fees implicate the right to travel. And even if the right to travel is found to have been implicated, this may not be enough to trigger strict scrutiny. Only regulations that actually "jeopardize" the exercise of the right to travel will be subject to such heightened review.[24] Unless the fee differential is very large, higher fees for nonresidents may be found to not jeopardize the right to travel; a fee must amount to a "significant 'penalty' on the right to travel;" not just be "merely 'uncomfortable,' " before a court will find that the right has been infringed and that heightened review is thus necessary.[25]

However, if a fee for nonresidents was found to significantly penalize travel and to thus trigger heightened review, it is doubtful that the ordinance would be upheld.[26] To pass strict scrutiny review, the ordinance must be necessary to promote a compelling state interest[27]—localities must have a compelling reason for charging nonresidents more, and the ordinance must be necessary to promote that purpose. For example, if the reason given for a fee differential is to slow rampant development, then the ordinance would likely fail.[28] If slowing growth is the state's goal, it doesn't make much sense to treat residents and nonresidents differently, as they both contribute to growth problems, unless it can be shown that nonresidents pose a particular problem that can be dealt with only by charging them higher fees.

Differential fees may survive strict scrutiny review if recouping the true cost of regulation is argued to be a compelling state interest and the court finds this to be the case. Differential fees may be found necessary to promote that interest only if the government can prove (1) that it costs more to regulate nonresidents or (2) that residents pay for the service through local taxes, while nonresidents do not. This is a much higher standard than the one used under rational basis review, discussed below.

Rational Basis Review

If heightened review is not triggered, local government regulations that charge nonresidents higher regulatory fees than residents will be examined under the lowest level of equal protection scrutiny. Such regulations must only "rationally further a legitimate state interest."[29] Under rational basis review, the Court uses a two-step approach: First, the court determines whether the legislation is backed up by a legitimate state interest. If the court finds that it is, then, second, the question of whether the legislation at issue rationally furthers that interest is addressed.

Legitimate state interest. Pertaining to the first step in rational basis review, most courts hold that discriminating against nonresidents or favoring residents over nonresidents does not constitute a legitimate purpose for enacting legislation.[30] Local governments cannot charge higher fees to nonresidents, because nonresidents cannot vote in local elections or otherwise effectively protest the higher charge. There must be some factor flowing out of residential status that differentiates between the two classes of citizens—there must be a legitimate purpose behind the discrimination.

An example of such a purpose is found in cases where regulating nonresidents costs more than regulating residents. In such instances, the purpose of charging higher fees to nonresidents is to recoup the

21. It is doubtful that requiring residency before issuing building permits would be found constitutional, though that analysis is beyond the scope of this writing.

22. *Soto-Lopez*, 476 U.S. at 904 n.3.

23. One commentator has noted, however, that if states can prohibit access to services by nonresidents altogether, surely they can impose higher fees on nonresidents for such access as well. Dan T. Coenen, *State User Fees and the Dormant Commerce Clause*, 50 VAND. L. REV. 795, 802, 814 (1997).

24. Nordlinger v. Hahn, 505 U.S. 1, 10 (1992).

25. *See* Hawaii Boating Ass'n v. Water Transp. Facilities Div., 651 F.2d 661, 665 (9th Cir. 1981) (citations omitted).

26. *See* TRIBE, *supra* note 15 §16-6.

27. *See, e.g.*, King v. New Rochelle Mun. Hous. Auth., 442 F.2d 646 (2d Cir.), *cert. denied*, 404 U.S. 863 (1971).

28. This argument assumes that a court would find slowing growth to be a legitimate state purpose.

29. *Nordlinger*, 505 U.S. at 10; *accord*, Richardson v. North Carolina Dep't of Correction, 345 N.C. 128, 478 S.E.2d 501 (1996).

30. *See* Little v. Miles, 204 N.C. 646, 169 S.E. 220 (1933) (holding that it is unconstitutional to arrest a nonresident for a crime for which a resident would not be arrested); State v. Williams, 158 N.C. 610, 73 S.E. 1000 (1912) (finding it unconstitutional to impose a privilege license tax on nonresidents only); City of Maitland v. Orland Bassmasters Ass'n, 431 So. 2d 178 (Fla. Dist. Ct. App. 1983), *petition for review denied*, 440 So. 2d 351 (Fla. 1983) (finding that assuring close parking spaces for residents is not a rational basis for excluding nonresidents from a parking area).

true cost of providing a service to them, not to discriminate against them. Several courts have also deemed the conservation of natural resources a rational basis for treating nonresidents differently from residents; nonresidents may be less likely to have a stake in a particular resource and may therefore be less concerned about its conservation.[31]

In the context of "user fees," it is clear that differential fees must only have "a rational relation to a legitimate state objective."[32] Because of this lower threshold, differential user fees for nonresidents are often upheld by the courts.[33] Local governments typically justify higher user fees for nonresidents by arguing that residents already pay for services through local taxes, thus charging nonresidents more simply equalizes their contribution.[34] The same reasoning could be used to justify differential regulatory fees. Local governments could argue, for example, that residents already pay for the cost of subdivision review in their local taxes, therefore the purpose of differential fee schedules for nonresidents is to equalize the burden of paying for such a service.

Rationality. Once a legitimate purpose is identified, local governments need not show that their legislation *did or will further* that purpose; they need only show that they *would be reasonable to think* that the purpose would be furthered.[35] The Supreme Court will uphold legislation that makes classifications based on residency "if there is any reasonably conceivable state of facts that could provide a rational basis for the classification."[36] In fact, when dealing with economic policy legislation, the Court has gone so far as to state that "those attacking the rationality of the legislative classification have the burden to negative every conceivable basis which might support it."[37]

This part of the rational basis test is very deferential to the legislative body. For example, one court held that relieving congestion at crowded municipal facilities is a legitimate purpose and that excluding nonresidents is a rational way to further that goal.[38] This court did not address whether it might have been more rational to limit the number of residents as well or to use some sort of ratio; no other alternatives were discussed. The court simply found that there was a conceivable basis for the city's action. As deferential as this part of the test is, legislation is sometimes invalidated under it. For example, the Alaska Supreme Court invalidated a borough ordinance establishing a lottery to sell borough-owned lands. The stated purpose of the lottery was to sell the lands to adjacent property owners so that conflicting claims of title could be cleared up. However, the borough did not allow nonresident owners, who owned 56 percent of the adjacent property, to participate. The court found that excluding such a large segment of the owners did not rationally further the goal of clearing up title.[39]

If the court accepts equalizing the tax burden for nonresidents as a legitimate purpose for differential regulatory fees, then it is doubtful the regulation would fail the second part of the rational basis test: The government need not prove that *there is in fact* a differential tax burden on residents and nonresidents, nor must it prove that the legislative scheme *actually equalizes* the burden. It is enough to prove that the legislative body *could have rationally believed* that such outcomes could come to pass.[40]

In a differential fee case, if the purpose is found to be legitimate and charging nonresidents more is found to rationally further that purpose, then challengers must essentially make the case that the amount of the fee is irrational. This is often a high hurdle, as the challengers have "the very difficult burden of showing

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31. *See* Baldwin v. Fish & Game Comm'n of Mont., 436 U.S. 371 (1978); Barlow v. Town of Wareham, 517 N.E.2d 146 (Mass. 1988); Maine v. Norton, 335 A.2d 607 (Me. 1975).

32. Barber v. Hawaii, 42 F.3d 1185, 1196 (9th Cir. 1994).

33. *See* Edward L. Winn, *Restricting Nonresident Use of Public Parks*, LOC. GOV'T L. BULL. No. 6 (Institute of Government, 1976).

34. *See Barber*, 42 F.3d 1185; LCM Enters., Inc. v. Town of Dartmouth, 14 F.3d 675 (1st Cir. 1994); Hyland v. Borough of Allenhurst, 372 A.2d 1133 (N.J. Super. Ct. App. Div. 1977), *modified*, 393 A.2d 579 (N.J. 1978).

35. *See* Tribe, *supra* note 15 § 16-3.

36. *See, e.g.*, FCC v. Beach Communications, 508 U.S. 307, 313 (1993); Clajon Prod. Corp. v. Petera, 70 F.3d 1566 (10th Cir. 1995).

37. *Beach Communications*, 508 U.S. 315 (internal quotation marks and citation omitted).

38. Schreiber v. City of Rye, 278 N.Y.S.2d 527 (Sup. Ct. 1967) (excluding nonresidents avoids "excessive congestion which would result in a breakdown of the facilities, and a deterioration thereof." *Id*. at 528.).

39. Gilman v. Martin, 662 P.2d 120 (Alaska 1983).

40. *See* LCM Enters., Inc. v. Town of Dartmouth, 14 F.3d 675 (1st Cir. 1994). However, if nonresident property owners are charged a higher fee for a service, and they pay local property taxes (a fact local government officials should be aware of), then it may not be rational to believe that tax burdens are unequal. *See also "PIC Requirements," infra* p. 7.

that a government's financial planning, calculation and analysis is unreasonable to the point of irrationality. . . [Challengers] cannot sustain this burden if the record evidences any reasonable basis for [the city] to believe that" the facts they relied on in setting the level of the fee were true.[41]

Summary

Most likely, differential regulatory fees will be judged under the lenient rational basis standard of review. An ordinance establishing such fees will be upheld so long as a local government tried to further a legitimate state interest by enacting it, and did so rationally. Possible legitimate interests include the goals of recouping the full cost of regulation and equalizing the burdens placed on residents and nonresidents. These goals are rationally furthered by charging nonresidents higher fees if the government could reasonably believe that (1) it costs them more to regulate nonresidents or (2) residents already pay for the services at issue through other taxes. The government would not have to prove that either scenario actually exists; it would just have to show that it is rational to think either could exist.

Privileges and Immunities Clause

The Privileges and Immunities Clause (PIC) of the United States Constitution mandates that "[t]he citizens of each state shall be entitled to all privileges and immunities of citizens in the several states."[42] The PIC bars "discrimination against citizens of other States where there is no substantial reason for the discrimination beyond the mere fact that they are citizens of other States. But it does not preclude disparity of treatment in the many situations where there are perfectly valid independent reasons for it."[43]

Does the PIC Apply?

State statutes and municipal ordinances are both subject to the strictures of the PIC,[44] but the clause may only be enforced by out-of-state citizens: Aliens and corporations are excluded from coverage,[45] as are in-state residents.[46] The PIC protects only the rights of residents of one state as against the rights of residents of another state[47] and requires equal treatment of residents and nonresidents "[o]nly with respect to those 'privileges' and 'immunities' bearing on the vitality of the nation as a single entity."[48] The PIC has been said to protect only "fundamental rights."[49]

The Supreme Court has never heard a PIC case involving differential regulatory fees, and it is therefore unclear whether equality of regulatory fees is one of the privileges and immunities protected by the PIC. Taxing schemes,[50] commercial fishing license fees,[51] and privilege taxes on doing business[52] that discriminate against nonresidents have all been subject to PIC scrutiny and have all been struck down by the Supreme Court. In contrast, however, the Court has held that differential recreational hunting license fees do not implicate the PIC,[53] and a lower court has held that the PIC does not protect "the right to live in a regularly shaped congressional district."[54]

The PIC is clearly implicated when fundamental rights are infringed.[55] If the right to travel is found to be infringed by differential regulatory fees,[56] then a PIC analysis is appropriate.[57] Other aspects of a differ-

41. *LCM Enters.*, 14 F.3d at 680.

42. U.S. CONST. art. 4, § 2.

43. Toomer v. Witsell , 334 U.S. 385, 396 (1948).

44. United Bldg. & Constr. Trades Council v. Mayor & Council of Camden, 465 U.S. 208 (1984).

45. *See* TRIBE, *supra* note 15 § 6-35 n.92.

46. Diane M. Allen, Annotation, *Supreme Court's Construction and Application of Privileges and Immunities Clause of United States Constitution,* 79 L. Ed.2d 918, 926 § 2[b] (regarding *United Bldg. & Constr*., 465 U.S. 208, 79 L.Ed.2d 149 (1984)). For example, residents of High Point cannot sue the city of Charlotte under the PIC, but residents of the state of South Carolina can. In addition, since corporations are not protected, if an ordinance discriminates only against out-of-state corporations and violates no other provision of the Constitution, the PIC will not bar such discrimination. It is unlikely that such a discriminatory ordinance would withstand Commerce Clause scrutiny, however. *See infra* p. 8.

47. *See generally* Tribe, *supra* note 15 § 6-34.

48. Baldwin v. Fish & Game Comm'n of Mont., 436 U.S. 371, 383 (1978) (citations omitted).

49. Allen, *Supreme Court's Construction, supra* note 46 § 7 [a].

50. *Id.* § 7[c].

51. *Id.* § 14[a].

52. *Id.* § 13.

53. *See Baldwin,* 436 U.S. 371.

54. Pope v. Blue, 809 F. Supp. 392, 399 (W.D.N.C. 1992), *aff'd*, 506 U.S. 801 (1992).

55. *See* TRIBE, *supra* note 15 § 6-34.

56. *See* discussion on the right to travel and the Equal Protection Clause *supra* p. 3.

57. *See* TRIBE, *supra* note 15 § 6-34; Ward v. Maryland, 79 U.S. (12 Wall.) 418 (1870).

ential fee issue may also trigger application of the PIC. The Supreme Court has held that "one of the privileges which the clause guarantees to citizens of State A is that of doing business in State B on terms of substantial equality with the citizens of that State."[58] The Court has also held that the clause protects the rights "to take and hold real estate"[59] and to be exempt "from higher taxes or impositions than are paid by the other citizens of the state."[60]

Taken together, these statements indicate that the Court may be willing to include the right to obtain building permits or subdivision reviews as privileges or immunities protected by the clause. Differential fees for such services are "higher . . . impositions than are paid by the other citizens of the state,"[61] and charging higher fees assures that nonresidents cannot do business "on terms of substantial equality" with residents.[62] Nonresidents who wish to build homes are put at a disadvantage if building permit fees are higher for them than they are for residents. In addition, the right to build on property is closely associated with the right "to take and hold real estate."[63]

The right to equal access to regulatory services is certainly more "basic to the maintenance and well-being of the Union" than the right to hunt at the same price as residents.[64] Still, no Supreme Court case has ever discussed regulatory fees in the context of the PIC, and it is possible that the Court would find that the PIC does not protect against this sort of discrimination.

PIC Requirements

In its most recent formulation of the applicable test, the Supreme Court has stated that laws that discriminate against nonresidents will be upheld under PIC scrutiny only if (1) there is a "substantial reason" for the differential treatment given to nonresidents and (2) the differential treatment "bears a substantial relationship to the State's objective" in enacting the legislation.[65] "Substantial" reasons accepted by the Court in previous cases include equalizing the burden—between residents and nonresidents—of providing for the programs at issue and charging nonresidents higher fees because regulating them costs the state more.[66] Nonresidency alone is not a substantial reason for disparate treatment.[67]

Rationally furthering a legitimate objective (a standard used in rational basis analysis under the EPC and discussed on page 5) is not enough to survive analysis under the PIC. Local governments cannot just assume "that any means adopted to attain valid objectives necessarily squares with the privileges and immunities clause."[68] Instead there must be a "fairly precise fit between remedy and classification."[69] For example, conserving shrimp may be a valid objective, but charging nonresidents a fee equal to 100 times the fee paid by residents for a shrimping license is not a tight enough fit to achieving that goal.[70]

Residency requirements for bar membership have also been struck down by the Court because, under the test discussed above, the fit was not precise enough. In one such case, the Virgin Islands proffered the following reasons why nonresidents should not be allowed to become members of the local bar: telephone and airline service to the island was irregular; there were problems with accommodating the schedules of nonresident attorneys; nonresidents lacked access to recent statutes, regulations, and court opinions; there was a lack of American Bar Association resources for managing a nationwide bar membership; and nonresidents would have problems complying with a local rule that required all attorneys to represent indigent criminal defendants on a regular basis.[71] The Court ruled that none of the justifications were sufficient to preclude nonresident membership to the bar.[72]

In a recent Fourth Circuit case, the Commonwealth of Virginia tried to justify a differential fishing license fee by arguing that a higher charge for nonresidents equalized contributions made by residents and nonresidents toward the maintenance of commonwealth fisheries.[73] The court assumed but did not decide that equalizing the burden was a substantial state interest for purposes of the PIC. Even assuming the validity of the statute's purpose, it still failed constitu-

58. Toomer v. Witsell, 334 U.S. 385, 396 (1948).

59. *Ward*, 79 U.S. (12 Wall.) at 430.

60. Austin v. New Hampshire, 420 U.S. 656, 661(1975).

61. *Id.*

62. *Toomer*, 334 U.S. at 396.

63. *Ward*, 79 U.S. (12 Wall.) at 430.

64. Baldwin v. Fish & Game Comm'n of Mont., 436 U.S. 371, 388 (1978).

65. Lunding v. New York Tax Appeals Tribunal, ____ U.S. ____, 118 S. Ct. 766, 774 (1998).

66. *See* TRIBE, *supra* note 15 § 6-35.

67. *See, e.g.*, State v. Nolfi, 358 A.2d 853 (N.J. Hudson County Ct. 1976).

68. Toomer v. Witsell, 334 U.S. 385, 398 (1948).

69. TRIBE, *supra* note 15 § 6-35.

70. *See Toomer*, 334 U.S. 385.

71. Barnard v. Thorstenn, 489 U.S. 546, 553–54 (1989).

72. *Id.* at 553.

73. Tangier Sound Waterman's Ass'n v. Pruitt, 4 F.3d 264 (4th Cir. 1993).

tionally because Virginia made no showing that residents and nonresidents currently contributed unequally to the program or that the additional charge would actually equalize contributions.[74] If the court had been viewing this under EPC rational basis review, it would not have looked to the validity of the underlying facts as it did here, under PIC review.[75]

To pass PIC scrutiny, local governments seeking to impose higher fees on nonresidents for the purpose of equalizing their contributions to the program at issue must justify the imposition *by reference to actual facts*. Although the existence of such facts may be assumed under EPC analysis, under PIC analysis, courts will require at least some showing that the facts alleged as justification for a higher fee are true. Residents must indeed be contributing more to the program, and the fee imposed on nonresidents must actually equalize that burden. For example, if nonresident property owners who pay local property taxes are the subject of a higher regulatory fee, then the local government must include in their calculations of that fee the contribution nonresidents make to the program through their property taxes. Likewise, if the reason for the higher fee is that it costs more to regulate nonresidents, local governments should also be prepared to present facts that clearly support that proposition.

Commerce Clause

The Commerce Clause of the United States Constitution grants Congress the power "[t]o regulate commerce . . . among the several states."[76] The Supreme Court interprets this phrase to mean that while Congress has the power to regulate interstate commerce, states can regulate it as well, so long as this state regulation does not unduly burden or discriminate against interstate commerce.[77] Legislation that on its face discriminates "against interstate commerce in favor of in-state interests results in almost per se invalidity."[78] Before analyzing regulatory fees under the Commerce Clause, however, an important threshold issue must be decided: Is what is at issue commerce to begin with? This question is integral because for the Commerce Clause to apply, there must be some underlying commerce that is being regulated.

74. *Id.* at 267.

75. *See* discussion of rational basis review *supra* p. 5.

76. U.S. CONST. art. I, § 8.

77. TRIBE, *supra* note 15 § 6-5.

78. Richard J. Roddewig & Glenn C. Sechen, *The Second Circuit Defines the Limits of* Carbone, 28 URB. LAW. 847, 848 (1996).

Is This Commerce?

The dictionary defines commerce as the "buying and selling, or exchange, of commodities, involving transportation from place to place."[79] At the most basic level, the imposition of regulatory fees involves the sale of commodities under this definition. A commodity is "anything bought and sold" or "any useful thing."[80] That definition is broad enough to include permits issued by a city for a fee. For example, fees are imposed upon developers (the buyers) who wish to procure a development permit (the commodity) from the town (the seller). Granted, these are not typical commodities, such as soybeans or computers, but permits are commodities nonetheless.

Fees imposed for city services, such as building inspections or subdivision reviews, also fall under the commodities definition. One commentator has noted that the Commerce Clause unquestionably applies to the sale of services by a state, such as waste disposal and "agricultural or small-business consulting services."[81] While such services are different from what one normally considers services—because state officials don't just offer the services, they require citizens to buy them if they want to pursue a regulated activity—the end result is still a sale of commodities. Developers buy these services, just as they would buy services from a general contractor.

Even if city permits and services are not defined as commodities, they would probably still qualify as commerce. Courts construe the term commerce broadly, finding that it includes "the purchase, sale, or exchange of commodities . . . *and all the instrumentalities by which such intercourse is carried on.*"[82] City permits and services are the instrumentalities that allow interstate commerce to be carried on. Without building permits or building inspections, for example, developers could not engage in the sale of housing units. Therefore such permits and services amount to commerce.

Regulation or Tax?

Once it is determined that commerce is involved, the next step is to classify the commerce: Is it a state regulation or is it a state tax? The Supreme Court uses different approaches when examining these two types

79. 15A AM. JUR. 2d *Commerce* § 3 (1976).

80. WEBSTER'S NEW WORLD DICTIONARY OF THE AMERICAN LANGUAGE 295 (College ed. 1960).

81. Coenen, *State User Fees*, *supra* note 23, at 807 n.59.

82. 15A AM. JUR. 2d *Commerce* § 3 (1976).

of commerce under the Commerce Clause, so proper classification is crucial.

[S]tate tax cases are controlled by the four-part test set forth in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). Under this test, a state tax survives a Commerce Clause challenge only if it "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." In contrast, the Court has examined cases that involved state regulatory measures by using a different, " 'two-tiered' approach." Under this analysis, the Court first determines whether the challenged policy "regulates evenhandedly with only 'incidental' effects on interstate commerce, or discriminates against interstate commerce." [The Court] then applies the operative legal test: "If a restriction on commerce is discriminatory, it is virtually per se invalid. By contrast, nondiscriminatory regulations that have only incidental effects on interstate commerce are valid unless 'the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.' "[83]

Taxes are typically thought of as general revenue raising measures, not payments "for some specific privilege or service."[84] Fees for permits and services fit the latter categorization and are more like user fees, which are regulatory measures. The Supreme Court has defined user fees as "specific charge[s] imposed by the State for the use of state-owned or state-provided transportation or other facilities and *services*."[85] These charges are "assessed to reimburse the State for costs incurred in providing specific quantifiable services. . . ."[86] Permit and service fees are not imposed as a general revenue raising measure but for the purpose of recovering the costs of regulation of a specific privilege or service. This view of the aim of regulatory fees is mandated by the North Carolina Supreme Court.[87] Therefore the fees cannot be taxes but instead must be classified as a general regulatory measure.

As stated above, the first step of Commerce Clause analysis of a regulatory measure is to determine whether the measure on its face discriminates against interstate commerce. If it does, it is almost certainly invalid. The fees at issue do explicitly discriminate against interstate commerce by charging nonresidents more than residents for the same service, thus discouraging out-of-state applications. This regulatory scheme, which results in "differential treatment of in-state and out-of-state economic interests . . . is [therefore] virtually *per se* invalid."[88] As the Court has stated, "special fees assessed on nonresidents directly by the State when they attempt to use local services impose an impermissible burden on interstate commerce."[89]

In order to overcome this presumption of invalidity, a local government must "demonstrate both that the statute 'serves a legitimate local purpose,' and that this purpose could not be served as well by available nondiscriminatory means."[90] Possible legitimate local purposes for regulatory fee differentials have been discussed in previous sections of this bulletin. If the purpose is to recoup the cost of regulation and it does in fact cost more to regulate nonresidents than to regulate residents, then there is no nondiscriminatory means by which to accomplish that legitimate purpose, and the differential fees should stand. Similarly, if the purpose is to equalize resident/nonresident contributions toward the provision of a service and residents do in fact pay more through local taxes, then there is no nondiscriminatory way to equalize contributions: Differential fees must be imposed. However, if the purpose is to slow growth, the fees will most likely be invalidated. This is because there is a nondiscriminatory means available for slowing growth, namely, charging both residents and nonresidents the same fee.

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83. Coenen, *State User Fees*, *supra* note 23, at 808 (footnotes omitted).

84. MERTENS LAW OF FEDERAL INCOME TAX § 27:01 (1997).

85. Commonwealth Edison Co. v. Montana, 453 U.S. 609, 621 (1981) (emphasis added).

86. *Id*. at 622 n.12.

87. *See* Homebuilders Ass'n of Charlotte v. City of Charlotte, 336 N.C. 37, 442 S.E.2d 45 (1994), *and* "North Carolina Supreme Court Has Upheld Regulatory Fees," *supra* p. 2.

88. Oregon Waste Sys., Inc. v. Department of Envtl. Quality of Or., 511 U.S. 93, 99 (1994). *See also* MCQUILLIN, *supra* note 11 § 19.73: A regulatory fee "is not an unconstitutional interference with interstate commerce, and is valid, where the ordinance is an exercise of the police power . . ., where the purpose of the [fee] is to make the exercise of the police power effective by contributing to its administration or financing, *and where the ordinance is not discriminatory as against nonresidents or interstate commerce*." (emphasis added).

89. Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, ___, 117 S. Ct. 1590, 1599 (1997).

90. Maine v. Taylor, 477 U.S. 131, 138 (1986) (citation omitted).

The Market Participant Exception

There is one category of cases to which the above analysis does not apply. If a local government is considered a "market participant," then the Commerce Clause is not invoked.[91] This is due to the fact that when local governments *merely participate in the market*, they are not "interfering with the natural functioning of an interstate market," and therefore the Commerce Clause has no relevance.[92]

Local governments do not act as market participants when imposing regulatory fees of the sort discussed in this bulletin. There is no properly functioning market for building (and other) permits: local governments have a monopoly over that commodity, and as one commentator has suggested, the market-participant doctrine should not apply when a state-run monopoly is involved.[93] In such a case, the government is not merely participating in the market but has created the market and set its entry fees and prices.

Conclusion

The North Carolina Supreme Court has confirmed that local governments can charge fees for regulatory services.[94] However, those fees must be reasonable, in that they are set at a level meant to "defray the costs of regulation."[95] Local governments cannot, therefore, set regulatory fees for either residents or nonresidents at levels higher than the actual costs of regulation. Local governments should be prepared to back up the amount of the fee charged as well, as the Court has indicated a willingness to investigate how the amount of the fee was determined.[96] In addition to the limitations imposed by the North Carolina Supreme Court, local governments who plan to impose regulatory fees must also be aware of constitutional limitations. Regulatory fees may not be set higher for nonresidents than for residents unless the local government can prove that there is something unique about nonresidents—other than their residency—that justifies higher fees.

Possible legitimate reasons for charging nonresidents higher fees include recouping the costs of regulation when regulating nonresidents costs more and equalizing the contributions made toward the provision of a service when residents contribute more through local taxes. However, to pass Privileges and Immunities Clause (PIC) and Commerce Clause scrutiny, a local government must be prepared to prove, through accurate facts and figures, that it does in fact cost more to regulate nonresidents or that residents do in fact pay more or higher local taxes than do nonresidents. Simple assertions will not suffice.

If a service does not in fact cost more for nonresidents, or if residents do not contribute more toward the service, then a local government must provide another rationale for its discrimination against nonresidents (other than residential status alone) to survive PIC and Commerce Clause scrutiny. Such a rationale is not easy to think of. For example, even if "slowing growth" is accepted as a legitimate state interest, a measure asserting this interest would still violate the PIC and the Commerce Clause because the fit between the classification and the remedy is not tight enough and because there is another, nondiscriminatory, means available to slow growth: charging residents higher fees as well.

In short, local governments who wish to charge higher permit and service fees to nonresidents should be prepared to back up those fees with hard numbers supporting the increased charges. If they do not do this, the legislation enumerating the fee differential will be found unconstitutional under the PIC, the Commerce Clause, or both.

91. *See* TRIBE, *supra* note 15 § 6-11.

92. *Id.*

93. *See* Coenen, *State User Fees*, *supra* note 23, at 826–29.

94. *See* Homebuilders Ass'n of Charlotte v. City of Charlotte, 336 N.C. 37, 442 S.E.2d 45 (1994).

95. *Id.* at 46, 442 S.E.2d at 51.

96. *See id.* at 46–47, 442 S.E.2d at 51 (citing trial court's findings of fact which delineated the process used by an accounting firm hired by the city to calculate the costs of the regulatory services at issue and the fee that would be charged).

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