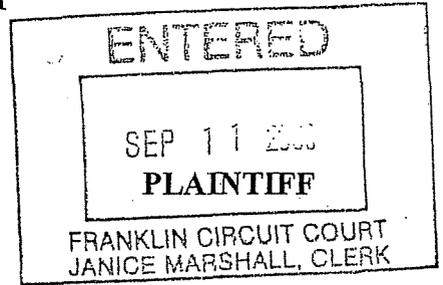


COMMONWEALTH OF KENTUCKY
FRANKLIN CIRCUIT COURT
DIVISION II
CIVIL ACTION NO. 02-CI-01177



CITY OF RUSSELLVILLE, KENTUCKY

v.

OPINION AND ORDER

PUBLIC SERVICE COMMISSION OF KENTUCKY,
EAST LOGAN WATER DISTRICT, INC., and
NORTH LOGAN WATER DISTRICT

DEFENDANTS

And

KENTUCKY LEAGUE OF CITIES

INTERVENING AMICUS CURIAE

* * * * *

This matter is before the Court on Plaintiff, City of Russellville, Kentucky's, appeal from a final order of the Kentucky Public Service Commission ("PSC"). The Court, having considered the arguments, and being otherwise sufficiently advised, hereby makes the following findings.

I. Background

Russellville is a fourth class city pursuant to KRS 81.0101(4). It supplies water to several thousand retail customers and to several water districts, including the defendants' East Logan Water District and North Logan Water District ("the Districts").

On May 24, 1999, Russellville's city council enacted ordinance No. 99-8 to adjust its water and sewer service rates. The ordinance revised retail rates and stated that "[w]holesale rates will be adopted and inserted for the sale of water to Water Districts which purchase water from the City of Russellville."

Russellville filed a cost-of-service study with the PSC on March 20, 2001, to modify its wholesale water rates. The study justified a rate increase from \$1.55 to \$2.45 per 1,000 gallons. Russellville sent a copy of the study to the Districts and informed them via letter that the study had been submitted to the PSC. Russellville explained in the letter that it was "in the process of increasing the water rate to \$2.45."

In a letter from the PSC to Russellville dated April 23, 2001, the PSC acknowledged the study had been received and reviewed. The letter included an "accepted copy" of the study with each page stamped "EFFECTIVE APR 21, 2001 PURSUANT TO 807 KAR 5:011, SECTION 9(1)." The letter requested Russellville to "file tariff pages setting out the rates to be [sic] charged to the districts." An e-mail sent on June 19, 2001, from the PSC to Russellville's attorney requested the tariff pages again. The e-mail clarified that the stamped copy of the study enclosed with the April letter "is the approval document that we issue for this type of filing. That document shows that the City is authorized to charge the proposed rates on and after April 21, 2001."

After receiving a bill with the new rate, the Districts filed a complaint with the PSC against Russellville on July 9, 2001. The complaint alleged that 1) Russellville failed to comply with PSC procedural regulations for rate increases, and 2) that the proposed rates did not represent the actual service cost and were contrary to the parties' contracts. The Districts requested the PSC to either void the \$2.45 rate or suspend it and investigate its reasonableness. Pending a decision, Russellville continued to supply water to the Districts, and the Districts established escrow accounts for amounts owed to Russellville above the \$1.55 rate. In an October 5, 2001, order regarding these accounts, the PSC seemed to acknowledge that the \$2.45 rate had been authorized. The order states that "[c]omplainants allege that a rate increase

approved by the Commission on April 21, 2001 is, or should be, void,” and that “[u]pon review of the record, it appears that Russellville’s April 21, 2001 rate increase is the filed rate pursuant to KRS 278.180.”

At an informal conference on October 22, 2001, the Districts questioned whether Russellville passed an ordinance sufficient to allow a rate increase application. On November 20, 2001, Russellville passed Ordinance No. 2001-16, which authorized the \$2.45 rate.

The PSC entered a final order on July 3, 2002, voiding the \$2.45 rate. Russellville appealed the final order to the Franklin Circuit Court. The Court denied Russellville’s request for a temporary injunction to prohibit the Defendants from using the escrow funds. The Court also permitted the Kentucky League of Cities to intervene as amicus curiae. The Court now upholds the PSC’s final order.

II. Discussion

A. Standard of Review

A PSC order can be vacated or set aside only if it is unlawful or unreasonable. KRS 278.410(1). A PSC order is unlawful if it violates a state or federal statute or constitutional provision. *National-Southwire Aluminum Co. v. Big Rivers Elec. Corp.*, Ky. App., 785 S.W.2d 503; 510 (1990). A PSC order is unreasonable “only when it is determined that the evidence presented leaves no room for difference of opinion among reasonable minds.” *Energy Regulatory Comm’n v. Ky. Power Co.*, Ky. App., 605 S.W.2d 46, 50 (1980) (citing *Thurman v. Meridian Mut. Ins. Co.*, Ky., 345 S.W. 635 (1961)). The party challenging the order has the burden of proving unlawfulness or unreasonableness by “clear and satisfactory evidence.” KRS 278.430. This Court cannot “pass on the credibility of witnesses and the weight of the evidence” because those functions lie solely with the PSC. *Ky. Power*, 605 S.W.2d at 50. When dealing

with issues of law, this Court may review them de novo without any deference to the agency. *Mill Street Church of Christ v. Hogan*, Ky. App., 785 S.W.2d 263, 266 (1990). Interpretation of a statute is a question of law and a reviewing Court is not bound by an agency's interpretation of the statute. *See Halls Hardwood Floor Co. v. Stapleton*, Ky. App., 16 S.W.3d 327, 330 (1996).

B. Ordinance Theory

In the present case, the PSC voided the \$2.45 rate because Russellville failed to comply with KRS 96.355(1)(a). The statute provides that:

(1) The legislative body of any city of the second, third, fourth, fifth, or sixth class may by ordinance:

- a) Provide the city with water; establish, regulate and control public cisterns, hydrants and reservoirs, together with extensions and appurtenances thereto, within or without the limits of the city; for fire protection and the use and convenience of its inhabitants;

According to the PSC, the statute requires a city to enact an ordinance or otherwise approve a proposed wholesale rate prior to filing for a rate change with the PSC. Since Russellville did not enact an ordinance or otherwise approve the \$2.45 rate before filing for a rate change, the PSC voided the rate.

This Court disagrees with the PSC's interpretation of KRS 96.355(1)(a). The statute does not address contract rates or ratemaking, nor does it require steps for a city to follow before filing for a rate change with the PSC. The agency reads language into the statute that is not there.

The PSC further supports its "ordinance theory" by contending that ratemaking is a legislative act accomplished by city legislatures. Assuming, *arguendo*, the validity of this proposition,¹ it does not necessarily follow that a city legislature must enact an ordinance or in

¹ This assumption is tenuous. The *Simpson County* court held that the PSC has exclusive jurisdiction over utility rates in contracts between cities and utilities, such as water districts. *Simpson County Water Dist. v. City of Franklin, Ky.*, Ky., 872 S.W.2d 460, 463 (1994). Since the PSC regulates rates and must approve rate increases, ratemaking could be considered more of an administrative agency activity.

some way authorize a specific rate prior to applying for a rate change with the PSC. Here, Russellville enacted an ordinance authorizing rate changes before it filed for a rate change with the PSC. That ordinance was not sufficient for the PSC because the ordinance did not authorize a precise rate, such as \$2.45 per 1000 gallons. The PSC, however, cannot create a specific application requirement out of a general legal principle in an adjudicative proceeding. KRS 13A.100 and KRS 278.040(3) require the PSC to create application requirements and other procedural conditions through the administrative regulatory process. Since no PSC regulation requires a city legislature to authorize an exact wholesale water rate before seeking PSC approval, the PSC's requirement is unlawful.

From a policy perspective, the PSC is concerned about city employees who may file for a rate change without proper authorization from the city. Other avenues, such as the rule-making process, likely allow the PSC to address this concern.

C. Statutory and Regulatory Violations

The PSC order seems entirely based on the "ordinance theory." Although this theory lacks legal support, courts must uphold agency orders if they are correct on other grounds. *Union Light, Heat, & Power v. Public Serv. Comm., Ky.*, 271 S.W.2d 361, 365 (1954). If a regulated entity fails to follow an agency's regulations, that failure is grounds for upholding the agency's order. *Id.* Pursuant to *Simpson County*, Russellville is subject to the PSC's regulations and applicable statutes regarding rate changes. *Ky.*, 872 S.W.2d 460, 463 (1994). Because Russellville failed to comply with KRS 278.180 and several PSC regulations, this Court upholds the PSC's final order. *See Union Light*, 271 S.W.2d at 365.

A footnote in the PSC's final order states that Russellville did not satisfy the requirements in KRS 278.180. When a utility gives notice of a proposed rate change to the PSC,

this statute requires the utility to state “plainly the changes to be made and the time when the changed rates will go into effect.” KRS 278.180. As the final order notes, Russellville did not fulfill this requirement.

The final order also found that Russellville failed to comply with several sections of 807 KAR 5:011. There is no need to discuss all of the violations, but Russellville’s disregard of Section 8 is worth elaboration. This Section requires notice of the proposed rate change to the utility’s customers. 807 KAR 5:011(8). Though Russellville gave the Districts notice via letter that it was “in the process of” changing the rate to \$2.45, “in the process of” does not necessarily mean that \$2.45 was the proposed rate. Furthermore, Russellville did not include in the letter the language required by the regulation to give notice to the Districts of their right to request to intervene before the PSC to challenge the proposed rate. *See id.* Since Russellville did not follow these and other requirements, the Districts apparently did not believe that \$2.45 was the proposed rate. They also did not get the opportunity to intervene in the rate change process to contest the adjustment. The lack of the opportunity to intervene raises procedural due process concerns, though the issue was not raised or briefed. *See Phelps v. Sallee, Ky., 529 S.W.2d 361, 365 (1975).*

Russellville’s response to these statutory and regulatory violations is that the PSC approved the new rate by letter, e-mail, and order; that the staff found that Russellville complied with several of the statutes and regulations; and that the oversights were minor. As explained in the above paragraph, the errors were not minor because they harmed the Districts. As for the mistakes made by the PSC’s staff, “a public officer’s failure to ‘correctly administer the law does not prevent a more diligent and efficient’ officer’s proper administration of the law, as ‘an erroneous interpretation of the law will not be perpetuated.’” *Natural Res. & Env’tl. Prot.*

Cabinet v. Ky. Harlan Coal Co., Ky. App., 870 S.W.2d 421, 427 (1993). (quoting *Delta Airlines, Inc. v. Commonwealth of Ky. Revenue Cabinet*, Ky., 689 S.W.2d 14, 20 (1985)). The PSC, in its final order, corrected the agency's previous mistakes by voiding the \$2.45 rate.

Russellville contends, nevertheless, that the \$2.45 rate became final due to the PSC's actions, so that voiding the \$2.45 rate is unlawful retroactive regulation. Russellville apparently means that the PSC waived the City's statutory and regulatory noncompliance. This argument fails because the PSC may alter its prior actions, including orders, until a "court of competent jurisdiction," such as the Franklin Circuit Court, suspends or vacates those orders. KRS 278.390. In *Mike Little Gas Co. v. Pub. Serv. Comm'n*, the court upheld a PSC order that corrected a clerical error in a prior order that misstated a utility rate increase. Ky. App., 574 S.W.2d 926, 927 (1978). Assuming that the PSC waived Russellville's violations and authorized the \$2.45 rate,² the PSC could issue a new order to correct prior errors. *See id*; *Natural Res.*, 870 S.W.2d at 427.

D. Equity

Finally, Russellville argues that unreasonable delay and laches prevents the PSC from voiding the \$2.45 rate. Equitable remedies are only available against government agencies in "exceptional circumstances." *Natural Res.*, 870 S.W.2d at 427. Russellville complains that the administrative litigation process, which took about one year, was excessive. Yet the City points to no evidence or authority suggesting that the length was unusual. If Russellville initially complied with KRS 278.180 and PSC regulations, moreover, the length of litigation would likely have been shorter.

² The PSC's final order states it "took no action to 'approve' the [2.45] rate." The April 23, 2001 letter, the June 19, 2001 e-mail, and the October 5, 2001 PSC order suggest the contrary. This Court admonishes the PSC for not following its own regulations and even more so for continuing to deny its errors.

Laches entails a party's failure to assert its rights within a reasonable time that results in prejudice to the other party. *Wigginton v. Com., ex. Rel. Caldwell*, Ky. App., 760 S.W.2d 885, 887 (1988). Russellville asserts that the Districts failed to promptly exercise their right to contest the rate change. Russellville must prove that the Districts knew their right but postponed filing their claim. *Klineline v. Head*, Ky., 266 S.W. 370, 372 (1924); see *Plaza Condo Ass'n v. Wellington Corp.*, Ky., 920 S.W.2d 51, 54 (1996). The Districts, however, did not know that they had a right at stake because Russellville failed to comply with PSC regulations. Rewarding Russellville and harming the Districts for Russellville's errors is unreasonable.

Amicus curiae argue that Russellville detrimentally relied on statements by PSC staff that purport to authorize the \$2.45 rate, but the PSC has ample authority to correct its mistakes. See KRS 278.390; *Natural Res.*, 870 S.W.2d at 427.

III. Conclusion

ACCORDINGLY, IT IS HEREBY ORDERED that the Plaintiff, City of Russellville, Kentucky's, appeal is OVERRULED. The Final Order of the Defendant, Kentucky's Public Service Commission, is AFFIRMED.

This is a final and appealable Order and there is no just cause for delay.

SO ORDERED, this 11 day of Sept. 2003.


WILLIAM L. GRAHAM, JUDGE
FRANKLIN CIRCUIT COURT
DIVISION II

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