

RECEIVED
SEP 16 2009
GENERAL COUNSEL

**COMMONWEALTH OF KENTUCKY
FRANKLIN CIRCUIT COURT
DIVISION II**

ENTERED
SEP 15 2009
FRANKLIN CIRCUIT COURT
SALLY JUMP, CLERK

CIVIL ACTION No. 08-CI-01669

GALLATIN COUNTY WATER DISTRICT

PETITIONER

vs.

**COMMONWEALTH OF KENTUCKY,
PUBLIC PROTECTION CABINET,
PUBLIC SERVICE COMMISSION, and
CARROLL COUNTY WATER DISTRICT NO. 1**

RESPONDENTS

OPINION AND ORDER

This matter is before the Court upon the appeal of Gallatin County Water District (“Gallatin”) from a September 12, 2008 Order of the Public Service Commission (“the Commission”). This appeal requires the Court to determine (1) whether the Defendant Public Service Commission acted beyond its jurisdiction and authority in settling a territorial dispute between the Gallatin County Water District and Carroll County Water District No. 1 (“Carroll”); (2) whether the Commission misapplied the law in requiring that Gallatin obtain a Certificate of Public Convenience and Necessity before providing water service to areas within Carroll District’s territory; and (3) whether Gallatin was denied procedural due process by the Commission’s hearing and decision procedures. Additionally, we must address the cross petition of Carroll contending that the Commission’s order fails to accurately depict Carroll District’s boundaries. Upon review of the parties’ briefs and papers, and after being sufficiently advised, this Court hereby

GRANTS the appeal of Gallatin District and **VACATES** the Order of the Commission.

Additionally, this Court **DISMISSES** Carroll's Cross-Petition.

STATEMENT OF FACTS

The relevant facts are as follows.¹ Respondent and cross-petitioner Carroll is a water district organized under Chapter 74. It owns and operates facilities that produce and distribute water to approximately 2,764 customers in Carroll, Gallatin, and Owen counties, Kentucky. In 1983, Carroll District's territorial limits were enlarged to include the western portion of Gallatin County, from the Carroll-Gallatin County boundary to Kentucky Highway 35. Currently, approximately 600 of Carroll's 2,764 customers are located in Gallatin County. Appellant Gallatin is also a water district organized under KRS Chapter 74. It owns and operates facilities that produce and distribute water to approximately 1,827 customers in Boone, Gallatin, and Grant counties, Kentucky. In 1985, the Gallatin Judge/Executive ratified the original creation of Gallatin District and established its boundaries as "excepting that part of the county lawfully annexed by Carroll County Water District #1."

In 1998, Carroll petitioned the Gallatin County Judge/Executive to clarify and redefine its boundaries in Gallatin County. The petition was based on discussions between Carroll and Gallatin regarding the construction of a motor speedway in Gallatin County and allowing Gallatin to serve the area. Accordingly, the Judge/Executive issued an order diminishing Carroll District's territory in Gallatin County and repositioning its eastern boundary from Kentucky Highway 35 to 1000 feet east of Kentucky Highway 1130. Gallatin then constructed a ground water well system, treatment facilities, and

¹ A more exhaustive and admirably catalogued accounting of the facts can be found in the Brief of Respondent Public Service Commission.

other improvements to provide water service to the Kentucky Speedway and the surrounding area. Gallatin did not at that time petition to enlarge its territory to include the area yielded by Carroll.

The central catalyst for this action involved a new interchange for Interstate Highway 71 and Kentucky Highway 1039. The interchange was to provide greater access to the Kentucky Speedway and was expected to bring significant economic benefits in the form of additional development to the interchange area. In 2002, Gallatin constructed an 8-inch water main extension from the Kentucky Speedway to Kentucky Highway 1039, part of which extended into Carroll District's territory. Gallatin did not apply for a Certificate of Public Convenience and Necessity, as it believed the extension to be an extension in the ordinary course pursuant to KRS 278.020(1). Carroll District remained silent about Gallatin's extension into its water district for the next five years. The line was installed by Carroll's Superintendent. Additionally, as late as 2005, Gallatin made incursions into Carroll's territory with the tacit or express approval of Carroll District.

In January 2007, Whitehorse Development Group approached Carroll and Gallatin to inform them of a commercial development planned for its property that would require 10,000 gallons of water per day. The tract in question was located in Gallatin County, within Carroll District's territorial boundaries. It lay approximately 4,700 feet from Carroll District's 4-inch water main and approximately 1,700 feet from Gallatin's 8-inch main. Based on the proximity and capacity of Gallatin's line, Whitehorse subsequently requested that Gallatin extend its 8-inch water main to Whitehorse's property line. Gallatin applied for a permit from the Kentucky Division of Water to

extend its 8-inch water distribution main, and the Division issued the permit on April 10, 2007.

On May 21, 2007, Carroll District filed a complaint against Gallatin District with the Public Service Commission. The complaint alleged that Gallatin District had violated KRS Chapter 74 by extending water service into Carroll District's territory and requested that Gallatin District be prohibited from serving the Whitehorse property. Additionally, Carroll filed a motion asking the Commission to order Gallatin to cease construction of a water line to the Whitehorse property pending a Commission decision on Carroll District's complaint. Carroll County did not file an action for a temporary or permanent injunction in an appropriate court, and it did not petition the Gallatin County Judge/Executive for a clarification of the respective water district boundaries of Gallatin and Carroll Districts or a ruling on the exclusivity of service rights. The Public Service Commission asserted jurisdiction over the Complaint.²

On July 17, 2007, the Commission held a hearing on Carroll District's motion to order Gallatin to cease construction. On August 1, 2007, the Commission entered an order directing Gallatin to refrain from constructing any water lines within Carroll District's territory, or to allow a third party to connect its existing water line within Carroll District's territory. Whitehorse had meanwhile contracted with Denny French³ to provide labor and materials to construct a water main extension from its property to Gallatin's 8-inch main. Mr. French installed the water main extension on September 11, 2007, notifying Gallatin of such. Seven days later, Gallatin District requested that Mr. French cease construction to comply with the Commission's August 1, 2007 Order. This

² The question of the Commission's jurisdiction over the Complaint is discussed further in Section II.

³ As both the Commission and Carroll stress, Mr. French was a former chairman of Gallatin District's Board of Commissioners. He was not a commissioner of Gallatin at the time of the construction.

request came after Gallatin learned of Carroll's protest, which was made despite its acknowledgment at the July 2007 hearing that a developer could lay the line. On October 10, 2007, Carroll District alleged to the Commission that Gallatin District was continuing to construct a water line in Carroll District's territory and moved for an Order to Show Cause against Gallatin. The Commission again asserted jurisdiction over Carroll's motion, apparently interpreting it as a motion for the imposition of civil penalties against Gallatin for failing to comply with the Commission's August 1, 2007 Order. A hearing was held on November 1, 2007. While the matter was pending with the Commission for decision, Gallatin petitioned Gallatin County Judge/Executive Kenny French to annex an area that included part of the Whitehorse tract. Pursuant to KRS Chapter 74, County Judge/Executive French ordered the enlargement of Gallatin District's territory to include the Whitehorse tract. Carroll District appealed this order in the Gallatin County Circuit Court, alleging that: (1) Carroll had the exclusive right to serve the territory annexed; (2) Federal law prohibits the annexation; (3) the annexation was procedurally defective; and (4) that the annexation order appealed from was not supported by substantial evidence.

On September 15, 2008, nearly a year after the hearing, the Commission issued its final Order, "granting" Carroll's Complaint. The Order found that Gallatin's construction of a water distribution main into Carroll District's territory was not an ordinary extension in the usual course of business and required a Certificate. Additionally, the Commission held that any subsequent construction to connect new facilities to the water distribution main would not be in the usual course of business and would require a Certificate. The

requirement of a Certificate was rendered moot, however, as the Order effectively ruled that water districts have exclusive rights to service customers within their territory.⁴

Gallatin District petitioned this Court for review of the Commission's Order of September 15, 2008 pursuant to KRS 278.410(1), leading to the instant action. Later, Carroll District filed a cross-petition, alleging that Figure 1 of the same Order contained factual errors in depicting the boundaries of each water district. On April 13, 2009, the Gallatin County Circuit Court issued a well-reasoned opinion ruling that: (1) Carroll District did not have the exclusive right to provide water service within its service territory; (2) Federal law did not prohibit the annexation; (3) County Judge/Executive French followed the appropriate annexation procedures; and (4) the annexation was supported by substantial evidence.

I. STANDARD OF REVIEW

In reviewing an agency decision, this Court may only overturn that decision if: (1) the agency acted arbitrarily or outside the scope of its authority; (2) the agency applied the incorrect rule of law; or (3) the decision itself is not supported by substantial evidence on the record. *Kentucky State Racing Commission v. Fuller*, 481 S.W.2d 298, 300-301 (Ky. 1972). Under KRS Chapter 278, the Commission is granted considerable authority to regulate public utilities. Consequently, the standard of review for an order entered by

⁴ The Order states that, while the Commission cannot enforce Chapter 74, a Certificate would be required for extra-territorial water service. Moreover, "a water district may not provide water service to customers outside its boundaries except under the most extraordinary conditions." Based on our review of the record, this Court is unable to discern any condition in which the Commission would grant such permission. Because the Commission then states that "[t]he construction of facilities outside those boundaries without proper authorization is unlawful and may serve as a basis for civil sanctions against the water district and its management," the Commission has effectively created solid boundaries between water districts.

the Commission is necessarily circumscribed. *Cincinnati Bell Telephone Co. v. Kentucky Public Service Com'n* 223 S.W.3d 829 (Ky. App. 2007).

This Court can vacate or set aside the order of the Commission only if it is unlawful or unreasonable. *Commonwealth ex rel. Stephens v. South Central Bell Telephone Co.*, 545 S.W. 2d 927, 931 (Ky. 1976). See also Murrell and Dexter, *Utility Law*, 70 Ky. L. J. 483, 486 (1981-82). A Commission order is unlawful if it violates a state or federal statute or constitutional provision. *National-Southwire Aluminum Co. v. Big River Elec. Co.*, 785 S.W.2d 503, 510 (Ky. App. 1990). A Commission order is unreasonable “only when it is determined that the evidence presented leaves no room for difference of opinion among reasonable minds.” *Energy Regulatory Commission v. Kentucky Power Co.*, 605 S.W.2d 46, 50 (Ky. App. 1980). Pursuant to KRS 278.430, any party seeking to set aside a determination of the Commission bears the burden of proof to show by clear and satisfactory evidence that the Commission’s determination is unlawful or unreasonable.

Although the scope of review of Commission decisions is limited, a reviewing court is not required to acquiesce in every factual determination by the Commission. See, e.g., *South Central Bell Tel. Co. v. Public Service Commission*, 702 S.W.2d 447, 454 (Ky. App. 1985). Moreover, judicial review of legal or constitutional issues is not circumscribed. See *Kentucky Power Co. v. Energy Regulatory Commission*, 623 S.W.2d 904, 907 (Ky. 1981). 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*, 785 S.W.2d 263, 266 (Ky. App. 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 Co. v. Stapleton*, 16 S.W.3d 327, 330 (Ky. App. 1996).

Notwithstanding its considerable authority, the Commission is a creature of statute. *Cincinnati Bell Telephone Co. v. Kentucky Public Service Com'n* 223 S.W.3d 829, 836. Therefore, it "has only such powers as granted by the General Assembly." *Id.* (citing *PSC v. Jackson County Rural Elec. Coop., Inc.*, 50 S.W.3d 764, 767 (Ky. Ct. App. 2000)). Whether the Commission exceeded the scope of its authority is a question of law that we scrutinize closely. *Cincinnati Bell Telephone Co. v. Kentucky Public Service Com'n* 223 S.W.3d 829, 836 (citing *Com'n., Transportation Cabinet v. Weinberg*, 150 S.W.3d 75 (Ky. Ct. App. 2004)).

II. STATUTORY AUTHORITY

Water districts are governed by KRS Chapter 74, which provides the proper procedure for the creation of water districts, an enlargement or diminishment of a water district, and the extension of a water district into an adjoining county. KRS 74.010, 74.012, 74.110, 74.115. The county fiscal court and judge/executive preside over both the creation and change of water district territories. KRS 74.010, 74.110, 74.115. Prior to the creation of a water district by the fiscal court, the Public Service Commission must hold a hearing "to evaluate the application of the proponents of said proposed water district ... and reach a decision in the best interests of the general public." KRS 74.012(1). This hearing is conducted pursuant to KRS 278.020, in which the Commission may issue or refuse to issue a certificate that public convenience and necessity require the service or construction. KRS 278.020(1). Any "ordinary extensions of existing systems in the usual

course of business” are excepted from the Certificate process. Under Chapter 74, the Commission is not involved in the enlargement, diminishment, extension, or other such territorial matters involving water districts.

The Public Service Commission is governed by KRS Chapter 278. The Commission’s jurisdiction extends to all utilities in Kentucky. KRS 278.040(2). The commission has “exclusive jurisdiction over the regulation of rates and service of utilities,” but nothing in Chapter 278 “is intended to limit or restrict the police jurisdiction, contract rights or powers of cities or political subdivisions.” *Id.*

The Public Service Commission has limited ability to enforce its orders within certain statutory bounds. Under 278.990(1), the Commission can impose civil penalties for willful violations of the provisions of KRS Chapter 278 or any regulation promulgated pursuant to it, and failure to obey an order of the commission “from which all rights of appeal have been exhausted.” Any action to recover these penalties must be brought in the name of the Commonwealth in the Franklin Circuit Court. Under 74.455, the Commission can remove a water commissioner or other governing persons of water associations for good cause. This removal cannot occur without a public hearing on the merits. In the case that the Commission wishes to enforce its orders using mandamus or injunction, the commission “may compel obedience to its lawful orders by mandamus, injunction or other proper proceedings in the Franklin Circuit Court or any other court of competent jurisdiction.” KRS 278.390.

III. ANALYSIS

A. The Scope of the Commission's Authority

The Public Service Commission is an administrative agency set up and appointed by law for the purpose of hearing facts and establishing reasonable rules, rates, and services to the public in order to secure conformity of services and rates affecting all classes of customers. *Smith v. Southern Bell Telephone & Telegraph Co.*, 104 S.W.2d 961, 962 (Ky. 1937). Its jurisdiction extends to all utilities in Kentucky, and it has “exclusive jurisdiction over the regulation of rates and service of utilities.” KRS 278.040(2). Gallatin and Carroll Districts, utilities within the definition contained in KRS 278.010(3), are within the Commission's jurisdiction. It does not matter whether the Commission exercises its authority in the context of quasi-legislative or quasi-adjudicative proceeding, so long as the exercise thereof is within the scope of its statutory authority.

Gallatin alleges the Commission exceeded its authority in exercising jurisdiction over a territorial dispute between two water districts. We agree. Were the issue presented to the Commission simply the question of whether a Certificate was required for Gallatin's extension of its main line, it may have been properly before the Commission. The heart of the issue here, however, was the territorial boundaries of water districts. This Order “granted” Carroll's Complaint asking for a ruling that their territory was exclusive, and for what was essentially injunctive relief, regardless of how it is couched by the Commission.⁵ The issue actually decided was whether Gallatin District was in violation

⁵ “[T]he Complainant Carroll County Water District No. 1 requests the Public Service Commission to determine: [...] That Gallatin County Water District *should be ordered to cease and desist* its construction of water lines and/or service to the commercial development along Highway 1039 in Gallatin County, Kentucky, within Carroll's territory.” Carroll County Water District No. 1 – *Complaint*, May 21, 2007

of Chapter 74 for extending water line services into Carroll's territory, and whether Gallatin County should be ordered to cease and desist. Effectively, the Commission, in its Order, established an exclusive territory for a water district, encroaching on the jurisdiction of the Courts. This matter was a territorial dispute. The Commission's authority to litigate complaints is confined to the issues of rates and services under KRS 278.260. The Commission asserts in page fourteen of its Order that "[w]hile the Commission lacks any authority to establish an exclusive service territory for water utilities, we clearly possess the authority to prevent wasteful duplication of facilities or excessive investment." The claimed authority does not extend to this territorial dispute.

The Supreme Court of Kentucky has noted that the Commission "acts as a quasi-judicial agency using its authority to conduct hearings, render findings of fact and conclusions of law, and using its expertise in area and to the merits of rates and service issues." *Simpson County Water District v. City of Franklin*, 872 S.W.2d 460, 465 (Ky. 1994). The definition of "service" is a broad and comprehensive term, which includes "any practice or requirement in any way relating to the service of any utility." See KRS

(emphasis added). The subject of the July 18, 2007 hearing, was essentially based on a motion for a temporary injunction: "Comes now the Complainant Carroll County Water District No. 1 and requests that the Public Service Commission enter an Order requiring the Defendant Gallatin County Water District to cease construction of the water line to the commercial development located along Kentucky Highway 1039 ..." Carroll County Water District No. 1 – *Motion to Cease Construction*, May 21, 2007 (emphasis added). The Commission's ultimate order "grants" Carroll District's Complaint.

Any doubt as to injunctive relief was the issue is resolved by a review of the recording of the July 18, 2007 hearing, which resulted in the Commission's August 1, 2007 Order prohibiting Gallatin from constructing new lines. The "review standard" applied by the hearing officer to Carroll's *Motion to Cease Construction*⁵ was "some showing ... of irreparable injury, a substantial question on the merits, and that the equities play in favor of an injunction." *Video Transcript of July 18, 2007 Hearing* at 1:05. Mr. Huddleston, attorney for Gallatin, noted that the motion could be compared to injunctive relief. *Id.* at 1:07. When Mr. Huddleston questioned the Commission's authority to order Gallatin to cease construction, the Hearing Officer referred the question to Mr. Osterloh, counsel for the Public Service Commission, who said that the parties were free to "debate that," but that, as he understood it, he "would put forth that the Commission has jurisdiction over service and rates over utilities," and that it was "something the Commission could consider." *Id.* at 1:22 – 1:23. While there was no further debate of the authority of the Commission to order injunctive relief, the substance and relief requested in Carroll's *Motion to Cease Construction* is an integral part of its original *Complaint* and the relief ultimately granted by the Commission in its final Order.

278.010(11). See also *Kentucky CATV Association v. Volz*, 675 S.W. 2d 393, 396 (Ky. Ct. App. 1983) (discretionary review denied, 1984). In applying this definition of “service” to this case, however, this Court concurs with Gallatin that adjudicating territorial disputes between two water districts is not within the Commission’s jurisdiction.⁶

Kentucky’s highest court has held that a water district does not have the exclusive right to furnish services within its confines. *City of Cold Spring v. Campbell County Water District*, 334 S.W.2d 269, 274 (Ky. 1960).⁷ More importantly, the court held that “[w]here a controversy concerns the *general statutory right* or authority *of a city, water district* or public utility *to furnish service within a certain area*, the question is one of *law* and *must be determined by a court.*” *Id.* at 273-74. We find this conclusive. As was the case in *City of Cold Spring*, whether Carroll District has the exclusive right to furnish water within its confines “is a question of law pertaining to the general powers of ... the water district. It presents a question of the construction of statutes, and does not involve a question of fact which the Commission is pre-eminently qualified to determine. *The court has jurisdiction to determine the extent of the authority of* either or both the City and *the Water District.*” *Id.* at 271 (emphasis added).

Carroll District should have brought its original claim to the Gallatin County Judge/Executive pursuant to KRS Chapter 74. Moreover, the Commission should not have exercised jurisdiction over a territorial dispute, nor issued what was, in effect, an injunction against Gallatin. Gallatin District’s petition to the Gallatin Judge/Executive

⁶ Service has been held to apply to quality and adequacy of a utility service. *Benzinger v. Union L.H. & P.*, 170 S.W.2d 38, 41 (Ky. 1943); *Peoples Gas Co. v. City of Corbin*, 625 S.W.2d 848, 849 (Ky. 1981); *Carr v. Cincinnati Bell*, 651 S.W.2d 126, 128 (Ky. App. 1983).

⁷ Overruled by *City of Georgetown v. Public Service Commission*, 516 S.W.2d 842 (Ky. 1974), where the court held that the jurisdiction of the Commission did not extend to cities. The court’s holding with respect to the jurisdiction of the court was not overruled.

pursuant to KRS Chapter 74 was proper, regardless of the fact that it was brought after the commencement of the Commission action. Lastly, the real issues here, specifically, the territorial exclusivity of a water district, as well as the propriety of Judge/Executive French's ruling, have been litigated in the Gallatin County Circuit Court. The jurisdiction of that court was proper, and its ruling is conclusive.

B. Gallatin's Additional Claims

Because we find that Carroll's Complaint was not properly before the Commission, and that the Commission improperly asserted jurisdiction over a matter that belonged in the courts, we are not required to reach the issues of whether the Commission correctly applied the law or afforded Gallatin District due process of law.

C. Carroll's Cross Petition

Carroll District failed to bring its action for review in a timely manner. Carroll attempts to disguise what is essentially a separate appeal of the Commission's September 15, 2007 Order by claiming that, since KRS 278.410 is "void of any provision for a cross-appeal by a party named by the Petitioner/Appellant," a respondent can then resort to the Civil Rules "cross-appeal" seemingly at any time. This theory holds no weight. Kentucky's highest court has made clear that KRS 278.410 "provides the exclusive method by which an order of the commission can be reviewed by the circuit court." *Kentucky Utilities Co. v. Farmers Rural Electric Cooperative Corp.*, 361 S.W.2d 300, 301 (Ky. 1962). KRS 278.410(1) mandates that:

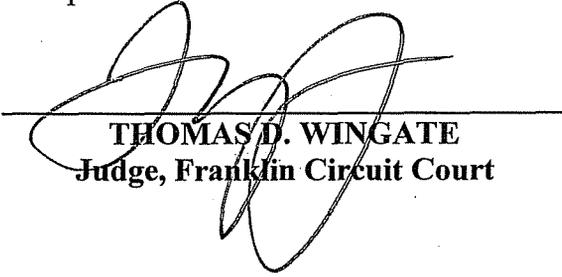
Any party to a commission proceeding or any utility affected by an order of the commission may, within thirty (30) days after service of the order,

or within twenty (20) days after its application for rehearing has been denied by failure of the commission to act, or within twenty (20) days after service of the final order on rehearing, when a rehearing has been granted, *bring an action against the commission in the Franklin Circuit Court* to vacate or set aside the order or determination on the ground that it is unlawful or unreasonable. (emphasis added)

“The right of appeal [from a Commission order] is purely statutory and those who seek to invoke it must comply with the requirements set forth in the law.” *Energy Regulatory Commission v. Kentucky Power Co.*, 605 S.W.2d 46, 51 (Ky. 1961). Carroll attempts to appeal a completely separate issue by simply attaching it to Gallatin’s appeal. As a party affected by the Commission’s Order, Carroll had permission under the statute to appeal the order with the statute’s time limits. The thirtieth day after service of the Order fell on Saturday, October 18, 2008. KRS 446.030(1)(a) extended the period for bringing an action until Monday, October 20, 2008. Because Carroll District did not file its Answer and Cross Petition with this Court until October 22, 2008, we dismiss the Cross Petition.

CONSIDERING THE FOREGOING, the Petitioner’s appeal is **GRANTED** and the Commission’s Order dated September 15, 2008 is hereby **VACATED**. Additionally, the cross petition of Carroll County is **DISMISSED**. This order is final and appealable and there is no just cause for delay.

SO ORDERED, this 15 day of September, 2009



THOMAS D. WINGATE
Judge, Franklin Circuit Court

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Order was mailed, this 15 day of September, 2009, to the following:

Stephen P. Huddleston, Esq.
Rhonda W. Huddleston, Esq.
Attorney for Appellant
Gallatin County Water District
P.O. Box 807
Warsaw, KY. 41095

David. S. Samford, Esq.
Gerald E. Wuetcher, Esq.
M. Todd Osterloh, Esq.
Attorney for Appellee
Public Service Commission
P.O. Box 615
Frankfort, KY. 40602-0615

Ruth H. Baxter, Esq.
Attorney for Appellee Carroll County Water District No. 1
503 Highland Ave.
P.O. Box 353
Carrollton, KY 41008


Sally Jump, Franklin County Circuit Court Clerk
