

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF LOUISVILLE)	
GAS AND ELECTRIC COMPANY FOR A)	CASE NO.
DECLARATORY ORDER REGARDING THE)	2016-00317
PROPER METHOD OF MUNICIPAL FRANCHISE)	
FEE RECOVERY)	

ORDER

On August 31, 2016, Louisville Gas and Electric Company (“LG&E”) filed an application requesting a declaratory order regarding the proper method of recovering the municipal franchise fee enacted by Louisville/Jefferson County Metro Government (“Louisville Metro”). Specifically, LG&E requested an order declaring that, absent an order from the Commission, LG&E must abide by its tariff which, pursuant to Commission policy, requires recovery of municipal franchise fees as a line-item charge on the bills of ratepayers residing within the jurisdiction imposing the franchise fee. By Orders issued on September 12, 2016, and September 22, 2016, respectively, Kentucky Industrial Utility Customers, Inc. (“KIUC”) and Louisville Metro were granted intervention in this matter.

Shortly after LG&E filed its application in this case, Louisville Metro filed a separate complaint action against LG&E, docketed as Case No. 2016-00347,¹ challenging LG&E’s tariffed methodology for recovery of the cost of a gas franchise fee. In particular, Louisville Metro’s complaint raises the following three claims: 1) it is improper to allow

¹ Case No. 2016-00347, *Louisville/Jefferson County Metro Government v. Louisville Gas and Electric Company* (filed Sept. 19, 2016).

LG&E to directly pass the cost of a franchise fee onto LG&E's gas customers as a utility bill line item; 2) if the Commission allows LG&E to pass the cost of a franchise fee directly to customers, then all LG&E gas customers receiving the benefit of the Louisville Metro's rights-of-way should pay the gas franchise fee; and 3) if the Commission allows LG&E to pass the cost of a franchise fee directly to customers, then the franchise fee should be collected throughout Louisville Metro. By Order issued on January 25, 2017, the Commission found that Louisville Metro failed to establish a *prima facie* case and rejected Louisville Metro's complaint against LG&E. However, the Commission found that Louisville Metro provided sufficient evidence to justify a review of the allegations contained in its complaint and consolidated Case No. 2016-00347 into the instant proceeding. The January 25, 2017 Order in Case No. 2016-00347 stated that Louisville Metro's claims would be reviewed along with the issues raised by LG&E in its request for a declaratory ruling in connection with the subject gas franchise agreement.

A revised procedural schedule was established pursuant to an Order issued on February 27, 2017.² The revised procedural schedule provided for each party to file direct testimony addressing all relevant issues, one round of discovery, and an opportunity for each party to file rebuttal testimony. No party requested an evidentiary hearing, but a hearing to allow the parties to present oral arguments on the relevant issues was conducted on September 28, 2017. LG&E and Louisville Metro submitted legal briefs on August 31, 2017, and reply briefs on September 15, 2017. On December 28, 2017, Louisville Metro filed a motion requesting that Mr. Gregory T. Dutton be withdrawn as its

² The initial procedural schedule was established on January 25, 2017, but revised at the request of Louisville Metro Government.

co-counsel because Mr. Dutton was joining a different law firm and this change would raise a potential conflict in his continued representation of Louisville Metro in this matter. Having reviewed Louisville Metro’s motion and being otherwise sufficiently advised, the Commission finds that Louisville Metro has established good cause to permit Mr. Dutton to withdraw as its co-counsel in this matter. The matter now stands submitted to the Commission for a decision.

BACKGROUND

In January of 2003, the city of Louisville and Jefferson County merged their governmental functions.³ There are 82 municipalities within the jurisdictional borders of Louisville Metro that were not included in the merger and, according to both LG&E and Louisville Metro, those municipalities retained their status following the merger.⁴ These municipalities, classified as Home Rule Cities, remain incorporated and their powers and functions remain unchanged post-creation of Louisville Metro.⁵ According to Louisville Metro, the citizens of those municipalities “regularly vote to elect representatives to a legislative council and a Mayor of Louisville Metro.”⁶

On August 30, 2016, Louisville Metro and LG&E executed a franchise agreement (“2016 Franchise Agreement”) in which Louisville Metro awarded a franchise to LG&E for the transmission, distribution, transportation, and sale of gas.⁷ The 2016 Franchise

³ LG&E Brief at 2. *See also* Louisville Metro Government Brief at 2–3.

⁴ Louisville Metro Government Brief at 3. LG&E’s brief, at page 2, indicates that there are 83 municipalities located within the jurisdictional borders of the Louisville Metro Government.

⁵ LG&E Brief at 2–3.

⁶ Louisville Metro Government Brief at 3.

Agreement provides for a five-year term⁸ and authorizes LG&E to have access to the public rights-of-way of Louisville Metro to operate and maintain its gas infrastructure. The 2016 Franchise Agreement defines the “Franchise Area” as “the public streets, avenues, alleys and other public ways of Louisville Metro, but not within the jurisdiction of any other city located within Jefferson County, Kentucky.”⁹ In consideration for the award of the gas franchise, Louisville Metro would collect from LG&E an annual franchise fee, which can be calculated at Louisville Metro’s option based upon five alternative methods, but is capped at 3 percent of LG&E’s gross receipts within the Franchise Area.¹⁰

The terms of the 2016 Franchise Agreement reflect the disagreement between Louisville Metro and LG&E regarding how and from whom the franchise fee is to be collected.¹¹ Pursuant to the 2016 Franchise Agreement, no franchise fee is due from LG&E and no liability for the franchise fee is accruing until this issue is ultimately resolved, including any appeals in this matter.¹² Under the terms of the 2016 Franchise Agreement,

⁷ Louisville Metro Government Brief at 2. The Louisville Metro gas franchise was created pursuant to Ordinance No. 132, Series 2016 passed by the Louisville Metro Council on May 26, 2016. The Commission authorized LG&E in Case No. 2016-00193, *Application of Louisville Gas and Electric Company for a Certificate of Public Convenience and Necessity to Bid on a Gas Franchise Established by the Legislative Council of Louisville/Jefferson County Metro Government* (Ky. PSC June 6, 2016), to bid on the gas franchise. On August 25, 2016, Louisville Metro passed Ordinance No. 214, Series 2016, accepting LG&E’s bid.

⁸ LG&E Application, Exhibit 1, 2016 Franchise Agreement, Section 9.

⁹ *Id.* at Section 1.

¹⁰ *Id.* at Section 11(a). In summary, the five methods of calculating the franchise fee are as follows: 1) the number of the linear feet of in-service transmission or distribution pipeline segments in the LG&E Geographic Information System owned or operated by LG&E within the Franchise Area; 2) each thousand cubic foot of gas utilizing LG&E’s transmission or distribution pipe, pipeline, main, pumping stations, or other means to transport for the purpose of providing natural gas service to customers as a local distribution company within the Franchise Area; 3) a percentage of gross receipts; 4) a flat fee; or 5) any combination of the four prior options.

¹¹ LG&E Application, Exhibit 1, 2016 Franchise Agreement, Sections 11(a) and 12.

¹² *Id.* at Section 11(b).

should the Commission determine that LG&E should comply with its Franchise Rider tariff and collect the franchise fee only from customers in the Franchise Area, no franchise fee would be due.¹³

LG&E's Position

LG&E contends that recovery of the franchise fee at issue should comply with its tariff, which requires that franchise fees be recovered as a line item on the bills of ratepayers residing within the municipal jurisdiction imposing the franchise fee.

Contrary to Louisville Metro's assertion that this matter is one of first impression before the Commission, LG&E states that the Commission's exclusive jurisdiction over rates and service has been affirmed multiple times by Kentucky courts.¹⁴ LG&E further states that Kentucky courts have held the Commission's jurisdiction does not offend Sections 163 and 164 of the Kentucky Constitution.¹⁵ Consistent with this exclusive jurisdiction, LG&E points out that KRS 278.200 authorizes the Commission to regulate rates and service standards set by agreement between utilities and cities including franchise agreements.¹⁶

¹³ *Id.*

¹⁴ LG&E Reply Brief at 3.

¹⁵ LG&E Reply Brief at 3–4, *citing Southern Bell Telephone & Telegraph v. City of Louisville*, 96 S.W.2d 695 (Ky. 1936) and *Florence v. Owen Electric Coop., Inc.*, 832 S.W.2d 876 (Ky. 1992).

¹⁶ LG&E Reply Brief at 4. KRS 278.200 provides, in relevant part, as follows: "The commission may, under the provisions of this chapter, originate, establish, change, promulgate and enforce any rate or service standard of any utility that has been or may be fixed by any contract, franchise or agreement between the utility and any city, and all rights, privileges and obligations arising out of any such contract, franchise or agreement, regulating any such rate or service standard, shall be subject to the jurisdiction and supervision of the commission...."

LG&E argues that neither Section 163 nor Section 164 of the Kentucky Constitution informs or limits the ratemaking jurisdiction of the Commission.¹⁷ LG&E states that neither Section 163 nor Section 164 mentions rates or services and points out that Kentucky's highest court in 1936, in *Southern Bell Telephone & Telegraph Co. v. City of Louisville*, rejected the claim that Sections 163 and 164 limit the exclusive jurisdiction of the Commission over utility rates.¹⁸ LG&E notes that the court in *Southern Bell* expressly held that while Sections 163 and 164 allow cities to issue franchises, they do not deprive the state of the authority to regulate utility rates after a franchise has been issued.¹⁹ LG&E further notes that the *Southern Bell* court confirmed that, while cities had the legal right to regulate utility rates prior to the enactment of KRS Chapter 278, the General Assembly had withdrawn that power and vested the Commission with exclusive jurisdiction over rates.²⁰ LG&E avers that there have been multiple court decisions subsequent to the *Southern Bell* opinion that reaffirm the Commission's plenary authority over utility rates, citing *Benzinger v. Union Light, Heat & Power Co.*,²¹ which held that Section 163 of the Kentucky Constitution gave authority to municipalities to control the manner in which a utility may occupy public property and streets, but that nothing in that constitutional provision takes away the Commission's exclusive jurisdiction over the regulation of rates pursuant to KRS Chapter 278.²² LG&E also relies upon *Florence v.*

¹⁷ LG&E Reply Brief at 5.

¹⁸ 96 S.W.2d 695 (Ky. 1936).

¹⁹ LG&E Reply Brief at 5.

²⁰ LG&E Reply Brief at 6.

²¹ 170 S.W.2d 38 (Ky. 1943).

Owen Electric Coop.,²³ which determined that Sections 163 and 164 were intended to prevent the legislature from authorizing the indiscriminate use of city streets without the city being able to control the decision as to what streets and public ways were to be occupied by the utility, but which expressly noted that Sections 163 and 164 do not speak to rates and the authority to regulate rates was vested in the state, not cities.²⁴

LG&E contends that the Commission's exclusive jurisdiction to regulate rates extends to the regulation of rate-related provisions in municipal franchise agreements.²⁵ LG&E relies upon *Peoples Gas Co. v. Barbourville*²⁶ and notes that Kentucky's highest court rejected the City of Barbourville's claims that Sections 163 and 164 prevented the Commission from regulating rates provided in a franchise agreement.²⁷ LG&E states that the *Peoples Gas* decision held that, while a municipality may impose conditions, even to the extent of fixing rates, in its franchise or other ordinances, those conditions are subject to the Commission's jurisdictional oversight to the extent they involve rates or services and that the Commission's jurisdiction attaches after the franchise has been acquired.²⁸ LG&E argues that the authorities relied upon by Louisville Metro do not undermine the Commission's jurisdiction under KRS Chapter 278 because the decisions cited by Louisville Metro are no longer controlling, in that they were decided before the 1934

²² LG&E Reply Brief at 6.

²³ 832 S.W.2d 876 (Ky. 1992).

²⁴ LG&E Reply Brief at 8.

²⁵ *Id.*

²⁶ 165 S.W.2d 567 (Ky. 1942).

²⁷ LG&E Reply Brief at 8.

²⁸ *Id.*

enactment of KRS Chapter 278 and before the opinions rendered in *Southern Bell* and its progeny.²⁹

LG&E contends that Louisville Metro's powers are confined to its territorial limits and it is, therefore, without authority to require the collection of the franchise fee beyond its jurisdictional limits.³⁰ LG&E asserts that Louisville Metro acknowledges this jurisdictional limitation in the 2016 Franchise Agreement, and that limitation is based upon a May 2, 2011 formal opinion of the Jefferson County Attorney.³¹ LG&E notes that the May 2, 2011 formal opinion of the Jefferson County Attorney clearly concludes that when granting a gas franchise, Louisville Metro's authority did not extend to the 82 Home Rule Cities located within the Louisville Metro jurisdictional boundaries.³² LG&E argues that Louisville Metro, pursuant to KRS 67.010(3)(a) and (b), is statutorily authorized to levy and collect taxes and to license, tax, and regulate privileges and occupations only within its jurisdictional boundaries.³³ LG&E maintains that Louisville Metro's right to require franchises and to impose franchise fees is conferred by Sections 163 and 164 of the Kentucky Constitution.³⁴ Section 163 of the Kentucky Constitution provides, in full, as follows:

No street railway, gas, water, steam heating, telephone, or electric light company, within a city or town, shall be permitted or authorized to construct its tracks, lay its pipes or mains, or

²⁹ LG&E Reply Brief at 9.

³⁰ LG&E Brief at 7–8.

³¹ *Id.* See also, LG&E Reply Brief at 26.

³² LG&E Reply Brief at 27.

³³ LG&E Brief at 8.

³⁴ *Id.*

erect its poles, posts, or other apparatus along, over, under or across the streets, alleys or public grounds of a city or town, without the consent of the proper legislative bodies or boards of such city or town being first obtained; but when charters have been heretofore granted conferring such rights, and work has in good faith been begun thereunder, the provisions of this section shall not apply.

Section 164 of the Kentucky Constitution provides, in full, as follows:

No county, city, town, taxing district or other municipality shall be authorized or permitted to grant any franchise or privilege, or make any contract in reference thereto, for a term exceeding twenty years. Before granting such franchise or privilege for a term of years, such municipality shall first, after due advertisement, receive bids therefor publicly, and award the same to the highest and best bidder; but it shall have the right to reject any or all bids. This section shall not apply to a trunk railway.

LG&E notes that these constitutional provisions expressly limit franchising authority to the public rights-of-way of the political subdivision granting the franchise.³⁵

Likewise, LG&E asserts that the Commission is without legal authority to expand the legal rights of Louisville Metro's franchising authority to extend to other cities and counties.³⁶ LG&E notes that, as an administrative agency, the Commission is a creature of statute and is limited to the powers granted by those statutes.³⁷ LG&E maintains that the Commission has exclusive jurisdiction over the regulation of rates and service of utilities, but the General Assembly has constrained that authority to prevent the Commission from limiting or restricting the police jurisdiction, contract rights, or powers of cities or political subdivisions.³⁸

³⁵ *Id.*

³⁶ LG&E Brief at 12.

³⁷ *Id.*

LG&E asserts that only those customers residing within Louisville Metro's jurisdictional boundaries should pay the franchise fee associated with the 2016 Franchise Agreement.³⁹ LG&E maintains that Louisville Metro's proposal that the franchise fee at issue be collected outside its borders, from customers in surrounding counties, would infringe upon the jurisdiction of those other counties.⁴⁰ LG&E further maintains that Louisville Metro's proposal is unlawful and unreasonable because residents of other counties have no representation on the Louisville Metro Council and have no redress against Louisville Metro.⁴¹ LG&E argues that because Louisville Metro's franchise fees are used to fund services and improvements within Louisville Metro, the residents of other counties receive no direct benefit from the fee paid.⁴²

LG&E also takes issue with Louisville Metro's contention that the franchise fee should be imposed on all LG&E gas customers, including those located outside of Louisville Metro's territorial boundaries, because all customers benefit from LG&E's use of Louisville Metro's public rights-of-way for the delivery of gas. LG&E relies on *City of Somerset v. Bell*⁴³ for the proposition that a municipality's imposition of a franchise fee beyond its jurisdictional limits based upon benefits received has been rejected as a matter of law. LG&E explained that the appellate court in *City of Somerset* held that the taxpayers who filed the action were entitled to a refund of property taxes previously paid

³⁸ *Id.* citing KRS 278.040(2).

³⁹ LG&E Brief at 17.

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

⁴³ 156 S.W.3d 321 (Ky. App. 2005).

to the city because those properties were never within the city of Somerset's jurisdictional boundaries.⁴⁴ LG&E further explained that the court rejected the city's argument that no refund was owed because the properties outside the city limits had received the benefit of city services, reasoning that no community could withstand a tax system that allows for the collection of taxes based upon the degree to which one benefitted from government services.⁴⁵ LG&E maintains that the reasoning in *City of Somerset* is equally applicable to the imposition of a franchise fee as in this matter.⁴⁶ LG&E asserts that no community could withstand a system of franchises and franchise fees which allowed for the collection of franchise fees based upon the degree to which one benefitted from government services.⁴⁷ Although Louisville Metro claims that customers in surrounding counties and cities benefit from LG&E's use of Louisville Metro's rights-of-way, LG&E argues that the record in this case shows that Louisville Metro also benefits from the rights-of-way of other localities.⁴⁸ LG&E notes that approximately 45 percent of LG&E's gas supply in 2016 was received by LG&E within the Louisville Metro Franchise Area; approximately 55 percent of LG&E's gas supply was received by LG&E outside Louisville Metro's Franchise Area.⁴⁹ Also, LG&E points out that approximately 72 percent of LG&E's total gas deliveries in 2016 were made to customers located within the Louisville Metro

⁴⁴ LG&E Brief at 18.

⁴⁵ *Id.*

⁴⁶ LG&E Brief at 19.

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.*

Franchise Area.⁵⁰ Thus, LG&E contends that the record reflects that deliveries to customers located within the Louisville Metro Franchise Area are dependent on gas supplies received by LG&E outside of the Louisville Metro Franchise Area.⁵¹

Regarding Louisville Metro's contention that LG&E's current method of collecting the franchise fee at issue benefits only the municipality and not the residents, LG&E asserts that the rights and privileges belonging to the citizens that are the subject of a franchise are those owned by a municipality for the benefit of its citizens, not the citizens themselves.⁵² LG&E asserts that the public at large benefits from any revenues a municipality receives, including those received directly or indirectly from the city's citizens.⁵³

LG&E contends that Kentucky law and Commission precedent permits the collection of the franchise fee, as a billing line item, from only those customers receiving service in the jurisdiction imposing the fee.⁵⁴ LG&E notes that, under Kentucky law, a franchise fee is a special legal fee as opposed to a rent, as claimed by Louisville Metro.⁵⁵ LG&E avers that when a municipality acts in its governmental capacity to grant rights or privileges not otherwise available to individuals, a municipality must issue a franchise.⁵⁶ Because the franchise fee is a prudent and reasonable operating expense, LG&E argues

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² LG&E Reply Brief at 11.

⁵³ *Id.*

⁵⁴ LG&E Brief at 9–11.

⁵⁵ LG&E Brief at 9–10.

⁵⁶ LG&E Brief at 10.

that requiring shareholders to absorb the cost of the franchise fee constitutes an unlawful taking under the United States and Kentucky Constitution and amounts to a confiscatory rate.⁵⁷

LG&E maintains that Commission has applied this legal reasoning as a basis in requiring the pass-through and collection of franchise fees as a line-item charge to the customers within the franchising authority.⁵⁸ In particular, LG&E relies upon a number of prior Commission decisions in which the Commission has found that a franchise fee is not an ordinary expense of a utility and, therefore, should not be treated as an ordinary utility expense; that a franchise fee is properly recovered as a line item so that customers are aware of what their government is charging.⁵⁹ LG&E contends that Louisville Metro's objection to the recovery of a franchise fee as a line-item charge on utility customers' bills would prevent its citizens from knowing the amount Louisville Metro is charging and that such objection would also conflict with the policies of the Commission.⁶⁰ LG&E argues that recovery of the franchise fee from all customers through base rates, as proposed by Louisville Metro, would unreasonably prejudice or disadvantage customers outside the

⁵⁷ LG&E Reply Brief at 13.

⁵⁸ LG&E Brief at 11.

⁵⁹ *Id.* citing, Case No. 7804, *General Adjustment of Rates of Kentucky Utilities Company*, Case No. 7804 (Ky. PSC Oct. 1, 1980); Case No. 7096, *The Local Taxes and/or Fees Tariff Filing of Columbia Gas of Kentucky, Inc.* (Ky. PSC Oct. 10, 1980); Case No. 7843, *The Local Taxes and/or Fees Tariff Filing of General Telephone Company of Kentucky* (Ky. PSC Oct. 3, 1980); Case No. 7891, *The Franchise Fee Tariff Filing of Continental Telephone Company of Kentucky* (Ky. PSC Oct. 10, 1980); Case No. 8154, *An Adjustment by the Union Light, Heat and Power Company to Include in Its Gas and Electric Tariffs, E.R.C. KY. No. 2 and E.R.C. KY. No. 3, Respectively, a Local Franchise Fee Applicable to All Schedules* (Ky. PSC June 24, 1981); and Case No. 89-054, *Taylor County Rural Electric Cooperative Corporation Notice of Tariff Revision* (Ky. PSC Apr. 10, 1989).

⁶⁰ LG&E Brief at 11.

fee-imposing municipality because those customers typically receive no benefit from the fee; furthermore, it would unlawfully expand the franchise authority of Louisville Metro.⁶¹

LG&E avers that its current gas tariff provides that franchise fees be passed through exclusively to the ratepayers located in the jurisdiction of the franchising authority and that the fee is to be recovered as a separate line item on a customer's bills.⁶² LG&E states that its Franchise Rider is a filed rate and, pursuant to KRS 278.160, LG&E is therefore prohibited from charging, demanding, collecting, or receiving from a customer a rate that is not prescribed in its Commission-approved gas tariff.⁶³ Thus, according to LG&E, Louisville Metro's demands violates LG&E's gas tariff and the filed-rate doctrine, which is embodied in KRS 278.160.⁶⁴

LG&E argues that the Commission's policies with respect to recovery of franchise fees via a line-item charge has not been altered by the General Assembly.⁶⁵ LG&E states that, in each year since 2011, the General Assembly has declined to enact bills that would amend KRS 96.010 to either prohibit the pass-through of franchise fees or grant permission to cities to prohibit such pass-through.⁶⁶ LG&E contends that the General Assembly, when considering those bills, is presumed to have been aware of the Commission's practices of permitting recovery of franchise fees by a line-item charge on

⁶¹ LG&E Brief at 14.

⁶² LG&E Brief at 13. LG&E's Franchise Rider is included in LG&E's gas tariff as LG&E Rates, Terms and Conditions for Furnishing Natural Gas Service, P.S.C. Gas No. 10, Original Sheet No. 90.

⁶³ LG&E Brief at 13.

⁶⁴ *Id.*

⁶⁵ LG&E Brief at 16.

⁶⁶ *Id.* KRS 96.010 governs the sale of public utility franchises by cities.

the bills of those customers located within the franchise jurisdiction.⁶⁷ LG&E argues that the General Assembly's decision to not amend KRS 96.010 in light of the Commission's policies and existing tariffs evidences legislative agreement with the Commission's policies.⁶⁸

LG&E contends that Louisville Metro erred in relying upon *City of Ashland v. Columbia Gas of Ky., Inc.*⁶⁹ for the proposition that LG&E's current practice of collecting the franchise fee is unlawful and that the *Columbia Gas* opinions are neither binding precedent nor persuasive authority.⁷⁰ Rather, LG&E argues that the *Columbia Gas* decisions are consistent with the Commission's exclusive jurisdiction to regulate rates after a franchise has been granted.⁷¹ LG&E points out that *Columbia Gas* involves the issue of a city's constitutional authority to determine the franchise's terms regarding both rates and services prior to the awarding of a franchise. The Kentucky Court of Appeals ruled that the city had such authority but further explained that the Commission's jurisdiction attaches once a city has awarded a utility franchise.⁷² To the extent the Commission desires to take the unpublished *Columbia Gas* decisions into consideration, LG&E asserts that the Commission should also consider a more recent opinion from Boyd

⁶⁷ LG&E Brief at 16.

⁶⁸ *Id.*

⁶⁹ *City of Ashland v. Columbia Gas of Ky., Inc.*, Div. II, No. 93-CI-458 (Boyd Cir. Ct. July 7, 1995)(unpublished), *aff'd*, No. 95-CA-2127-MR (Ky. App. July 19, 1996).

⁷⁰ LG&E Reply Brief at 18.

⁷¹ LG&E Reply Brief at 18–20.

⁷² LG&E Reply Brief at 20.

Circuit Court in *City of Ashland v. Kentucky Power Co.*,⁷³ which also addressed the issue of whether the City of Ashland could mandate the absorption of a franchise fee by a utility.⁷⁴ LG&E points out that because the city accepted Kentucky Power's bid and granted it a franchise which required the recovery of the franchise fee from customers, the Boyd Circuit Court held that the Commission had exclusive jurisdiction over rates and services and Kentucky Power was required by its Commission-approved tariff to recover the fee from customers.⁷⁵ LG&E further points out that the *Kentucky Power* decision held that once the franchise had been granted, the city had no authority to dictate that Kentucky Power cannot recoup the franchise fee from its customers as required under its tariff.⁷⁶

Louisville Metro Position

Louisville Metro states that this action is one of first impression for the Commission and presents two issues to be resolved. Louisville Metro's first issue is that LG&E's practice of recovering franchise fees as a line item on customer bills violates the Kentucky Constitution.⁷⁷ Alternatively, Louisville Metro contends that LG&E's method of collecting the subject franchise fees from only those customers located within Louisville Metro's

⁷³ *City of Ashland v. Kentucky Power Co.*, Boyd Cir. Ct., Div. II, Case No. 11-CI-00902 (Sept. 15, 2013)(unpublished).

⁷⁴ LG&E Reply Brief at 20.

⁷⁵ LG&E Reply Brief at 21.

⁷⁶ *Id.*

⁷⁷ Louisville Metro Brief at 1.

jurisdiction is inconsistent with its own tariff and violates Commission precedent, and other applicable law, and that it is not fair, just, and reasonable.⁷⁸

Louisville Metro argues that LG&E's current method of recovering the franchise fees as a line item on customers' bills violates Sections 163 and 164 of the Kentucky Constitution. Louisville Metro cites to *Hilliard v. George G. Fetter Lighting and Heating Co.*⁷⁹ for the proposition that these two constitutional provisions prohibit LG&E from collecting franchise fees as a line item on customers' bills.⁸⁰ Louisville Metro notes that the *Hilliard* court determined that the intent of Sections 163 and 164 was to allow a city to extract a fair price from a franchisee, and that the term of years allows a municipality to reap a portion of the economic benefits realized by a utility serving the population within the municipality's jurisdiction.⁸¹ Louisville Metro also relies upon *Kentucky CATV Association v. City of Florence*,⁸² which found that intent of Sections 163 and 164 was a delegation to municipalities the right to reap long-term economic benefits associated with the control of public rights-of-way through the issuance of a franchise.⁸³ Louisville Metro argues that LG&E's current practice would "allow the municipalities to benefit from the franchise fee, but would rob the actual public, those individuals that constitute the municipalities, from reaping the benefit of the franchise fee."⁸⁴

⁷⁸ *Id.*

⁷⁹ 105 S.W. 115 (Ky. 1907).

⁸⁰ Louisville Metro Brief at 5.

⁸¹ Louisville Metro Brief at 5–6.

⁸² 520 S.W.3d 355 (Ky. 2017).

⁸³ Louisville Metro Brief at 6–7.

⁸⁴ Louisville Metro Brief at 7.

Louisville Metro contends that LG&E's current method of collecting franchise fees as a pass-through is directly contrary to the unpublished opinion of *City of Ashland v. Columbia Gas of Ky., Inc.*⁸⁵ Louisville Metro states that the *Columbia Gas* case involved the question of whether a city has the right to prevent a utility from placing the franchise fee as a line item on customers' bills.⁸⁶ Louisville Metro points out that the Kentucky Court of Appeals affirmed the circuit court's opinion, ruling that a city does possess the legal right under Section 164 of the Kentucky Constitution to force a utility, when submitting a bid on a franchise, to contractually agree to absorb the cost of the franchise as a normal operating expense.⁸⁷ Louisville Metro concludes that it has the authority to prevent LG&E from collecting the franchise fee at issue as a line item on customer bills.

With respect to LG&E's current practice of collecting the franchise fee only from those customers located within Louisville Metro's boundaries, Louisville Metro argues that such a practice is contrary to LG&E's own tariff, which states: "A surcharge shall be calculated and added to the total bill for gas service for all customers located within local governmental jurisdictions which currently or in the future impose municipal franchise fees or other local taxes on [LG&E] by ordinance, franchise, or otherwise."⁸⁸ Louisville Metro contends that LG&E's tariff requires that the collection of franchise fee be on all customers located within the Louisville Metro jurisdiction, including those customers located within

⁸⁵ *City of Ashland v. Columbia Gas of Ky., Inc.*, Div. II, No. 93-CI-458 (Boyd Cir. Ct. July 7, 1995) (unpublished), *aff'd*, No. 95-CA-2127-MR (Ky. App. July 19, 1996).

⁸⁶ Louisville Metro Brief at 10.

⁸⁷ Louisville Metro Brief at 10–11.

⁸⁸ Louisville Metro Brief at 12, *quoting* LG&E Tariff Sheet No. 90.

the 82 municipalities that kept their own governmental status and powers post-merger.⁸⁹ Louisville Metro argues that LG&E's violation of its own tariff also constitutes a violation of the filed-rate doctrine as codified in KRS 278.160(2) because LG&E is failing to collect the franchise fee from those customers located in the 82 municipalities that are confined within Louisville Metro jurisdictional boundaries.⁹⁰ Louisville Metro asserts that LG&E has offered no argument that its current practice of collecting franchise fees is fair, just, and reasonable.⁹¹ Rather, Louisville Metro contends that state law requires collection of the franchise fee throughout Louisville Metro,⁹² and that a Louisville Metro ordinance typically applies with equal effect throughout Louisville Metro.⁹³

Louisville Metro maintains that LG&E's actions are also contrary to Commission precedent.⁹⁴ Citing past Commission decisions finding that a franchise fee should not be recovered from customers residing outside the political boundaries of the franchise area, because doing so would amount to taxation without representation, Louisville Metro contends that the facts of the instant matter are the exact opposite, noting that each and every citizen in Louisville Metro, including those residing within the Home Rule Cities, is able to vote for a city council representative and the Mayor.⁹⁵ Louisville Metro asserts that customers located within the Home Rule Cities within Louisville Metro have

⁸⁹ Louisville Metro Brief at 12.

⁹⁰ Louisville Metro Brief at 13.

⁹¹ Louisville Metro Reply Brief at 2.

⁹² Louisville Metro Reply Brief at 3, *citing* KRS 67C.117.

⁹³ Louisville Metro Reply Brief at 2.

⁹⁴ Louisville Metro Brief at 13.

⁹⁵ *Id.*

representation on the city council, which passed the ordinance offering the franchise agreement.⁹⁶ Louisville Metro also asserts that the customers located within the Home Rule Cities receive numerous services and benefits from Louisville Metro, which are funded in part by the franchise fee.⁹⁷ Because the Commission has previously found that those customers receiving the benefit of services financed by franchise fees should contribute to the franchise fee, Louisville Metro contends that this position supports its proposal to have LG&E collect the franchise fees from all customers residing in Louisville Metro.⁹⁸

Louisville Metro maintains that LG&E's current method of collecting franchise fees has a discriminatory and disparate impact on the customers located within Louisville Metro.⁹⁹ Louisville Metro points out that the minority population in the Home Rule Cities is roughly half that of the Louisville Metro population and that there appears to be an approximately \$40,000 gap in median household income between the Home Rule Cities and the full Louisville Metro population.¹⁰⁰ Louisville Metro contends that these impacts, regardless of intent, appear to create discriminatory and disparate treatment that negatively impacts minority and less economically advantaged populations.¹⁰¹ Louisville Metro further contends that LG&E's current practice is not fair, just, and reasonable, and

⁹⁶ *Id.*

⁹⁷ Louisville Metro Brief at 14.

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

that LG&E should be directed to collect the franchise fee from all customers located in Louisville Metro.¹⁰²

KIUC's POSITION

Although it did not submit legal briefs, KIUC's counsel, at the oral arguments hearing on September 28, 2017, argued that LG&E should be allowed to recover the franchise fee and that such recovery should be collected via a line item on customer's bills.¹⁰³ KIUC contends that LG&E's Commission-approved tariff must govern and that the police power to establish utility rates has been delegated to the Commission pursuant to KRS Chapter 278.¹⁰⁴ KIUC maintains that it would be bad policy to require the recovery of franchise fees through base rates, as this would socialize such costs amongst all LG&E gas customers and would improperly impose a tax burden on all ratepayers of LG&E. KIUC asserts that a utility cannot be denied recovery of reasonable expenses, including franchise fees.¹⁰⁵ A denial of recovery of such costs would be a breach of the regulatory compact and would harm customers.¹⁰⁶ KIUC argues that LG&E's tariff could be interpreted to allow Louisville Metro to recover the franchise fee from all LG&E gas customers residing within Louisville Metro's jurisdiction, including those customers

¹⁰² Louisville Metro Brief at 14–15.

¹⁰³ September Hearing Video Transcript, 2:02:04.

¹⁰⁴ *Id.* at 2:03:14.

¹⁰⁵ *Id.* at 2:04:20.

¹⁰⁶ *Id.* at 2:06:32.

located in the 82 Home Rule Cities.¹⁰⁷ KIUC notes that Louisville Metro provides certain services to those cities without compensation.¹⁰⁸

DISCUSSION

Having reviewed the record and being otherwise sufficiently advised, the Commission finds that the authority to grant a franchise generally resides in a state's legislative body, but that Section 163 of the Kentucky Constitution delegates this authority to municipalities. Section 163 has been judicially interpreted as vesting municipalities with the right and power to control the original occupation of their streets by public utilities.¹⁰⁹ However, a municipality's power to grant a franchise is not absolute. Section 164 of the Kentucky Constitution limits a municipality from awarding a franchise with a term in excess of 20 years and requires a municipality to advertise and obtain public bids before awarding a franchise to the highest and best bidder. Significant to this case, the legislature's enactment of the Public Service Commission Act of 1934 ("PSC Act")¹¹⁰ also restricts municipalities' franchise powers. The PSC Act conferred exclusive jurisdiction over utility rates and service to the Commission¹¹¹ and empowered the Commission to change any rate fixed by a city pursuant to a franchise.¹¹² Based on the case law cited by both Louisville Metro and LG&E in this matter, it is well-settled Kentucky law that the

¹⁰⁷ *Id.* at 2:07:09.

¹⁰⁸ *Id.* at 2:08:33.

¹⁰⁹ *Kentucky Utilities Co. v. Bd. of Com'rs of City of Paris*, 71 S.W.2d 1024, 1027 (Ky. 1933).

¹¹⁰ 1934 Ky. Acts ch. 145.

¹¹¹ KRS 278.040(2).

¹¹² KRS 278.200.

Commission has exclusive jurisdiction over the rate and services of a utility and that jurisdiction extends to the regulation of a rate or service standard fixed by a franchise between a utility and a city.¹¹³ The Commission's jurisdiction under KRS 278.200 attaches after a franchise has been awarded. Sections 163 and 164 of the Kentucky Constitution impose no limit on the Commission's jurisdiction. Accordingly, we find that the Commission has jurisdiction of the franchise fee at issue in this matter.

Having determined that we have jurisdiction over the 2016 Franchise Agreement franchise fee, we next address the issue of whether LG&E may lawfully collect the franchise fee as a line item on customer's bills. The Commission finds that LG&E's method of recovering the franchise fee as a line item is lawful and consistent with Commission precedent. In a series of cases beginning in 1980, the Commission addressed the issue concerning the manner in which a franchise fee should be recovered by a utility.¹¹⁴ The Commission found that franchise fees represented an identifiable part of the cost of providing service within a municipality's boundaries and, therefore, should

¹¹³ We find Louisville Metro's reliance upon *Columbia Gas* and *KCTA* to be misplaced. We note that the *Columbia Gas* opinion involves the narrow issue of a city's authority over the franchise bid process. The *Columbia Gas* decision did not limit the Commission's jurisdiction under KRS 278.200. Rather, the opinion acknowledged that the Commission has exclusive jurisdiction over utility rates and that the Commission's jurisdiction attaches after a franchise has been awarded. The *KCTA* decision is distinguishable in that the case involves the issue of whether cities under Sections 163 and 164 have the right to collect franchise fees from utilities. These two cases do not purport to limit the Commission's jurisdiction over rates and service or in any way impact the Commission's authority as set forth in KRS 278.200.

¹¹⁴ Case No. 7804, *General Adjustment of Rates of Kentucky Utilities Company* (Ky. PSC Oct. 1, 1980); Case No. 7906, *The Local Taxes and/or Fees Tariff Filing of Columbia Gas Company of Kentucky, Inc.*(Ky. PSC Oct. 10, 1980); Case No. 7843, *The Local Taxes and/or Fees Tariff Filing of General Telephone Company of Kentucky* (Ky. PSC Oct. 3, 1980); Case No. 7891, *The Franchise Fee Tariff Filing of Continental Telephone Company of Kentucky* (Ky. PSC Oct. 10, 1980); Case No. 7900, *General Adjustment of Electric Rates of Kentucky Power Company* (Ky. PSC Dec. 17, 1980); Case No. 8154, *An Adjustment by the Union Light, Heat and Power Company to Include in its Gas and Electric Tariffs, E.R.C. Ky. No. 2 and E.R.C. Ky. No. 3, Respectively, A Local Franchise Fee Applicable to All Schedules* (Ky. PSC June 24, 1981).

be recovered from those receiving that service.¹¹⁵ The Commission further found that the recovery of franchise fees should be as a separate line item on customers' bills, noting that the practical effect of franchise fees is to have a utility act as the conduit by which ratepayers are assessed a franchise fee which the utility collects and then passes on to the municipality¹¹⁶ and that ratepayers have the right to know the amount of such charges collected from them for government operating expenses.¹¹⁷ The Commission addressed this issue in Case No. 7804; in that decision we rejected Lexington-Fayette Urban County Government's argument that ratepayers should not receive any itemization on their bills as to the franchise fee paid to the city, finding no justification in hiding this charge from the consumer or treating these franchises as ordinary utility expenses to be recovered from all customers.¹¹⁸ We find nothing in the record of the instant matter to justify a deviation from Commission precedent.

As to the scope of recovery of the franchise fee, the Commission also relies upon past Commission precedent to guide us on this issue. In Case No. 7843, a matter involving a tariff filing of General Telephone Company of Kentucky concerning customer billing for certain local taxes or fees, including franchise fees, that might be levied or imposed upon the utility, we found that "a uniform system should be adopted to recover

¹¹⁵ Case No. 7804, *Kentucky Utilities Company* (Ky. PSC Oct. 1, 1980).

¹¹⁶ In requiring recovery of franchise fees as a line item, the Commission also relied upon KRS 160.613, which authorizes school districts to assess a tax on a utility's gross receipts. Specifically, KRS 160.617 requires utilities to reflect this tax as a separate line item on customers' bills. See, Case No. 7804, *Kentucky Utilities Company* (Ky. PSC Oct. 1, 1980).

¹¹⁷ Case No. 7804, *Kentucky Utilities Company* (Ky. PSC Oct. 1, 1980).

¹¹⁸ *Id.*

these costs fairly with respect to the entire customer body.”¹¹⁹ The final order in Case No. 7843 further found that “[t]he fairest and best way to accomplish this is to recover franchise fees as a separate item on utility bills of customers receiving service within a municipality requiring such a fee.”¹²⁰ In general, the Commission’s policy on recovery of franchise fees has not changed since its implementation nearly four decades ago.¹²¹

Louisville Metro argues that the 2016 Franchise Agreement franchise fee should be borne by all LG&E gas customers located within Louisville Metro because citizens of the Home Rule Cities have elected representation on the legislative council of Louisville Metro and also vote to elect the Mayor of Louisville Metro, and because the Louisville Metro legislative council voted to approve the 2016 Franchise Agreement and the Mayor of Louisville Metro executed the agreement. We note, however, that the record also clearly establishes that, under Kentucky law, those Home Rule Cities remain incorporated and retain all powers and functions previously held before the consolidation of city and county governments.¹²² Whereas LG&E provides substantial case law and statutory law supporting its argument that all of powers of Louisville Metro are confined to its territorial limits, Louisville Metro offers no evidence to show that its authority extends to these Home

¹¹⁹ Case No. 7843, *The Local Taxes and/or Fees Tariff Filing of General Telephone Company of Kentucky* (Ky. PSC Oct. 3, 1980) Order at 2.

¹²⁰ *Id.*

¹²¹ The Commission in Case No. 7900, *General Adjustment in Electric Rates of Kentucky Power Company* (Ky. PSC Dec. 17, 1980), found that separate billing was not feasible or practical because the charges on a per unit basis were small but directed Kentucky Power Company to establish a plan for providing its customers with an annual informational billing insert describing the annual cost of franchise fees to the average residential customer by each separate municipality imposing a franchise fee.

¹²² KRS 67C.111(1).

Rule Cities. To the contrary, there is evidence showing that Louisville Metro is in agreement with LG&E's position on this issue based upon the May 2, 2011 formal opinion of the Jefferson County Attorney.¹²³ In concluding that Louisville Metro has no authority to require a private utility franchisee, by contract or otherwise, to provide services in any area not within Louisville Metro's jurisdiction, or to pay Louisville Metro franchise fees based on the utility's provision of services within other municipal jurisdictions, that formal opinion states:

Thus, the defined cities within Jefferson County, post merger, remain as fully empowered municipalities under Section 157a of the [Kentucky] Constitution and the enactments of the General Assembly applicable to each class of city. Thus, the general jurisdiction and authority of Louisville Metro as a municipality is limited by law to (1) the territory encompassed by the city of the first class [Louisville] which the consolidated government replaced, and (2) those areas of Jefferson County *outside* the territorial boundaries of all *other* cities within Jefferson County which existed as of the onset of Louisville Metro Government pursuant to KRS Chapter 67C.

Sections 163 and 164 of the [Kentucky] Constitution make it clear that when a municipality awards a franchise for the purpose of providing utility services to its constituents, it is clearly undertaking what is known as a governmental function as that term is understood and applied under Kentucky law. It is equally clear that unless otherwise authorized by statute or by the [Kentucky] Constitution, a municipality may only provide governmental services within its territorial boundaries (jurisdiction) for the benefit of those citizens who live or work within those boundaries. It is but a short step to the principle of Kentucky law that one municipality, Louisville Metro, may not directly or indirectly tax or otherwise assess the citizens of other equally sovereign municipalities, that are incorporated cities within Jefferson County, for services purportedly provided by one to the other.¹²⁴

¹²³ LG&E Reply Brief, Appendix H.

¹²⁴ *Id.* at 3. (footnote and citations omitted).

Thus, based on the entirety of the record, we conclude that Louisville Metro's authority is confined within its territorial boundaries and the franchise fee can be recovered only from those LG&E gas customers who reside within Louisville Metro's territorial boundaries, i.e., the territory encompassed by the City of Louisville, which Louisville Metro replaced, and those areas of Jefferson County outside of the 82 Home Rule Cities. We further find that our conclusion is buttressed by the clear and unambiguous language of the 2016 Franchise Agreement which sets forth the Franchise Area as being "the public streets, avenues, alleys and other public ways of Louisville Metro, but not within the jurisdiction of any other city located in Jefferson County, Kentucky."¹²⁵ In light of this conclusion, we further find that LG&E's Franchise Fee Rider, which provides that the franchise fee shall be applied exclusively to the bills of customers receiving service within the territorial limits of the authority imposing the franchise fee, to be fair, just, and reasonable.

IT IS THEREFORE ORDERED that:

1. LG&E's requests that the Commission issue a declaratory order confirming that LG&E must calculate and add to the total bill for gas service of all customers located within Louisville Metro's jurisdiction, excluding those customers who reside with the 82 Home Rule Cities, a surcharge to collect any fees for the 2016 Franchise Agreement is granted.
2. LG&E shall recover the franchise fee associated with the 2016 Franchise Agreement in accordance with its Commission-approved Franchise Fee Rider.
3. Louisville Metro's request that the franchise fee at issue should be paid for by LG&E and not be passed directly on to customers is denied.

¹²⁵ Application, Exhibit 5, page 3 of 20.

4. Louisville Metro's alternative request that LG&E should either be required to recover the franchise fees from all LG&E customers located within Louisville Metro's jurisdiction, including those customers who reside within the 82 Home Rule Cities, or be required to recover the franchise fees from all LG&E gas customers is denied.

5. Louisville Metro's motion to allow Gregory T. Dutton to withdraw as counsel for Louisville Metro is granted.

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By the Commission

ENTERED
MAR 14 2018
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:


Executive Director

Case No. 2016-00317

*Honorable Allyson K Sturgeon
Senior Corporate Attorney
LG&E and KU Energy LLC
220 West Main Street
Louisville, KENTUCKY 40202

*Louisville Gas and Electric Company
220 W. Main Street
P. O. Box 32010
Louisville, KY 40232-2010

*Jody Kyler Cohn
Boehm, Kurtz & Lowry
36 East Seventh Street
Suite 1510
Cincinnati, OHIO 45202

*Louisville Gas and Electric Company
220 W. Main Street
P. O. Box 32010
Louisville, KY 40232-2010

*Honorable Kurt J Boehm
Attorney at Law
Boehm, Kurtz & Lowry
36 East Seventh Street
Suite 1510
Cincinnati, OHIO 45202

*Honorable Kendrick R Riggs
Attorney at Law
Stoll Keenon Ogden, PLLC
2000 PNC Plaza
500 W Jefferson Street
Louisville, KENTUCKY 40202-2828

*Michael J O'Connell
Jefferson County Attorney
Brandeis Hall of Justice
600 West Jefferson St., Suite 2086
Louisville, KENTUCKY 40202

*Honorable Michael L Kurtz
Attorney at Law
Boehm, Kurtz & Lowry
36 East Seventh Street
Suite 1510
Cincinnati, OHIO 45202

*Robert Conroy
LG&E and KU Energy LLC
220 West Main Street
Louisville, KENTUCKY 40202