BELLSOUTH

BellSouth Telecommunications, Inc.
601 W. Chestnut Street
Room 407
Louisville, KY 40203

Mary.Keyer@BellSouth.com

Mary K. Keyer
General Counsel/Kentucky

502 582 8219
Fax 502 582 1573

July 26, 2007

RECEIVED

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PUBLIC SERVICE
COMMISSION

Ms. Beth O'Donnell
Executive Director
Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, KY 40602

Re: Dialog Telecommunications, Inc., Complainant v. BellSouth Telecommunications, Inc., Defendant
KPSC 2005-00095

Dear Ms. O'Donnell:

Enclosed for filing in the above-referenced matter are the original and ten (10) copies of AT&T Kentucky's Response to Dialog's Supplemental Comments.

Sincerely,

Mary K. Keyer

cc: Parties of Record

685615

Dialog's substantive argument (essentially, the revised Affidavit of Steven L. Lenarz) merits minimal response from AT&T Kentucky because the Affidavit is irrelevant. As discussed in AT&T Kentucky's Supplemental Brief at pages 5-8, even if true, the Revised Lenarz Affidavit does not negate, implicate, undermine, or otherwise impact the fact that Dialog has a ***contractual obligation*** under GTCs Section 11.4.3 to pay the amounts it has refused to pay. That said, AT&T Kentucky must respond to some of the more egregious misstatements and omissions made by Dialog in its Supplemental Comments.

First, Dialog claims that it has disputed the applicability of sales tax on UNEs since 2001, and that it has sought "a ruling on a clear question of law [regarding sales tax on UNEs]" for six years "while the ILEC [AT&T Kentucky] has continued its course of harassing, and reducing the cash flow of, its competitors by continuing to charge the alleged 'tax' while refusing to seek a Department of Revenue ruling . . . ."[1] In its Complaint, Dialog alleged that it first raised the sales tax on UNEs issue in 2002.[2] Moreover, Dialog's purported six year "odyssey" for a tax ruling conveniently ignores the one ruling directly on point – that is, the letter issued to Dialog by the Kentucky Revenue Cabinet – Division of Tax Policy in October 2003. This letter – issued almost four years ago and prior to Dialog's filing of its Complaint with this Commission --- squarely and unequivocally rejected Dialog's "no sales tax on UNEs" position.[3] Of course, Dialog has refused to pay the tax in question,[4] hence it has suffered no reduced cash flow.

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[1] Dialog's Supplemental Comments at footnote 1.

[2] Dialog Complaint, ¶ 14 ("Since 2002, DIALOG has asserted that BellSouth is in error to collect sales tax on UNEs.")

[3] Supplemental Brief of AT&T Kentucky, Exhibit B.

[4] *See* Exhibits 1 and 2 to AT&T Kentucky's Motion for Rehearing and/or Reconsideration.

Further, since the inception of this case, AT&T Kentucky has repeatedly offered to seek a tax refund on Dialog's behalf – as soon as Dialog actually pays the tax in question.[5] As such, AT&T Kentucky has not refused to seek the tax ruling that Dialog claims it wants.[6]

Second, Dialog makes the incredulous assertion that whether or not it paid sales tax on UNEs (an amount that exceeds $530,000) is irrelevant.[7] If true, then it is puzzling why Dialog represented to the Commission that it had actually paid sales tax on UNEs[8] when it had actually withheld such amounts. Moreover, if whether or not Dialog had actually paid sales tax on UNEs were truly irrelevant, then it is odd that Dialog vehemently opposed AT&T Kentucky's Motion for Rehearing and/or Reconsideration[9] -- a motion that simply requested the Commission to correct an error of fact in its original *Order* and issue an *Order* that reflected the true facts; that is, Dialog has withheld payment of the tax in question. Such behavior leads to the inescapable conclusion that Dialog has sought to hide the true facts in an attempt to side-step its contractual obligation to pay the amounts that it has steadfastly refused to pay. It is respectfully submitted that the Commission should not reward such antics, and

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[5] *See* BellSouth Telecommunications, Inc.'s Amended Response to Dialog Telecommunications, Inc.'s Complaint at 3.

[6] In fact, in December 2005, AT&T Kentucky moved to dismiss Dialog's tax claim based on the fact that AT&T Kentucky was (and remains) willing to pursue a refund of sales taxes on UNEs that Dialog had actually paid (before withholding those amounts again), but Dialog opposed that motion. *See* Response of Dialog Telecommunications, Inc. to BellSouth Motion to Dismiss and Cross Motion for Summary Judgment.

[7] Dialog's Supplemental Comments at 2.

[8] *See* Letter of Doug Brent to Beth O'Donnell, Executive Director of the Kentucky Public Service Commission, dated May 5, 2006, at page 2.

[9] *See* Response of Dialog to BellSouth's Motion for Rehearing.

therefore should issue an Order that requires Dialog to do what it is contractually obligated to do – immediately pay the amounts it has wrongfully withheld.

Third, Dialog asserts that GTCs Section 11.4.4 "was the heart of BellSouth's [AT&T Kentucky's] March 5, 2007 Motion for Reconsideration.[10] This assertion is inaccurate. Although AT&T Kentucky cited GTCs Section 11.4.4, on page 5 of AT&T Kentucky's Motion for Reconsideration and/or Rehearing, AT&T Kentucky also cited GTCs Section **11.4.3** in support of its position that Dialog has a contractual obligation to pay the amounts it has wrongfully withheld. This position is not new. Indeed, well over a year ago, on page 5 of BellSouth's Response to Dialog's Cross Motion for Summary Judgment, AT&T Kentucky quoted the full text of GTCs Section **11.4.3** in support of its position that Dialog has a contractual obligation to pay the amounts it has wrongfully refused to pay.

Fourth, Dialog claims that AT&T Kentucky has refused "to assist Dialog despite Judge Crittenden's February 2004 Order, [which] is why Dialog is before this Commission in the first place."[11] Dialog's claim is incorrect. Judge Crittenden's one paragraph Order concludes as follows: "**The Court further ORDERS that the Plaintiff [Dialog] shall make a formal written demand to BellSouth to file a refund claim on its behalf.**"[12] This Order obviously was based on Judge Crittenden's assumption that Dialog had paid the tax in question to BellSouth, which Dialog had represented to the

[10] Dialog's Supplemental Comments at 5.

[11] Dialog's Supplemental Comments at 6 (footnote omitted).

[12] The Court's Order is attached as Exhibit 2 to Dialog's Complaint (emphasis added).

Court on at least two occasions.[13] Not only did Dialog misrepresent the facts to the Court, but a strong argument could be made that Dialog is in violation of Judge Crittenden's Order because it did not, and indeed could not, ask BellSouth to seek a refund *on its behalf* of taxes that it had not paid. Moreover, by its own admission, Dialog is still not seeking for AT&T Kentucky to file a refund claim on its behalf.[14]

REPLY TO DIALOG'S RESPONSE TO AT&T KENTUCKY'S SUPPLEMENTAL BRIEF

In a scrambling attempt to avoid its clear and unambiguous obligation under GTCs 11.4.3 to pay the amounts that it has wrongfully withheld, Dialog makes three arguments. As explained below, such arguments lack merit, as well as clarity, and should be summarily disregarded by the Commission.

First, Dialog suggests that GTCs Section 11.4.3 is contrary to Kentucky tax law and thus should be ignored because "no contract trumps the law; instead, the law is incorporated into contracts and governs the parties' relationships. *See e.g., Grayson Rural Electric Corp. v. City of Vanceburg,* 4 S.W.3d 526, 531 (Ky. 1999) [("Grayson case")]"[15] The Grayson case has nothing to do with a contract dispute or contract interpretation and does not stand for the proposition for which Dialog has cited it. A copy of the Grayson case is attached hereto as Exhibit B. Indeed, a review of the Grayson case demonstrates that Dialog has misinterpreted the following language in

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[13] See Dialog's Response to the Revenue Cabinet's Motion to Dismiss, at p. 1 ("Dialog has been paying the sales tax, and it continues to do so."); Dialog's Complaint for Declaratory Relief, ¶ 8 ("Since Dialog began its Kentucky operations in January of 2002, BellSouth has collected sales tax from Dialog on the lease or purchase of each of these particular UNE's."). These pleadings are attached hereto as Exhibit A.

[14] Dialog's Supplemental Comments at 7 ("Dialog does not demand, and has not demanded, that AT&T Kentucky (or BellSouth before it) file a refund claim with the Revenue Cabinet." (footnote omitted).

[15] *See* Response to Supplemental Brief at 2 ("no contract trumps the law; instead, the law is incorporated into contracts and governs the parties' relationships.")

the Grayson case: "That is, rights accorded to parties by statute become a part of the operative facts which govern their relationship."[16] Misinterpreting this language and the holding of the Grayson case to mean that "no contract trumps the law; instead, the law is incorporated into contracts and governs the parties' relationships," is just another example of Dialog's efforts to "bend the facts" to achieve its goal of avoiding paying over $530,000 that Dialog is contractually obligated to pay AT&T Kentucky.

As explained in AT&T Kentucky's Supplemental Brief at pages 6-10, AT&T Kentucky's position regarding GTCs Section 11.4.3 is completely consistent with Kentucky tax law. Further, AT&T Kentucky's position is in accord with the only opinion on the matter -- the letter issued to Dialog by the Kentucky Revenue Cabinet -- Division of Tax Policy, which squarely and unequivocally rejected Dialog's "no sales tax on UNEs" position.

Second, without citing any portion of the parties' interconnection agreement, Dialog makes the unsupported and confusing statement that "the Interconnection Agreement imposes upon BellSouth [AT&T Kentucky] the 'responsibility' to determine the tax, not the 'authority.'"[17] Regardless of what Dialog means by this statement, the plain language of GTCs Section 11.4.3 obligates Dialog to pay the amounts that it has wrongfully withheld. In any event, Dialog has failed to explain why it should be "excused" from its contractual obligation under GTCs Section 11.4.3 to pay the tax in question.

Third, Dialog makes the baseless assertion that AT&T Kentucky has somehow violated an obligation of good faith and fair dealing "to cooperate with, rather than

[16] Grayson case at 531 (emphasis added).

[17] Response to Supplemental Brief at 2.

stonewall, Dialog."[18] Presumably, Dialog is of the belief that good faith and fair dealing means AT&T Kentucky has an obligation to waive its contractual rights, establish detrimental precedent, and disregard its non-discriminatory obligations to other competitive local exchange carriers, all in order to "cooperate" with Dialog's efforts to skirt its contractual obligation to pay the amounts that it has wrongfully withheld. Such an assertion is nonsensical. AT&T Kentucky has repeatedly offered to seek a tax refund on Dialog's behalf – as soon as Dialog actually pays the tax in question. Given the parties' contractual provisions regarding payment of taxes, this offer more than satisfies AT&T Kentucky's obligation to cooperate in good faith, and raises doubts as to whether Dialog is acting in good faith and fair dealing in its refusal to pay the amounts it owes AT&T Kentucky.

Stripped of its hyperbole, Dialog's Response to AT&T Kentucky's Supplemental Brief is nothing more than a blatant plea for the Commission to re-write the parties' contract and allow Dialog to evade its contractual obligation to pay the amounts that it has wrongfully refused to pay.

CONCLUSION

As stated herein and in AT&T Kentucky's Supplemental Brief, Dialog has a contractual obligation under GTCs Section 11.4.3 to pay the substantial amount (over $530,000) that it has wrongfully refused to pay AT&T Kentucky. Accordingly, the Commission should deny Dialog's Motion to Reopen and issue an Order that supplements and reaffirms the *Recon Order* by making clear that Dialog has a contractual obligation under Section 11.4.3 to pay AT&T Kentucky the amounts that have been withheld.

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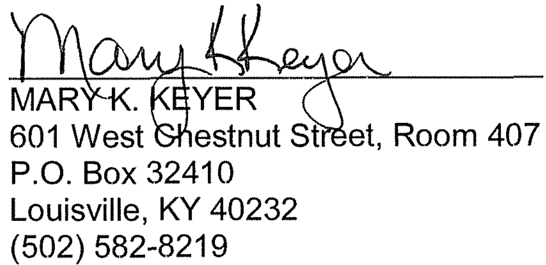
[18] Response to Supplemental Brief at 3

Respectfully submitted this 26th day of July 2007,



MARY K. KEYER
601 West Chestnut Street, Room 407
P.O. Box 32410
Louisville, KY 40232
(502) 582-8219

ROBERT A. CULPEPPER
Suite 4300, AT&T Midtown Center
675 West Peachtree Street, NE
Atlanta, GA 30375
(404) 335-0841

Counsel for AT&T Kentucky

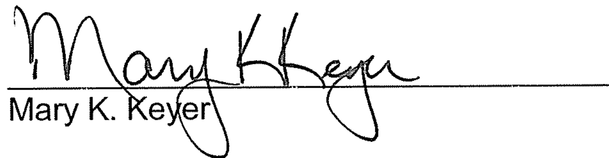
685098

CERTIFICATE OF SERVICE – KPSC 2005-00095

It is hereby certified that a true and correct copy of the foregoing was served on the following individuals by mailing a copy thereof, this 26th day of July, 2007.

Jim Bellina
Dialog Telecommunications, Inc.
756 Tyvola Road
Suite 100
Charlotte, NC 28217

Douglas F. Brent
Attorney at Law
Stoll Keenon Ogden, PLLC
2000 PNC Plaza
500 West Jefferson Street
Louisville, KY 40202
Douglas.Brent@skofirm.com



Mary K. Keyer

EXHIBIT A

JAN 2 3 2004
FRANKLIN CIRCUIT COURT
JANICE MARSHALL, CLERK

COMMONWEALTH OF KENTUCKY
FRANKLIN CIRCUIT COURT
DIVISION I
CASE NO. 03-CI-1617

DIALOG TELECOMMUNICATIONS, INC. PLAINTIFF

v.

THE COMMONWEALTH OF KENTUCKY and
THE KENTUCKY REVENUE CABINET DEFENDANTS

****

RESPONSE TO MOTION TO DISMISS

Dialog Telecommunications, Inc. ("Dialog"), by counsel, responds to the Kentucky Revenue Cabinet's ("the Cabinet's") motion to dismiss the complaint and states that the Cabinet's motion should be denied for the following reasons.

INTRODUCTION

The court should not dismiss Dialog's complaint for a declaratory judgment. In its motion to dismiss, the Cabinet claims that Dialog: (1) has failed to exhaust its administrative remedies; and (2) lacks standing to pursue its claims because there is, allegedly, no actual controversy regarding the issue of whether the Cabinet is properly interpreting and applying KRS 139.100 and KRS 139.200. Both of these claims are unfounded.

Dialog has attempted to resolve this matter through every possible administrative procedure, yet with each attempt the Cabinet has repeatedly informed Dialog that no such administrative procedure is available. In light of this position, it is almost inconceivable that the Cabinet could now claim that there is no actual controversy regarding Dialog's liability for the sales tax that is being imposed on it. Dialog has been paying the sales tax, and it continues to do so. And given the Cabinet's refusal to provide Dialog with any administrative avenues for

pursuing its claims, Dialog is forced to petition the court for the declaratory judgments sought in the complaint. The court should, therefore, deny the Cabinet's motion to dismiss and afford Dialog the due process rights that the Cabinet has repeatedly refused to recognize.

STATEMENT OF THE FACTS

Given the accusations thrown about by the Cabinet in its motion to dismiss, the court should understand the factual background and procedural history leading up to the filing of the complaint in this matter. Dialog is a competitive local exchange carrier who purchases and/or leases certain unbundled network elements ("UNE's") of BellSouth's telecommunications system and then combines those UNE's in its own proprietary fashion to provide local exchange and data services to its own end-user customers. (Complaint at para. 1). Despite the fact that BellSouth sells and/or leases these UNE's to Dialog — as it is required to do pursuant to the Telecommunications Act of 1996 (the "Act") — Dialog and BellSouth are direct competitors. (*See* Affidavit of Jim Bellina at para. 2, attached as Exhibit 1; *see also* Complaint at para. 40).

When Dialog purchases/leases UNE's from BellSouth, BellSouth collects sales tax on those purchases. (Complaint at para. 8). In late 2002, Dialog filed a protest with BellSouth contesting the collection of sales tax on Dialog's purchases/leases. (*See* Ex. 1 at para. 3). The protest was made because Dialog was being forced to suffer a competitive disadvantage to BellSouth by paying sales taxes that BellSouth either did not itself pay or that should have already been accounted for in the UNE rates charged by BellSouth. (*See* Ex. 1 at para. 4). BellSouth denied that protest on January 23, 2003. (*See* January 15, 2004 e-mail from Linda Adams, attached as Exhibit 2). Prior to that time, Dialog had filed similar protests with BellSouth six or seven additional times, not surprisingly all with identical results; after all, it was

in BellSouth's competitive interest to deny those protests and thereby increase Dialog's cost of doing business. (*See* Ex. 1 at para. 5).

Dialog turned to the Cabinet for help. On September 3, 2003, counsel to Dialog sent a detailed, seven page letter to the Cabinet. (*See* September 3, 2003 letter attached as Exhibit 3 to this response). The purpose of that letter was "to request a ruling from the Kentucky Revenue Cabinet regarding the applicability of the sales tax imposed upon Dialog by KRS 139.200." *Id.* The letter set forth all factual and legal bases for Dialog's requested ruling. *See id.* After two months of deliberation, the Cabinet responded to Dialog's letter, claiming that it was the Cabinet's position that Dialog's purchases/leases were subject to the sales tax. (*See* October 31, 2003 letter from Richard Dobson, attached as Exhibit 4). The Cabinet concluded, stating that "it is the Cabinet's responsibility to administer the current language of the law as it applies to companies such as Dialog until such time as appropriate legislative or judicial body determines otherwise." *Id.*

Believing this to be the Cabinet's final ruling, on November 24, 2003, Dialog filed a petition of appeal with the Kentucky Board of Tax Appeals (the "KBTA").[1] (*See* file-stamped Petition of Appeal, attached as Exhibit 5; *see also* Affidavit of Edward Depp at para. 2, attached as Exhibit 6). Not long after this filing, the KBTA contacted counsel to Dialog stating that the Cabinet's October 31, 2003 letter was not in the typical format for final rulings. (*See* Ex. 6 at para. 3). The KBTA stated that in order for the petition of appeal to move forward, the Cabinet would need to certify its October 31, 2003 letter as being its final ruling in the matter. (*See* Ex. 6 at para. 4).

Counsel to Dialog telephoned Mr. Richard Dobson (who had signed the October 31, 2003 letter) and requested that the Cabinet certify the ruling as its final ruling in the matter. (*See* Ex. 6

[1] That filing was timely pursuant to the thirty (30) day window provided by statute.

at para. 5). Mr. Dobson refused, stating that the Cabinet could not issue a final ruling because it could only do so in response to a protested assessment or a denied refund claim.[2] (*See* Ex. 6 at para. 6). Mr. Dobson further stated that because this was a sales tax issue, the proper means of obtaining an appealable final ruling was to file a refund claim for the sales tax. (*See* Ex. 6 at para. 7). Mr. Dobson also stated that Dialog would be unable to file for a refund claim, however, because BellSouth was actually the taxpayer, and the Cabinet only considers refund requests from taxpayers. (*See* Ex. 6 at para. 8).

Despite this information, Dialog nevertheless printed out Cabinet Form 51A209 ("Sales and Use Tax Refund Application") to determine whether it had a right to file a refund claim. (*See* Ex. 6 at para. 9; *see also* Form 51A209, attached as Exhibit 7). Consistent with the Cabinet's oral representations, instruction number 2 on that form provides that "Only the person making payment of the tax directly to the Kentucky State Treasurer may file the application for refund." (*See* Ex. 7). Left with no other alternative, administrative means of reviewing the Cabinet's initial determination, as set forth in the October 31, 2003 letter, Dialog sought the assistance of the courts.

ARGUMENT & ANALYSIS

I. Standard of Review.

"When a motion to dismiss a complaint seeking a declaration of rights is filed, the question presented to the circuit court is... whether the complaint states a cause of action for declaratory relief." *Curry v. Coyne*, Ky. App., 992 S.W.2d 858, 859 (1998) (citation omitted). "The complaint must be construed in the light most favorable to the plaintiff and all allegations taken as true." *Id.* (citation omitted). Pursuant to CR 12.03, if "matters outside the pleading are presented to and not excluded by the court, the motion shall be treated as one for summary

[2] This is also the position the Cabinet has taken at page 2 of its Motion to Dismiss.

judgment, and disposed of as provided for in Rule 56," which requires the court to draw all inferences in favor of the nonmovant. *See id.*

In this case the Cabinet has proffered two theories by which it alleges that Dialog has failed to state a claim. First, the Cabinet alleges that Dialog has failed to exhaust its administrative remedies. Second, the Cabinet alleges that there is no actual controversy regarding Dialog's liability for sales tax on its purchase/lease of UNE's from BellSouth. Both theories are fundamentally flawed for the reasons set forth below.

II. Dialog Has Pursued Every Possible Administrative Remedy.

The Cabinet's contention that Dialog has failed to exhaust its administrative remedies is completely unfounded. Dialog is not, as the Cabinet alleges, trying to "circumvent the administrative process...." (Motion to Dismiss at 3). Quite the contrary, Dialog has made substantial efforts to resolve this matter administratively. It is the Cabinet which has forced Dialog to resort to judiciary means.

Dialog requested a Cabinet ruling that the sales tax did not apply to its purchase/lease of UNE's from BellSouth. The Cabinet refused. Dialog requested that the Cabinet certify its ruling as a final ruling so that Dialog could appeal to the KBTA. The Cabinet refused. Dialog investigated the viability of applying for a sales tax refund. The Cabinet's application form forbid it. Filing an action in the court was Dialog's last option. The Cabinet has closed every possible administrative avenue for seeking the relief requested in the complaint in this matter. Now, the Cabinet wants to prevent Dialog from pursuing this issue in court, too.

Kentucky's highest court has held that the prohibition against the "exercise of arbitrary power over the lives, liberty, and property" of the Commonwealth's citizens is the "pole star section of the Constitution of Kentucky." *Bruner v. City of Danville*, Ky., 394 S.W.2d 939, 941

(1965). And, "[j]ust what act or threatened act of government would amount to an arrogation of such power is inevitably a judicial question." *Id.*; *see also Pigeons' Roost, Inc. v. Com.*, Ky.App., 10 S.W.3d 133, 135 (1999) (holding, "In order to pass constitutional muster, a statute must be rationally related to a legitimate state objective."). One such unconstitutional act is the delegation of legislative powers to the unlimited discretion of a third party. *See id.* (multiple citations omitted).

In the *Bruner* case, the Court ruled that a legislative grant of power to a municipality constituted the unconstitutional, arbitrary exercise of power because the municipality was left with unlimited discretion to exercise the power. *Bruner*, 394 S.W.2d at 941-944. In the current case, if the court grants the Cabinet's motion, it will effectively uphold an even more arbitrary exercise of legislative power: the delegation to BellSouth of unlimited discretion to seek a tax refund on behalf of its direct competitor. Kentucky law does not permit such a result.

If this complaint is dismissed, Dialog will be left with absolutely no venue for a meaningful review of the Cabinet's application of the sales tax to Dialog's operations. Dialog's constitutionally protected due process rights require that it not be forced to rely on the good graces of a direct competitor in order to meaningfully contest the collection of sales tax pursuant to KRS 139.200. *See* Kentucky Constitution § 2 (prohibiting the arbitrary exercise of power by the state government); *see also Bruner*, 394 S.W.2d 939. Pursuant to the Cabinet's interpretation of KRS 134.580 (governing refund of the sales tax), however, Dialog must rely on the unlimited discretion of BellSouth to pursue Dialog's claims that the sales tax is not properly applied to Dialog's purchase/lease of UNE's from BellSouth. Clearly, BellSouth has no incentive to apply for a sales tax refund that would help Dialog more effectively compete against it; BellSouth has, in fact, already refused to do so. Thus, to grant the Cabinet's motion to dismiss is tantamount to

arbitrarily depriving Dialog of its constitutionally protected due process rights. The court should deny the Cabinet's motion to dismiss.

III. An Actual Controversy Exists Because There Are No Available Administrative Remedies for Dialog to Pursue.

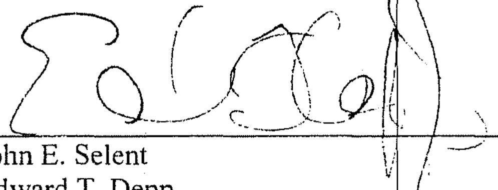
The Cabinet's argument that there is no actual controversy for the court to decide rests upon its mischaracterization that Dialog has failed to exhaust its administrative remedies. According to the Cabinet, "A claim that Plaintiff is harmed, without more, is insufficient to confer subject-matter jurisdiction on this Court." (Motion to Dismiss at 5). Yet, this misses the point entirely; there is "more." There is: (1) the Cabinet's stated and continuing position that sales tax should be collected when Dialog purchases/leases UNE's from BellSouth; (2) the Cabinet's refusal to certify that its stated and continuing position constitutes a final ruling; (3) the Cabinet's refusal to consider a tax refund claim by Dialog; and there is (4) the fact that BellSouth continues to collect sales tax on Dialog's purchase/lease of UNE's.

All of this goes to show that Dialog's complaint is hardly "future," "'hypothetical,'" "'moot,'" or "not yet ripe for judicial determination." (Motion to Dismiss at 2, 3, 6). Considering the complete lack of administrative remedies available to it, Dialog's claims are as ripe as they will ever be. Dialog is not asking the court to make a determination *in advance* of some possible future determination to be made by the Cabinet or the KBTA. The Cabinet's actions have foreclosed the possibility of any future determinations. Thus, the court is the only remedy left for Dialog to exhaust. Dialog has presented the court with an actual controversy, and pursuant to KRS 418.040, Dialog requests that the court hear the merits of that controversy. The court should deny the Cabinet's motion to dismiss.

CONCLUSION

For the reasons set forth above, Dialog respectfully requests that the court deny the Cabinet's motion to dismiss.

Respectfully submitted.



John E. Selent
Edward T. Depp
DINSMORE & SHOHL LLP
1400 PNC Plaza
500 West Jefferson St.
Louisville, Kentucky 40202
(502) 540-2300 (tel.)
(502) 585-2207 (fax)

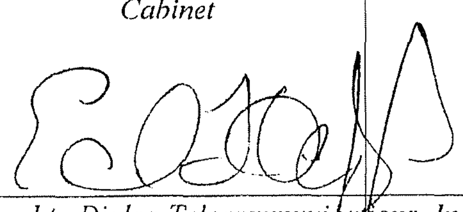
Counsel to Dialog Telecommunications, Inc.

CERTIFICATE OF SERVICE

It is hereby certified that a true copy of the foregoing response to the Kentucky Revenue Cabinet's motion to dismiss was served, by first-class United States mail, sufficient postage prepaid, and facsimile on the following individuals, this 23rd day of January, 2004.

Hon. Gregory D. Stumbo
Attorney General
Office of the Attorney General
1024 Capital Center Drive
Frankfort, KY 40601
(502) 696-8310 (Facsimile)

Laura M. Ferguson
Kentucky Revenue Cabinet
Division of Legal Services
P.O. Box 423
Frankfort, Kentucky 40602-0423
(502) 564-4044 (Facsimile)
Counsel to the Kentucky Revenue Cabinet



Counsel to Dialog Telecommunications, Inc.

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COMMONWEALTH OF KENTUCY
FRANKLIN CIRCUIT COURT
DIVISION I
CASE NO. 03-CI-1617

DIALOG TELECOMMUNICATIONS, INC. PLAINTIFF

v.

THE COMMONWEALTH OF KENTUCKY and
THE KENTUCKY REVENUE CABINET DEFENDANTS

****

ORDER

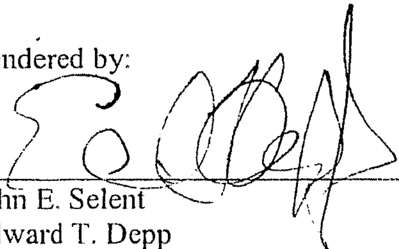
The Kentucky Revenue Cabinet (the "Cabinet"), having moved the court to dismiss the complaint of Dialog Telecommunications, Inc. ("Dialog'), and the court being otherwise sufficiently advised,

IT IS HEREBY ORDERED AND ADJUDGED that the Cabinet's motion to dismiss the complaint in this matter is OVERRULED.

Done this ___ day of ______________, 2004.

____
JUDGE, FRANKLIN CIRCUIT COURT

Tendered by:



John E. Selent
Edward T. Depp
DINSMORE & SHOHL LLP
1400 PNC Plaza
500 West Jefferson St.
Louisville, Kentucky 40202
(502) 540-2300 (tel.)
(502) 585-2207 (fax)

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COMMONWEALTH OF KENTUCKY
FRANKLIN CIRCUIT COURT
CIVIL ACTION NO. 03-CI-01617
DIVISION I

FRANKLIN CIRCUIT COURT
JANICE MARSHALL, CLERK

DIALOG TELECOMMUNICATIONS, INC. **PLAINTIFF**

v.

THE COMMONWEALTH OF KENTUCKY **DEFENDANTS**

Serve: Hon. A. B. Chandler, Attorney General
Office of the Attorney General
1024 Capital Center Drive
Frankfort, KY 40601

and

THE KENTUCKY REVENUE CABINET

Serve: Debra Eucker, Director
Department of Law
Kentucky Revenue Cabinet
200 Fair Oaks Lane
Frankfort, KY 40620

****

COMPLAINT FOR DECLARATORY RELIEF

Plaintiff, Dialog Telecommunications, Inc. ("Dialog"), by counsel, pursuant to KRS 418.040, and for its request for a declaration of rights states as follows.

THE PARTIES

1. Dialog is a competitive local exchange carrier under the terms of the Telecommunications Act of 1996 (the "Act"). Dialog is a North Carolina corporation whose full name and principal place of business are Dialog Telecommunications, Inc., 540 Griffith Road, Charlotte, North Carolina 28217. Dialog provides competitive local exchange services in Kentucky by leasing or purchasing unbundled network elements ("UNE's") from incumbent local

exchange carriers (such as BellSouth) and combining those UNE's with other network elements and services to create a telecommunications service to provide to its own Kentucky end-users.

2. Defendant the Kentucky Revenue Cabinet (the "Revenue Cabinet") is independent administrative agency of the Defendant Commonwealth of Kentucky and exists pursuant to KRS Chapter 131. The Revenue Cabinet, pursuant to KRS 139.710, possesses "all of the powers, rights, duties, and authority with respect to the assessment, collection, refunding, and administration of the taxes levied by [KRS Chapter 139]...." *Id.* The Revenue Cabinet's address is 200 Fair Oaks Lane, Frankfort, Kentucky 40620.

JURISDICTION AND VENUE

3. The Franklin Circuit Court has jurisdiction and venue pursuant to the facts that the Revenue Cabinet is an administrative agency of the Commonwealth of Kentucky and that the Commonwealth of Kentucky, through the Revenue Cabinet, enforces and applies the statutes at issue in this action.

4. The Revenue Cabinet's interpretation and application of KRS Chapter 139 ("Sales and Use Taxes") are based on legal conclusions that violate the United States Constitution, the Kentucky Constitution, the Telecommunications Act of 1996[1], and the Kentucky Revised Statutes. The Revenue Cabinet exceeded its statutory authority and jurisdiction by interpreting and applying KRS Chapter 139 in the manner described below. Because of the effect that the Revenue Cabinet's continued interpretation and application of KRS Chapter 139 has had and will continue to have on Dialog, a case in controversy exists.

BACKGROUND

5. This action is a request for a declaration of rights which relates to an ongoing dispute between the Revenue Cabinet and Dialog as to the proper interpretation and application

[1] 47 U.S.C. § 201, *et seq.*

of KRS 139.200, which imposes a sales tax on certain sales made within the Commonwealth of Kentucky. Specifically, this complaint for declaratory relief arises from the Revenue Cabinet's October 31, 2003, ruling (the "Ruling") denying Dialog's request for a determination that the sales tax imposed by KRS 139.200 is not applicable to Dialog's purchase of UNE's from incumbent local exchange carriers. (A copy of the Revenue Cabinet's Ruling is attached to this Complaint as Exhibit 1).

6. By way of context, Dialog's business operates as follows. Dialog is a competitive local exchange carrier ("CLEC") that provides telecommunications services to end-users in the same territory that BellSouth Telecommunications, Inc. ("BellSouth") serves. In order to provide those telecommunications services, Dialog leases and purchases various UNE's from BellSouth.[2] Then, as contemplated by the Act, Dialog combines these UNE's in accordance with its business plan "in order to provide... telecommunications service" to its own end-users. 47 U.S.C. § 251(c)(3).[3]

7. Dialog leases or purchases the following UNE's from BellSouth:

- 2-wire loop;
- a switch port;
- installation and repair services;
- switch processing;
- network transport; and
- voice-mail services.

[2] BellSouth is required, pursuant to section 251(c)(3) of the Act (47 U.S.C. § 251(c)(3)). (A copy of section 251 of the Act is attached to this Petition of Appeal as Exhibit 2).

[3] The UNE platform by which Dialog operates is distinct from the more common "resale" CLEC operations authorized pursuant to section 251(c)(*4*) of the Act. A "reseller" operating pursuant to section 251(c)(4) of the Act simply purchases "prepackaged" telecommunications services, at wholesale rates, from an incumbent local exchange carrier ("ILEC") and then typically does little more than rebrand the services and market it them as the CLEC's own service. A UNE-platform CLEC, by contrast. offers its own facilities-based service by purchasing or leasing (from the ILEC and other vendors) separate components of the telecommunications network and various other services, which the UNE-platform CLEC then combines in its *own* discretion to offer telecommunications services to its end-users.

8. Since Dialog began its Kentucky operations in January of 2002, BellSouth has collected sales tax from Dialog on the lease or purchase of each of these particular UNE's.

9. The Revenue Cabinet, in its Ruling, justified BellSouth's collection of sales tax on each of these UNE's (pursuant to KRS 139.200) by claiming that each of these UNE's qualify as "retail sales" because they allegedly constitute the "furnishing of communications services to a service address in this state..." pursuant to KRS 139.100(2)(d). In any event, the Revenue Cabinet has posited, even if the leasing of these UNE's does not fall within the grasp of KRS 139.100(2)(d), the UNE's being purchased are allegedly "subject to sales tax as a lease of tangible personal property." (Exhibit 1 at 1).

10. The central legal issues involved in this Complaint are two-fold: (1) whether BellSouth's leasing of the specific UNE's to Dialog constitutes the furnishing of a "communications service," as that term is defined in KRS 139.100(3); and (2) if the leasing of these UNE's constitutes the furnishing of a "communications service," is the "communications service" being furnished to a "service address," as that term is defined in KRS 139.100(4).

11. Related to these issues is the question of whether the Kentucky legislature intended Kentucky's sales tax to apply to the sale of UNE's to Dialog. Dialog does not dispute whether it should collect sales tax from its own end-users, but it disputes any application of the Kentucky sales tax statute to itself because it is not the ultimate end-user of the telecommunications services.

12. Any such application of KRS 139.100 to a UNE-platform CLEC like Dialog — aside from violating the spirit of that statutory provision — also violates section 253(a) of the Act[4], which provides that "No State or local statute or regulation, or other State or local legal

[4] 47 U.S.C. § 253(a).

requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service." *Id.*

13. BellSouth's lease and sale of the UNE's in question does not constitute the making of "retail sales" to Dialog, as that term is defined at KRS 139.100(1)-(2).

COUNT 1

(Dialog's Lease of the 2-Wire Loop and the Switch Port Is Not Subject to KRS 139.200)

14. Dialog realleges and incorporates by reference as if fully set forth herein, all preceding allegations in this Complaint.

15. KRS 139.100(2) provides that a "retail sale" includes the furnishing of "communications service" to a "service address" in this state.

16. KRS 139.100(3) provides that a "communications service" means:

> the provision, transmission, conveyance, or routing, for a consideration, of voice, data, video, or any other information or signals of the purchaser's choosing to a point, or between or among points, specified by the purchaser, by or through any electronic, radio, light, fiber optics, or any similar medium or method now in existence or later devised.

Id.

17. Dialog leases 2-wire loop and the switch port from BellSouth for a flat fee. As leased from BellSouth, the 2-wire loop and the switch port are simply physical facilities through which a *Dialog-created* communications service will be delivered to end-users. Thus, while these UNE's are the "pipeline" through which a communications service will ultimately be delivered by Dialog to its own end-users, BellSouth's lease of these facilities to Dialog does not impute the provision of a *service* by BellSouth to Dialog.

18. Accordingly, the 2-wire loop and the switch port are not "communications services," as that term is defined in KRS 139.100(2)(3).

19. KRS 139.100(1)(a)(1) also provides that a "retail sale" includes "[a] sale for any purpose other than resale in the regular course of business of tangible personal property...." *Id.*

20. The 2-wire loop and the switch port constitute tangible personal property; however, Dialog's lease of these facilities is effectively for the purpose of resale in the regular course of business.

21. Therefore, Dialog's lease of these UNE's does not qualify as a "retail sale," as that term is defined in KRS 139.100(1)(a)(1), either.

22. Dialog's purchase of these services is not subject to the Kentucky sales tax.

COUNT II
(Dialog's Purchase of Installation and Repair Services Is Not Subject to KRS 139.200)

23. Dialog realleges and incorporates by reference as if fully set forth herein, all preceding allegations in this Complaint.

24. KRS 139.100(3)(c) provides that, provided such services are separately itemized on the bill provided to the purchaser, "communications service" does not include:

> Installation, reinstallation, or maintenance of wiring or equipment on a customer's premises. However, this provision does not apply to any charge attributable to the connection, movement, change, or termination of a communication service....

Id.

25. Dialog purchases installation and repair services from BellSouth. BellSouth's charges for these installation and repair services are separately itemized on BellSouth's bills to Dialog.

26. Moreover, these installation and repair services relate only to the installation and repair of the 2-wire loop that Dialog separately purchases from BellSouth.

27. Because the 2-wire loop is not a "communications service," as that term is defined in KRS 139.100(c), BellSouth's charges for the installation and repair services purchased by

Dialog are not "attributable to the connection, movement, change, or termination of a communication service."

28. Therefore, pursuant to KS 139.100(3)(c), Dialog's purchase of installation and repair services from BellSouth should not be subject to the sales tax imposed by KRS 139.200 because Dialog's purchase does not constitute a "retail sale," as that term is defined in KRS 139.100(1)-(2), and Dialog's purchase of these services is not subject to the Kentucky sales tax.

COUNT III
(Dialog's Purchase of Switch Processing, Network Transport, and Voice Mail Services Is Not Subject to KRS 139.200)

29. Dialog realleges and incorporates by reference as if fully set forth herein, all preceding allegations in this Complaint.

30. The definition, pursuant to KRS 139.100(3), of a "communications service" requires that the *purchaser* of the service direct the transport of voice and/or data between points.

31. Dialog purchases switch processing services and network transport services from BellSouth; however, Dialog's *end-user* — by placing telephone calls — directs BellSouth to provide switch processing and to transport the end-user's voice and/or data between network points chosen by the end-user.

32. Because BellSouth is routing voice/data traffic to a point or between points as directed by Dialog's end-users — and not the purchaser of the services, Dialog — the switch processing and network transport services do not meet the statutory requirements for the furnishing of a "communications service," as that term is defined pursuant to KRS 139.100(3).[5]

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[5] KRS 139.100(3) specifically identifies "voice mail and other electronic messaging services" as "communication services." *Id.* Dialog reiterates, however, that despite the fact that voice mail is identified as being a "communications service," the Revenue Cabinet's application of the sales tax to the purchase of this service by a UNE-platform CLEC who is *not* the ultimate end-user nevertheless violates the spirit of KRS Chapter 139.

33. Regardless of whether switch processing, network transport, and voice mail constitute "communications services," however, the sale of these services cannot constitute "retail sales," under KRS 139.100(1)-(2), unless they are sales of "communications services" to "a service address" in this state. KRS 139.100(2)(d).

34. KRS 139.100(4)(a) defines a "service address" as:

> The location of communications equipment from which communications service is originated or at which communications service is received by the purchaser....

Id.

35. Dialog neither originates nor receives the switch processing, network transport, and voice mail services. Dialog's *end-users* originate and receive those services.

36. Therefore, pursuant to KRS 139.100(4), because Dialog neither originates nor receives the services in question, Dialog has no "service address," pursuant to the statutory definition set forth in KRS 139.100(4).

37. Accordingly, BellSouth's sale of switch processing, network transport, and voice mail services to Dialog does not constitute the making of "retail sales," pursuant to KRS 139.100(1)-(2), and Dialog's purchase of these services is not subject to the Kentucky sales tax.

COUNT IV
(The Revenue Cabinet's Interpretation/Application of KRS 139.200 Violates the Act)

38. Dialog realleges and incorporates by reference as if fully set forth herein, all preceding allegations in this Complaint.

39. Any construction of KRS 139.100 that requires Dialog to pay sales tax on the UNE's it is purchasing or leasing from BellSouth would violate not only the spirit of KRS Chapter 139, but also the express terms of section 253[6] of the Act, which prohibits the erection,

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[6] 47 U.S.C. § 253.

by any State, of any effective barrier to entry into the interstate or intrastate telecommunications business. *See id.*

40. The Revenue Cabinet's proposed construction not only preempts governing federal law for a conflicting state interest, it allows BellSouth (by virtue solely of its position as the monopolist, incumbent local exchange carrier) to avoid the payment of taxes that are imposed on its competitors.

41. This approach violates the mandates of Section 253 of the Act and the clear congressional (and Federal Communications Commission) policy that incumbent and competitive carriers be allowed to compete on equal footing.

42. Thus, the imposition of KRS 139.200 on Dialog's lease and purchase of UNE's would is subject to attack by virtue of the Supremacy Clause of the United States Constitution, which prohibits the states from enforcing any law in conflict with applicable federal law.

WHEREFORE, Dialog prays for relief as follows:

1. A declaratory judgment that Dialog's lease of the 2-wire loop and the switch port is not subject to the sales tax imposed by KRS 139.200;

2. A declaratory judgment that Dialog's purchase of installation and repair services is not subject to the sales tax imposed by KRS 139.200;

3. A declaratory judgment that Dialog's purchase of switch processing, network transport, and voice mail services is not subject to the sales tax imposed by KRS 139.200;

4. A declaratory judgment that the Revenue Cabinet's interpretation and application of KRS 139.200 violates section 253 of the Act[7] and the Supremacy Clause of the United States Constitution; and

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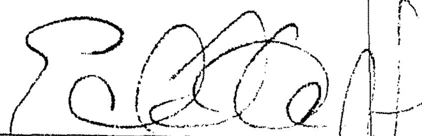
[7] 47 U.S.C. § 253.

5. All other relief to which Dialog may be entitled.

Respectfully submitted,



John E. Selent
Edward T. Depp
DINSMORE & SHOHL LLP
1400 PNC Plaza
500 West Jefferson St.
Louisville, Kentucky 40202
(502) 540-2300 (tel.)
(502) 585-2207 (fax)

Counsel to Dialog Telecommunications, Inc.

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KENTUCKY REVENUE CABINET
DIVISION OF TAX POLICY
200 FAIR OAKS LANE
FRANKFORT, KENTUCKY 40620
PHONE 502-564-6843
FAX 502-564-9565

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October 31, 2003

Edward T Depp
Dinsmore & Shohl LLP
1400 PNC Plaza
500 West Jefferson Street
Louisville, KY 40202

Dear Mr. Depp:

Your correspondence addressed to Mr. Kevin West of the Sales and Use Tax Branch has been forwarded to the Division of Tax Policy for review and response. You are requesting information regarding the application of sales tax on purchases made by your client, Dialog Telecommunications, Inc. (Dialog).

Dialog is a competitive local exchange carrier (CLEC) under the Telecommunications Act of 1996 (the Act). According to the provisions of the Act, Dialog is purchasing unbundled network elements (UNE's) from BellSouth at wholesale rates. These elements include 2-wire loop, a switch port, installation and repair services, switch processing, network transport, and voice mail services, etc. Your letter characterizes these elements as "pieces of the entire telecommunications system that are necessary to provide telecommunications services." By virtue of these wholesale purchases, Dialog is able to provide local exchange service to its own retail end-user customers.

The 1996 Telecommunications Act was to encourage greater competition by requiring the incumbent local exchange carriers (ILEC's) to give competitors access to their networks. Section 251(c)(4) of the Act characterizes this access as the resale at wholesale rates of any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers. In Section 5 of your ruling request, Overarching Concerns Regarding KRS 139.200, you also describe the transactions in question as the wholesale purchase of communications services. BellSouth is providing the pieces of communications service that Dialog packages into local exchange service and sells to its own customers.

The argument that Dialog's purchase of telecommunications elements such as the 2-Wire Loop and the switch port are a lease of "facilities" rather than communications service is not persuasive. BellSouth is clearly providing Dialog with a communications service that enables it to provide local telephone service to its own clients. However, for the sake of argument, even if the purchase of access to the phone line or switch port were characterized as a lease of facilities or communications equipment, this lease would be subject to sales tax as a lease of tangible personal property. Dialog's purchase of taxable services or property is no different than the hotel operator who pays sales tax on beds, linens, and other items for use in providing taxable accommodations services. The hotel

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operator then collects sales tax from customers who pay for the hotel accommodations. The Court of Appeals held in *Kentucky Board of Tax Appeals v. Brown Hotel Co.*, 528 S.W.2d 715 (1975) that a service provider could not purchase tangible personal property exempt from tax based upon the theory that the hotel acquired the property for resale to its customers who are the ultimate users of the property when paying for the accommodations service.

According to the provisions of Kentucky Regulation 103 KAR 28:140, Section 2, "communications service providers that purchase communications services from facilities-based carriers to resell to their own customer base shall not claim the communications services purchased are exempt as being transactions for resale." Furthermore, BellSouth is properly following Section 3 of the Regulation in refusing to accept Dialog's issuance of a resale certificate for the communications services in question. Dialog is the consumer of the communications services purchased in these transactions as stated in Section 1 of the Regulation. The resale exclusion from the definition of retail sale in KRS 139.100 applies only to the sale of tangible personal property for resale.

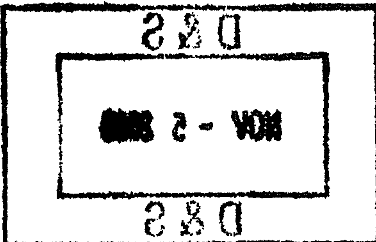
You have also asserted that the Act prohibits Kentucky from imposing sales tax on your client's wholesale purchase of UNE's. Upon review, it is the Cabinet's position that the Act does not prohibit the statutes in question. There is no evidence that this so-called "collection scheme" is a barrier to the wholesale purchase of UNE's. In fact, the use of the UNE platform is being utilized by CLEC's now more than ever. Furthermore, it is the Cabinet's responsibility to administer the current language of the law as it applies to companies such as Dialog until such time as an appropriate legislative or judicial body determines otherwise.

If you should have any further questions regarding this matter, please do not hesitate to contact my office at (502) 564-6843, ext. 4442.

Sincerely,

Richard Dobson
Tax Consultant
Division of Tax Policy

C: Kevin West



ties for representatives of the general public to testify.

"(4) **Additional rules.**—The Commission may adopt other rules as necessary to carry out this section.

"(h) **Gifts, bequests, and devises.**—The Commission may accept, use, and dispose of gifts, bequests, or devises of services or property, both real (including the use of office space) and personal, for the purpose of aiding or facilitating the work of the Commission. Gifts or grants not used at the termination of the Commission shall be returned to the donor or grantee.

"(*l*)[sic] **Termination.**—The Commission shall terminate 30 days after the submission of the report under subsection (d) or November 30, 2000, whichever occurs earlier.

"(m)[sic] **Inapplicability of Federal Advisory Committee Act.**—The Federal Advisory Committee Act (5 U.S.C. App.) shall not apply to the Commission."

WESTLAW ELECTRONIC RESEARCH

See WESTLAW guide following the Explanation pages of this volume.

PART II—DEVELOPMENT OF COMPETITIVE MARKETS

LIBRARY REFERENCES

Law Review and Journal Commentaries

Models of cooperative federalism for telecommunications. Raymond W. Lawton & Bob Burns, 6 Alb.L.J.Sci. & Tech. 71 (1996).

Working together: Suggestions for federal and state cooperation in telecommunications. Ruth Milkman, 6 Alb.L.J.Sci. & Tech. 141 (1996).

51. Interconnection

eral duty of telecommunications carriers

telecommunications carrier has the duty—

to interconnect directly or indirectly with the facilities and pment of other telecommunications carriers; and

not to install network features, functions, or capabilities not comply with the guidelines and standards established t to section 255 or 256 of this title.

ons of all local exchange carriers

exchange carrier has the following duties:

le

not to prohibit, and not to impose unreasonable or ory conditions or limitations on, the resale of its nications services.

portability

provide, to the extent technically feasible, number accordance with requirements prescribed by the

(3) Dialing parity

The duty to provide dialing parity to competing providers of telephone exchange service and telephone toll service, and the duty to permit all such providers to have nondiscriminatory access to telephone numbers, operator services, directory assistance, and directory listing, with no unreasonable dialing delays.

(4) Access to rights-of-way

The duty to afford access to the poles, ducts, conduits, and rights-of-way of such carrier to competing providers of telecommunications services on rates, terms, and conditions that are consistent with section 224 of this title.

(5) Reciprocal compensation

The duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications.

(c) Additional obligations of incumbent local exchange carriers

In addition to the duties contained in subsection (b) of this section, each incumbent local exchange carrier has the following duties:

(1) Duty to negotiate

The duty to negotiate in good faith in accordance with section 252 of this title the particular terms and conditions of agreements to fulfill the duties described in paragraphs (1) through (5) of subsection (b) of this section and this subsection. The requesting telecommunications carrier also has the duty to negotiate in good faith the terms and conditions of such agreements.

(2) Interconnection

The duty to provide, for the facilities and equipment of any requesting telecommunications carrier, interconnection with the local exchange carrier's network—

(A) for the transmission and routing of telephone exchange service and exchange access;

(B) at any technically feasible point within the carrier's network;

(C) that is at least equal in quality to that provided by the local exchange carrier to itself or to any subsidiary, affiliate, or any other party to which the carrier provides interconnection; and

(D) on rates, terms, and conditions that are just, reasonable, and nondiscriminatory, in accordance with the terms and conditions of the agreement and the requirements of this section and section 252 of this title.

(3) Unbundled access

The duty to provide, to any requesting telecommunications carrier for the provision of a telecommunications service, nondiscriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory in accordance with the terms and conditions of the agreement and the requirements of this section and section 252 of this title. An incumbent local exchange carrier shall provide such unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service.

(4) Resale

The duty—

(A) to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers; and

(B) not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of such telecommunications service, except that a State commission may, consistent with regulations prescribed by the Commission under this section, prohibit a reseller that obtains at wholesale rates a telecommunications service that is available at retail only to a category of subscribers from offering such service to a different category of subscribers.

(5) Notice of changes

The duty to provide reasonable public notice of changes in the information necessary for the transmission and routing of services using that local exchange carrier's facilities or networks, as well as of any other changes that would affect the interoperability of those facilities and networks.

(6) Collocation

The duty to provide, on rates, terms, and conditions that are just, reasonable, and nondiscriminatory, for physical collocation of equipment necessary for interconnection or access to unbundled network elements at the premises of the local exchange carrier, except that the carrier may provide for virtual collocation if the local exchange carrier demonstrates to the State commission that physical collocation is not practical for technical reasons or because of space limitations.

(d) Implementation

(1) In general

Within 6 months after February 8, 1996, the Commission shall complete all actions necessary to establish regulations to implement the requirements of this section.

(2) Access standards

In determining what network elements should be made available for purposes of subsection (c)(3) of this section, the Commission shall consider, at a minimum, whether—

(A) access to such network elements as are proprietary in nature is necessary; and

(B) the failure to provide access to such network elements would impair the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer.

(3) Preservation of State access regulations

In prescribing and enforcing regulations to implement the requirements of this section, the Commission shall not preclude the enforcement of any regulation, order, or policy of a State commission that—

(A) establishes access and interconnection obligations of local exchange carriers;

(B) is consistent with the requirements of this section; and

(C) does not substantially prevent implementation of the requirements of this section and the purposes of this part.

(e) Numbering administration

(1) Commission authority and jurisdiction

The Commission shall create or designate one or more impartial entities to administer telecommunications numbering and to make such numbers available on an equitable basis. The Commission shall have exclusive jurisdiction over those portions of the North American Numbering Plan that pertain to the United States. Nothing in this paragraph shall preclude the Commission from delegating to State commissions or other entities all or any portion of such jurisdiction.

(2) Costs

The cost of establishing telecommunications numbering administration arrangements and number portability shall be borne by all telecommunications carriers on a competitively neutral basis as determined by the Commission.

(3) Universal emergency telephone number

The Commission and any agency or entity to which the Commission has delegated authority under this subsection shall designate 9–1–1 as the universal emergency telephone number within the United States for reporting an emergency to appropriate authorities and requesting assistance. The designation shall apply to both wireline and wireless telephone service. In making the designation, the Commission (and any such agency or entity) shall provide appropriate transition periods for areas in which 9–1–1 is not in use as an emergency telephone number on October 26, 1999.

(f) Exemptions, suspensions, and modifications

(1) Exemption for certain rural telephone companies

(A) Exemption

Subsection (c) of this section shall not apply to a rural telephone company until (i) such company has received a bona fide request for interconnection, services, or network elements, and (ii) the State commission determines (under subparagraph (B)) that such request is not unduly economically burdensome, is technically feasible, and is consistent with section 254 of this title (other than subsections (b)(7) and (c)(1)(D) thereof).

(B) State termination of exemption and implementation schedule

The party making a bona fide request of a rural telephone company for interconnection, services, or network elements shall submit a notice of its request to the State commission. The State commission shall conduct an inquiry for the purpose of determining whether to terminate the exemption under subparagraph (A). Within 120 days after the State commission receives notice of the request, the State commission shall terminate the exemption if the request is not unduly economically burdensome, is technically feasible, and is consistent with section 254 of this title (other than subsections (b)(7) and (c)(1)(D) thereof). Upon termination of the exemption, a State commission shall establish an implementation schedule for compliance with the request that is consistent in time and manner with Commission regulations.

(C) Limitation on exemption

The exemption provided by this paragraph shall not apply with respect to a request under subsection (c) of this section,

from a cable operator providing video programming, and seeking to provide any telecommunications service, in the area in which the rural telephone company provides video programming. The limitation contained in this subparagraph shall not apply to a rural telephone company that is providing video programming on February 8, 1996.

(2) Suspensions and modifications for rural carriers

A local exchange carrier with fewer than 2 percent of the Nation's subscriber lines installed in the aggregate nationwide may petition a State commission for a suspension or modification of the application of a requirement or requirements of subsection (b) or (c) of this section to telephone exchange service facilities specified in such petition. The State commission shall grant such petition to the extent that, and for such duration as, the State commission determines that such suspension or modification—

(A) is necessary—

(i) to avoid a significant adverse economic impact on users of telecommunications services generally;

(ii) to avoid imposing a requirement that is unduly economically burdensome; or

(iii) to avoid imposing a requirement that is technically infeasible; and

(B) is consistent with the public interest, convenience, and necessity.

The State commission shall act upon any petition filed under this paragraph within 180 days after receiving such petition. Pending such action, the State commission may suspend enforcement of the requirement or requirements to which the petition applies with respect to the petitioning carrier or carriers.

(g) Continued enforcement of exchange access and interconnection requirements

On and after February 8, 1996, each local exchange carrier, to the extent that it provides wireline services, shall provide exchange access, information access, and exchange services for such access to interexchange carriers and information service providers in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation) that apply to such carrier on the date immediately preceding February 8, 1996 under any court order, consent decree, or regulation, order, or policy of the Commission, until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after February 8, 1996. During the period beginning on

February 8, 1996 and until such restrictions and obligations are so superseded, such restrictions and obligations shall be enforceable in the same manner as regulations of the Commission.

(h) Definition of incumbent local exchange carrier

(1) Definition

For purposes of this section, the term 'incumbent local exchange carrier' means, with respect to an area, the local exchange carrier that—

(A) on February 8, 1996, provided telephone exchange service in such area; and

(B)(i) on February 8, 1996, was deemed to be a member of the exchange carrier association pursuant to section 69.601(b) of the Commission's regulations (47 C.F.R. 69.601(b)); or

(ii) is a person or entity that, on or after February 8, 1996, became a successor or assign of a member described in clause (i).

(2) Treatment of comparable carriers as incumbents

The Commission may, by rule, provide for the treatment of a local exchange carrier (or class or category thereof) as an incumbent local exchange carrier for purposes of this section if—

(A) such carrier occupies a position in the market for telephone exchange service within an area that is comparable to the position occupied by a carrier described in paragraph (1);

(B) such carrier has substantially replaced an incumbent local exchange carrier described in paragraph (1); and

(C) such treatment is consistent with the public interest, convenience, and necessity and the purposes of this section.

(i) Savings provision

Nothing in this section shall be construed to limit or otherwise affect the Commission's authority under section 201 of this title.

(June 19, 1934, c. 652, Title II, § 251, as added Feb. 8, 1996, Pub.L. 104–104, Title I, § 101(a), 110 Stat. 61; Oct. 26, 1999, Pub.L. 106–81, § 3(a), 113 Stat. 1287.)

HISTORICAL AND STATUTORY NOTES

Revision Notes and Legislative Reports

1996 Acts. House Report No. 104–204 and House Conference Report No. 104–458, see 1996 U.S. Code Cong. and Adm. News, p. 10.

1999 Acts. Statement by President, see 1999 U.S. Code Cong. and Adm. News, p. 242.

EXHIBIT B

GRAYSON RURAL ELECTRIC CORPORATION; and East Kentucky Power Cooperative, Inc., Appellants,

v.

CITY OF VANCEBURG; Electric Plant Board of the City of Vanceburg; Kentucky Power Company, Appellees.

No. 98-SC-000202-DG.

Supreme Court of Kentucky.

June 17, 1999.

As Modified on Denial of Rehearing Nov. 18, 1999.

Utility company brought action against competitor for a declaration of rights as to which entity had superior right to furnish retail electrical service to new customers in area. The Lewis Circuit Court, Lewis D. Nicolls, J., ruled in favor of utility company. Competitor appealed. The Supreme Court, Graves, J., held that competitor was entitled to serve new customers within its certified territory in contested area.

Reversed and remanded with directions.

Wintersheimer, J., dissented in separate opinion.

1. Electricity ⊂=1.5

Municipally-owned electric utilities are creatures of statute having only such authority as the Legislature grants to them.

2. Electricity ⊂=8.1(2.1)

A municipally-owned or municipally-franchised electric utility has no exclusive service rights even within municipal boundaries in the absence of statutory authority.

3. Electricity ⊂=8.1(2.1)

Competitor was entitled to serve new customers within its certified territory in contested area and utility company was entitled to serve its existing customers in contested area, in action for declaration of rights; while it might be financially advantageous for utility company to service nonresidents outside city as means of subsidizing cost of providing retail electric service to city and its residents, statute and cases construing it did not provide for exclusive rights. KRS 96.550, 96.570, 96.890.

4. Contracts ⊂=167

Rights accorded to parties by statute become a part of the operative facts which govern their relationships.

5. Estoppel ⊂=52(1)

Estoppel is established where another party relies in good faith on the representations made by the estopped party.

6. Estoppel ⊂=52(1, 3)

An estoppel can be created by a party's words or by a party's conduct.

Foster J. Collis, Dale W. Henley, Winchester, KY, W. Jeffrey Scott, Grayson, KY, for appellant.

E.V. Holder, Jr., Clayton G. Lykins, Jr., Vanceburg, for appellees City of Vanceburg and Electric Plant Board of the City of Vanceburg.

Bruce F. Clark, Elizabeth K. Broyles, Jason Patrick Thomas, Stites & Harbison, Frankfort, KY, for appellee Kentucky Power Company.

GRAVES, Justice.

This case involves the determination of the superior right between competing utilities to furnish retail electric service to new customers in an area now served by the Vanceburg Electric Plant Board (hereinafter "EPB"), but being in the territory assigned to Grayson Rural Electric Cooperative Corporation (hereinafter "Grayson") by the Kentucky Public Service Commission (hereinafter "KPSC"). Because the contested area once produced insufficient revenue to make the area competitively desirable, for years Grayson did not exer-

cise any of its rights to provide the retail electrical service. The environment and attention of the competing utilities changed substantially when a large industrial customer recently expressed an interest in locating a plant in the area. Even though the EPB and its predecessors had served smaller customers in Grayson's territory, it lacked the capacity to satisfy the requirements for a large industrial customer. Consequently, the EPB assigned its rights to Kentucky Power Company. When Kentucky Power Company sought approval of the assignment from the KPSC, Grayson intervened.

The EPB's predecessor (Vanceburg Utility Commission) then brought suit in Lewis Circuit Court seeking a declaratory judgment that it had the right to provide retail electrical service to the contested area and to the potential industrial customer. The circuit court entered judgment for the EPB. The Court of Appeals affirmed the judgment of the circuit court. After hearing oral arguments and having reviewed the record, we reverse the lower courts and remand to the circuit court for entry of a judgment consistent with this opinion.

A historical review of the parties' positions is helpful. In 1939, the City of Vanceburg created the Vanceburg Utility Commission (hereinafter "VUC") when it purchased a bankrupt electric company. The VUC was organized to provide electric service to the city of Vanceburg, as well as to all other residential, commercial and industrial customers located within a twenty mile strip of land along the Ohio River from Vanceburg in Lewis County to South Portsmouth in Greenup County, the location of the electric distribution plant. The VUC retailed electric energy which it purchased wholesale from the Kentucky Power Company. The VUC's 20-mile distribution line from Kentucky Power at South Portsmouth was described as a gigantic extension cord connecting rural customers to the line all the way to Vanceburg. Being a municipal utility, the VUC was exempt from regulation by the KPSC.

Grayson Rural Electric Cooperative is a retail supplier of electric energy which was organized in 1951 and which is regulated by the KPSC. For fifty-four years from 1939 to 1993, the VUC and Grayson honored an unwritten boundary and neither solicited the other's customers. Their "gentleman's agreement" was discarded in 1993, when a potential customer expressed interest in a 1400 acre industrial site located in the community of St. Paul, which lies within the 20-mile corridor being served by the then VUC. The VUC, lacking the capacity to satisfy the requirements of the potential customer's electric needs, entered into an agreement with Kentucky Power Company to supply the necessary power. When Kentucky Power Company sought KPSC's approval of the agreement to serve an industrial customer outside of its certified territory, Grayson objected. The KPSC allowed Grayson to intervene since the industrial site was within Grayson's certified territory on the KPSC maps. Kentucky Power Company then abated its KPSC application and joined with the City of Vanceburg and the VUC in filing an action for a declaration of rights in the Lewis Circuit Court.

Grayson moved for summary judgment on the grounds that the industrial tract was within its service area and the VUC was not permitted to resell purchased electricity outside its municipal boundaries. The City of Vanceburg then obtained a ten-month continuance during which time an ordinance was passed transforming the VUC into the current Electric Plant Board (EPB). Under KRS 96.570, an EPB is permitted to provide electric service "within and without the boundaries" of the municipality. The complaint for a declaratory judgment was amended to substitute the EPB for the VUC.

Ruling in favor of the City, the EPB and Kentucky Power, the trial court found, *inter alia*, (1) the KPSC lacked authority to regulate municipal utility corporations;

(2) the KPSC maps only showed boundaries between nonmunicipal retail electric suppliers such as Kentucky Power and Grayson; (3) Grayson had recognized the existence of the VUC boundary for a number of years as evidenced by a partial green line on the map of its certified service area; (4) Grayson's claim based on the KPSC map of certified areas was flawed because the KPSC lacked jurisdiction to resolve disputes involving municipalities; (5) KRS 96.550 to 96.900 gives the EPB the authority to provide service in the disputed area as long as it does not interfere with any other board, municipality or electric cooperative; and (6) the legislature intended for each utility to operate exclusively in its area and thus the EPB's right to operate in the disputed corridor was exclusive.

However in 1972, the legislature enacted Kentucky's Territorial Law which granted the right to the KPSC to establish geographical boundaries of certified areas within which its regulated utilities have the exclusive right and obligation to furnish retail electric service to all electric-consuming facilities. KRS 278.018. This legislation was designed to encourage an orderly development of retail electric service, and its constitutional validity was upheld in *City of Florence v. Owen Elec. Co-op., Ky.*, 832 S.W.2d 876 (1992) and *City of Nicholasville v. Blue Grass R. E. Coop. Corp.*, Ky., 514 S.W.2d 414 (1974). It "has a substantial relation to the public welfare, safety and health and, in a real degree, promotes these objectives." *City of Florence, supra*, at 882.

The Territorial Law was enacted to protect each KPSC-regulated utility in its certified territory against invasion or competition by another KPSC-regulated utility. The statute provides that no KPSC-regulated utility may, "furnish, make available, render or extend its retail electric service to a consumer for use in electric-consuming facilities located within the certified territory of another retail electric supplier." KRS 278.018(1).

[1, 2] Municipally-owned electric utilities are creatures of statute having only such authority as the Legislature grants to them. This principle was recognized in *City of Nicholasville, supra*, and affirmed in *City of Florence, supra*. Both opinions denied municipally-owned or municipally-franchised electric utilities an exclusive right to provide retail electric service to all utility customers within the city's boundaries. This Court has held that the Legislature determines the extent of authority which cities have to operate their own or franchised electric systems. That is, a municipally-owned or municipally-franchised electric utility has no exclusive service rights even within municipal boundaries in the absence of statutory authority. *City of Cold Spring v. Campbell Co. Water Dist.*, Ky., 334 S.W.2d 269 (1960) and *City of Corbin v. Ky. Utilities Co., Ky.*, 447 S.W.2d 356 (1969).

The VUC operated under KRS 96.520 for 56 years (1939–1995). The statute confers authority to own and operate the system only for purposes of supplying the city and its inhabitants with electric light, heat and power.

> Any city of the second, third, fourth, fifth or sixth class may purchase, establish, erect, maintain and operate electric light, heat and power plants with extensions and necessary appurtenances thereto, within or without the corporate limits of the city, for the purpose of supplying the city and its inhabitants with electric light, heat and power. KRS 96.520

The statute confers no authority to serve non-residents outside the city. Further, no cases have interpreted the statute so broadly as to authorize an exclusive service area outside the city.

During this litigation, the City of Vanceburg reconstituted its utility as an EPB which is authorized by KRS 96.550 to provide retail electric service to any user or consumer within or without the boundaries of a municipality. An EPB's rights are

not exclusive and the statute does not create or authorize an exclusive service area outside the city in which an EPB is free from competition regardless of its ability, willingness or obligation to serve customers within the area.

The statute allows an EPB to serve non-resident customers, but does not compel it. An EPB "may provide electric service to any user or consumer within and without the boundaries of any municipality...." KRS 96.570(2).

KRS 96.890 provides:

> No municipality or board operating an electric plant under the provision of KRS 96.550 to 96.900 shall enter into competition with, or construct, maintain, or operate, any facilities or service in competition with any rural electric cooperative corporation or electric plant operated by another municipality or board organized under the laws of this state in any territory being serviced by any such rural electric cooperative corporation or other municipality or board; but any municipality or board operating an electric plant under the provision of KRS 96.550 to 96.900 may enter into cooperative agreements with any such rural electric cooperative corporation or other municipality or board for a connection for cooperative service upon such terms and conditions as may be mutually agreed upon between any such municipality or board and any such rural electric cooperative corporation or other municipality or board. Such agreements may provide, but not by way of limitation, for exchange of electric service the cooperative use of transmission lines and other facilities, and the common use or exchange of other service or facilities.

The VUC acknowledged an inability to meet the electrical demands of the potential customer within the contested service area. Moreover, it lacks any statutory obligation to serve customers within this area should it choose not do so.

The Legislature has never chosen to authorize exclusive service rights or exclusive service areas for municipally-owned electric utilities. Should the Legislature intend for a city to have exclusive rights, it will so provide as it has for KPSC-regulated utilities in the Territorial Law.

For a municipally-owned utility to have the exclusive service rights or an exclusive service area over which there was no statutory or regulatory oversight enables it to assign those rights to third parties. There is no statutory authority for such assignments. Moreover, such assignments disrupt the Legislature's control over the retail distribution of electricity. The proposed assignment between the VUC and Kentucky Power Company was recognized by KPSC as an invasion of the certified territory of Grayson. The Court in *City of Cold Spring, supra,* rejected an exclusive service area claim stating that,

> Perhaps even more disastrously, this holding completely ignores the need for service of those residents within the Water District territory whom the Water District may be unable, or unwilling, to serve, and whom the Water District has no obligation to serve.

Id. at 272.

Similarly, in *Louisville Water Co. v. Public Service Com'n.,* Ky., 318 S.W.2d 537 (1958), our predecessor Court recognized that voting power gave residents of a city some means of protection against excessive rates or inadequate service of a utility owned by the city. *Id.* at 539. However, customers outside the city have no such protection. Moreover, rural consumers serviced by the EPB lack any recourse regarding rates charged or services extended or denied.

The EPB claimed that KRS 96.520 gave it authority to provide retail electric service to non-residents. However, *Miller v. City of Owensboro,* Ky., 343 S.W.2d 398 (1961), construed the statute to mean exactly what it says, that is, that a city is authorized to acquire and operate an electric plant only "for the purpose of supplying the city and its inhabitants" with elec-

tric energy. *Id.* at 401. At issue in *Miller* was the city's entitlement, under the statute, to build a generating plant having surplus capacity above or in excess of the immediate needs of the city and its inhabitants. The Court found that construction of the generating plant was not in violation of the statute since its primary purpose was to serve the needs of the city and its inhabitants and that it was "a matter of sound economic planning to provide initially for a surplus capacity rather than to add to the plant on a piecemeal basis as the needs from time to time arise; ..." *Id.* at 401. The Court recognized that the surplus "will gradually diminish and within fifteen years it is probable that the entire capacity will be needed for city consumers, ..." *Id.* The decision was further supported by well-established case law recognizing a city's right to sell the surplus production of city-owned utilities to nonresidents.

KRS 96.520 was construed in *City of Corbin, supra,* to prohibit the municipally-owned electric utility from constructing facilities and providing retail electric service to an industrial plant located about two miles outside the city. Corbin, like Vanceburg, had no power generation of its own, but acquired its power through wholesale purchases. In reaching the decision, our predecessor Court found that the proposed activity did not serve the purpose of supplying the city and its inhabitants with electric light, heat and power, and rejected the idea that the making of a profit by engaging in the business of retailing electricity beyond the municipal limits qualifies as a legitimate municipal purpose. *Id.* at 358–359. The Court distinguished its decision from *City of Owensboro, supra,* by pointing out that Owensboro was selling surplus generation, for a limited time, from its own generating plant as part of a sound plan to provide for the future needs of the city and the city's inhabitants. *Id.* at 359.

This Court has held that a municipally-owned utility might be permitted to extend its service outside the city to areas which fell naturally into its territory and which would likely in the future be embraced by an extension of the city limits. *Warren Rural Elec. Coop. Corp. v. Electric Plant Bd.,* Ky., 331 S.W.2d 117 (1960). No such claim is being made about the 20 mile corridor outside the City of Vanceburg.

The Lewis Circuit Court concluded that Vanceburg was authorized to provide retail electric service to nonresidents for the reason that the supplying of non-residents with electric power was correlated with serving the municipal customers. The circuit court's rationale was that,

> [T]he rural non-municipal customers paying their utility bills immediately became a vital source of revenue for VUC. Without this source of revenue, VUC would be unable to function in 1939 as well as today. Furthermore, from 1939 to present, the City of Vanceburg would be unable to financially run their municipal utility without the support of the additional rural customers which the city inherited when they obtained the utility company. Thus, the contested corridor served by VUC is correlated with the purpose of supplying the city and its inhabitants with electric power. The Court believes that all of these facts create the necessary set of circumstances to make it a valid exception to legitimatize the VUC's operation outside the municipal boundaries under KRS 96.520–540.

[3] While it may be financially advantageous for Vanceburg and its EPB to service non-residents outside the city as a means of subsidizing the cost of providing retail electric service to the city and its residents, the statute and the cases construing it do not so provide. The EPB's operation is comparable to that proposed by the *City of Corbin, supra,* in buying electrical power wholesale and reselling at retail for purposes of making money from non-residents.

Vanceburg operates its municipally-owned electric utility as an EPB under KRS 96.550, and although it may provide

electric service to users or consumers outside the city (but not to a designated area), it is restricted from entering into competition with, or constructing, maintaining or operating any facilities or service in competition with any rural electric cooperative corporation such as Grayson.

> No municipality or board operating an electric plant under the provision of KRS 96.550 to 96.900 shall enter into competition with, or construct, maintain, or operate, any facilities or service in competition with any rural electric cooperative corporation or electric plant operated by another municipality or board organized under the laws of this state in any territory being serviced by any such rural electric cooperative corporation.... KRS 96.890.

Any authority conferred upon Vanceburg's EPB by statute was not exercised before July 1, 1995, and by that date, Kentucky's Territorial Law had been in effect for over 20 years and Grayson was statutorily certified as the exclusive retail supplier for the entire territory which includes Vanceburg's claimed exclusive service area.

[4] Grayson sought to protect its territory and claimed the entirety of the area when Vanceburg converted its electric operations to an EPB. KRS 96.550 does not confer transfer rights to or from a pre-existing municipal system, but expressly limits an EPB's authority to operate under its provision "from the time of the exercise of such election and the appointment of a board hereunder...." KRS 96.560(1). That occurred upon enactment of City of Vanceburg Ordinance 650.00 on July 1, 1995. The EPB came into existence with rights subordinate to those of Grayson to provide retail electric service in the entirety of its service area since the territorial certification to Grayson was pursuant to specific legislation which controls earlier, general legislation on the same subject. *Brown v. Hoblitzell*, Ky., 307 S.W.2d 739 (1957). That is, rights accorded to parties by statute become a part of the operative facts which govern their relationships.

City of Nicholasville, *supra*, and *City of Florence*, *supra*, hold the Legislature is entitled to establish the operating parameters of a municipally-owned electric system, and in the exercise of that power, the Legislature restricted the EPB from competing in territory served by Grayson. Grayson's certified territory includes the 20-mile so-called exclusive service area, and by statute Grayson is required to serve the entirety of this boundary as the exclusive supplier of retail electric service. After July 1, 1995, the EPB entered into competition with Grayson by serving customers in an area certified by state law to Grayson.

However, since Grayson chose not to compete for the existing non-municipal customers being served by EPB and its predecessor VUC, we find that Grayson has acquiesced in and is estopped from contesting Vanceburg's EPB's current service rights in the disputed area. Until Grayson and East Kentucky Power Company learned of the potential industrial customer, neither utility ever sought to serve the 20-mile corridor.

[5, 6] In *Hunts Branch Coal Co. v. Canada*, Ky., 599 S.W.2d 154, 155 (1980), this Court reaffirmed the principles of equitable estoppel:

> One who knows or should know of a situation or a material fact is precluded from denying it or asserting the contrary where by his words or conduct he has misled or prejudiced another person or induced him to change his position.

Estoppel is established where another party relies in good faith on the representations made by the estopped party. *Electric & Water Plant Bd. v. Suburban Acres Development*, Ky., 513 S.W.2d 489, 491 (1974). An estoppel can be created by a party's words or by a party's conduct. *Hunts Branch Coal*, *supra*, at 155.

The trial court detailed the evidence establishing the VUC's continuous investment and service in the area which occurred without objection by Grayson. The

evidence demonstrated that Grayson has always been aware of Vanceburg's service to the customers in this area. Grayson and its wholesale power supplier, East Kentucky Power Company, worked closely with the VUC on the construction of a $140,000,000 hydroelectric plant to meet expected growth in industrial sites east of the city that Vanceburg was to serve. Throughout the project, including applications made to the Federal Power Commission, Grayson acknowledged that Vanceburg served the area lying between South Portsmouth and Vanceburg. In addition to the plant construction in the 1950's, 1980's, and as late as 1990, Vanceburg has made significant capital investments in facilities located in the disputed area to improve service to those customers as well as the city and its inhabitants. As a result of this reasonable reliance, Vanceburg changed its position to its detriment.

The decision of the Court of Appeals is reversed and this matter is remanded to the Lewis Circuit Court for entry of a judgment holding that Grayson is entitled to serve new customers within its certified territory in the contested area and the EPB is entitled to serve its existing customers in the contested area.

LAMBERT, C.J., COOPER, GRAVES, JOHNSTONE, KELLER, and STUMBO, J.J., concur.

WINTERSHEIMER, J., dissents in a separate opinion.

WINTERSHEIMER, Justice, dissenting.

I must respectfully dissent from the majority opinion because the Vanceburg Electric Plant Board has the exclusive right to serve its existing customers in the contested area as well as the absolute right to serve new customers in the area. I would affirm the Court of Appeals and the circuit court in their decisions.

KRS 96.520 and *City of Corbin v. Kentucky Utilities Company*, Ky., 447 S.W.2d 356 (1969), support the proper legal conclusion that the Vanceburg Electric Plant Board has the authority to supply power to the disputed area. The statute provides in pertinent part as follows:

> Any city of the ... fourth ... class may purchase, establish, erect, maintain and operate electric light, heat and power plants with extensions and necessary appurtenances thereto, within or without the corporate limits of the city, for the purpose of supplying the city and its inhabitants with electric light, heat and power, and for such purpose, may enter into and fulfill the terms of an interconnection agreement with any utility....

KRS 96.520.

City of Corbin, *supra*, states that "under exceptional circumstances, the supplying of those outside the city limits may be correlated to" the primary purpose of supplying the city and its inhabitants with electricity. The trial judge correctly found that the facts existing in this case create the necessary circumstances to make it a valid exception so as to permit the Vanceburg utility entities to operate outside the municipal boundaries pursuant to KRS 96.520–540. I must fully agree with the Court of Appeals that the findings of the trial court were not clearly erroneous and should not be set aside.

The trial judge correctly found that as a matter of fact, the Grayson Rural Electric Corporation had no facilities or means to supply power to the contested area, and consequently, there was no competition. The trial judge further correctly held that the public service commission has no authority to regulate the service area of the Vanceburg Utilities Commission or the Vanceburg Electric Plant Board. This is not a case which involves a usurpation of the authority of the PSC. The conduct involved is clearly contemplated by the appropriate statutes.

This is a very fact-specific case, and under the unique circumstances presented here where one utility has served the same area for nearly sixty years with unchal-

lenged, uninterrupted service and given the knowledge, acquiescence and the assistance of the other utility there can be no basis to object at this time. Any decision that permits the existing provider of electric service to continue to provide that service does not promote any disorder or instability. The benefits that accrue to the Vanceburg Electric Plant Board are benefits that are clearly contemplated by the rural electric acts over more than seven decades. There are no far-reaching implications that in any way disturb the existing order of providing necessary electric service at affordable rates to all the consumers of the Commonwealth. Clearly, this decision avoids the wasteful duplication of distribution facilities sought to be promoted by KRS 278.016. Exclusive service areas are no more unstable when a municipality exercises that privilege than when an electric cooperative exercises it.

I must disagree with the majority on its interpretation of *City of Florence v. Owen Electric Cooperative, Inc.*, Ky., 832 S.W.2d 876 (1992). In that case, a utility had been granted a franchise by the city and the utility sought to have the right to serve an area that the city had recently annexed. The newly annexed area was located in the certified territory of another utility which had been providing service. This Court correctly held that the legislature has authority to limit the grant and operation of municipal franchises. The Court further held that because the area had been certified as the territory of the other utility under the territorial act, the other utility had exclusive right to serve.

In the *City of Nicholasville v. Blue Grass Rural Electric Cooperative Corp.*, Ky., 514 S.W.2d 414 (1974), the city was attempting to serve an area where it did not have facilities but where a cooperative did have facilities and was already providing service. This Court affirmed the ruling that under the relevant statute, KRS 96.538, the city could not compete with the cooperative.

In this case Vanceburg does not challenge the statutory prohibition of competition. In that respect, this case is clearly distinguishable from both *Florence, supra*, and *Nicholasville, supra*, because Vanceburg relies on the premise of the statutes that prohibit competition when it claims that it has the right to serve the disputed area free from other competition.

It is somewhat curious to note that since 1939 and until 1990, Vanceburg Electric Plant Board or its predecessor served only a small number of city residents and an equally small number of rural residents outside the municipal boundaries. In 1990, Vanceburg made a substantial investment in upgrading its facilities for the purpose of providing power to industrial customers located in Black Oak, an industrial site located three miles outside the city limits. The only customer in the St. Paul vicinity served by Grayson RECC is located outside the disputed area. Vanceburg has continuously relied upon their belief that the disputed area was being served exclusively by Vanceburg and this view was based on the acquiescence of Grayson RECC and East Kentucky Power as found by the trial judge. It was only in late 1993 that a prospective industrial customer expressed an interest in locating and purchasing a 1400-acre site in St. Paul owned by Kentucky Power Company since 1975.

Under all the circumstances of this case, Vanceburg and its allied power suppliers have an exclusive right to provide electric service in the disputed area. Such a result would not undermine the orderly distribution of retail electric service as required by Kentucky law.

I would affirm the decision of the circuit court and the Court of Appeals.