

## **PSC REGULATION OF MUNICIPAL WATER UTILITIES – A HISTORY**

### **I. INTRODUCTION**

### **II. BEFORE SIMPSON COUNTY WATER DISTRICT**

#### **A. Public Service Commission Act of 1934. 1934 Ky.Acts 580-613.**

1. “Utility” is broadly defined to include all “persons and corporations or their lessees, trustees or receivers that now or may hereafter own, control, operate or manage” utility facilities.

a. Corporation includes “private, quasi public and public corporations.”

b. Cities are not specifically mentioned, but fall within the definition of utility by virtue of being a public corporation and owning utility facilities.

2. PSC Granted the Authority to Change Rates - § 4(n).

The commission shall have power, under the provisions of this act, to enforce, originate, establish, change, and promulgate any rate, rates, joint rates, charges, tolls, schedules or service standards of any utility, subject to the provisions of this act, that are now fixed or that may in the future be fixed, by any contract, franchise or otherwise, between any municipality and any such utility, and all rights, privileges and obligations arising out of any such contracts and agreements regulating any such rates, charges, schedules or service standards, shall be subject to the jurisdiction and supervision of the commission; provided, however, that no such rate, charge, schedule or service standard shall be changed, nor any contract or agreement affecting same shall be abrogated or changed until and after a hearing has been had before the commission in the manner prescribed in this act.

**Nothing in this section or elsewhere in this act contained is intended or shall be construed to limit or restrict the police jurisdiction, contract rights, or powers of municipalities or political subdivisions, except as to the regulation of rates and service, exclusive jurisdiction over which is lodged in the Public Service Commission.**

3. Purpose of § 4(n).

a. Act effectively stripped municipalities from regulating utility rates through their franchising authority. “The power to regulate rates had been delegated to the city by the Legislature, and what it had given it could take away. The act of 1934 which created the Public Service Commission divested the city of the power to regulate rates and reposed that power in the Commission. Southern Bell Telephone & Telegraph Co., 265 Ky. 286, 96 S.W.2d 695, 698 (1936).

b. It was the intention of the Legislature “to clothe the Public Service Commission with complete control over rates and services of the utilities enumerated in the act . . . .” Id. at 697 (1936).

4. Municipal Opposition.

a. Act viewed as stripping local control of utilities away from cities.

b. Strong opposition in Louisville where the Louisville Public Rate Bureau regulated utility rates and City directly established Louisville Water Company rates.

c. Concerns that the commission would become the captive of investor-owned utilities. No regulated utility opposed the proposed law.

d. Concerns about conflicts with statutes that enabled second class cities to purchase, construct and operate their own utility facilities.

B. 1936 Revision to Public Service Commission Act. 1936 Ky.Acts 300-302.

1. Definition of “Utility” is revised.

Provided, however, that for the purposes of this act the term “utility” or “utilities” shall not mean or include any city or town or water districts established in pursuance of Chapter one hundred thirty-nine (139), Acts one thousand nine hundred twenty-six (1926) and amendments thereto, owning, controlling, operating or managing any facility or facilities enumerated in this paragraph.

2. Municipal utilities expressly excluded from the definition of utility.

3. Principal reasons for amendment.
  - a. Remove conflict with municipal utility acquisition/construction statute.
    - (1) 1932 Act permitted second class cities to purchase, establish, and **operate** electric plants. Public Service Commission Act of 1934, by allowing PSC to regulate municipal utility rates, effectively modified the 1932 Act.
    - (2) Legislature revised 1932 Act to permit second through sixth-class cities to purchase, establish, and operate electric plants. Further provided that all laws and parts of laws in conflict with 1932 Act were repealed. Effectively repealed utility definition provisions.
  - b. Concern that PSC would prevent competition with private investor utilities by municipal utilities. Captive PSC would refuse to issue certificates.
  - c. Concerns of the City of Louisville regarding the Louisville Water Company.
4. Revision does not affect requirement to obtain a certificate. City of Vanceburg v. Plummer, 275 Ky. 713, 122 S.W.2d 772 (1938).

[The amendment to 1934 Act] only divested the Public Service Commission of supervisory and regulatory power over plants owned and operated by municipalities, and **left in effect the requirement that a municipality must obtain from the commission a certificate of convenience and necessity before it can begin the construction of a plant.** After a city has obtained a certificate and constructed a utility plant, it can operate the plant and fix the rates for the utility commodity through its city utility commission free from any supervision or regulation by the State Public Service Commission. The chief purpose of the requirement in the Public Service Commission Act, that a certificate of convenience and necessity be obtained from the Public Service Commission before construction of a utility plant is begun, is to prevent the unnecessary duplication of facilities for utility service and to protect the consuming public from inadequate service and higher rates which frequently result from such duplication. The reason for the requirement applies alike to municipally and privately owned utilities. The Legislature recognized the public evil which results from

unlimited competition in the public utility field, and placed this provision in the act as a safeguard against it, and we find nothing in the amendment to the 1934 Act which indicates that the Legislature intended to remove that safeguard so far as municipally owned utilities are concerned.

C. Jurisdiction over retail operations outside of a city's boundaries.

1. Olive Hill v. Public Service Commission, 305 Ky. 249, 203 S.W.2d 68 (1947).

a. City was providing electric service outside the city limits. Customers dissatisfied with service petitioned PSC to permit them to obtain service from another supplier. PSC ordered City to show cause why it had the authority to provide service outside its boundaries and two neighboring utilities to show cause why they should not be required to extend their lines to provide service to the complaining customers. After holding a hearing, PSC found that the City did not have the legal authority to serve outside its boundaries, directed the City to cease providing the service and directed the neighboring utilities to extend service to the complaining customers.

b. City brings action for review in Franklin Circuit Court. PSC's action upheld. Appeal to Court of Appeals.

c. Held:

(1) PSC does not have the authority to determine whether a city may provide service outside its boundaries.

(2) "When the City supplied [utility service] outside its corporate limits, its exemption from regulation as to rates and service by the Commission ceased, and the City came within the jurisdiction of the Commission and was subject to such regulation by it."

d. Rationale.

(1) Not expressly stated.

(2) Legal precedent that Court cites in support of PSC holds that cities when supplying water service are not acting in a governmental capacity but in a proprietary capacity. In such capacity, the city is no more than a private corporation.

2. Followed until 1961.
  - a. Louisville Water Company v. Preston Street Road Water District, Ky., 256 S.W.2d 26 (1953).
  - b. Fraley v. Beaver Elkhorn Water District, Ky., 257 S.W.2d 536 (1953) (exempted water district providing gas service outside its boundaries is subject to PSC jurisdiction).
  - c. City of Covington v. Sohio Petroleum, Ky., 279 S.W.2d 746 (1955).
  - d. City of Richmond v. Public Service Commission, Ky., 294 S.W.2d 513 (1956).
  - e. Louisville Water Company v. Public Service Commission, Ky., 318 S.W.2d 537 (1958).

3. Reasoning behind PSC Jurisdiction.

- a. Legal. City ceases to be city when it provides services outside its borders.
- b. Political. Non-residents are without power to influence city policymakers.

Residents of a city have some means of protection against excessive rates or inadequate service of a utility owned by the city, through their voting power. However, customers outside the city have no such means of protection, and unless their interests are protected by the Public Service Commission they are at the mercy of the utility. This consideration, we think, was the basis for the decisions that the legislature did not intend to exempt municipally owned utilities from regulation in rendering service outside the city.

Louisville Water Company v. Public Service Commission, Ky., 318 S.W.2d 537, 539-540 (1958).

4. McClellan v. Louisville Water Company, Ky., 351 S.W.2d 197 (1961).
  - a. Louisville Water Company (“LWC”) had substantially increased its non-resident rates in 1939 and 1946 without PSC

approval. In 1956 LWC decreased the discount provided to non-resident customers. LWC customers who lived outside Louisville's city limits brought an action in Jefferson Circuit Court to have LWC's non-resident rates declared void, to enjoin LWC from collection of non-residential rates, and to require LWC to refund unlawful rates. Jefferson Circuit Court rendered judgment for LWC. Customers appealed to Court of Appeals.

b. Held: Court's prior interpretation of KRS 278.010(3) is erroneous. The exemption provided in KRS 278.010(3) "extends to all operations of a municipally owned utility whether within or without the territorial boundaries of the city." Olive Hill is overruled. "While we recognize that this decision deprives nonresident utility customers of the protection afforded by the Public Service Commission against excessive rates or inadequate service, nevertheless matters of this character are of legislative rather than judicial concern."

5. City of Georgetown v. Public Service Commission, Ky., 516 S.W.2d 842 (1974).

a. Facts: City of Georgetown sought to extend its water system outside its city boundaries. Kentucky-American Water Company ("KAW") filed a complaint with PSC in which it alleged that City's proposed facilities would enable it to serve within KAW's service territory. Arguing that the PSC had lacked jurisdiction over it, City moved to dismiss the complaint. PSC denied motion. City filed an action for declaration of rights and injunctive relief. Franklin Circuit Court denied the motion for injunctive relief. City appealed.

b. Positions:

(1) PSC/Kentucky American: KRS 278.020(1) refers to "person," not to "utility". McClellan holding therefore is not applicable.

(2) City: KRS 278.010(3) clearly exempts cities from PSC jurisdiction. McClellan cited in support.

c. Holding: Reverses lower court. "It would be entirely inconsistent with the McClellan ruling to require a municipal water plant to obtain a certificate from the Commission . . . . It is our view that the plain intent of the General Assembly as expressed in KRS 278.010(1) should prevail and should not be circumscribed by a strained reasoning process bringing into play KRS 278.020(1)."

### III. Simpson County Water District Decision

#### A. Facts:

1. In 1967 Simpson County Water District ("Simpson District") and City of Franklin, Kentucky ("Franklin") enter a water purchase agreement. Franklin would provide Simpson District's water requirements (up to 20MGD) for a period of 45 years. Contract specifies a rate of \$.21 per 1,000 gallons but permitted Franklin to adjust rate. If Franklin increases the rates to **each of its customers**, the contract rate to Simpson District is increased by the same percentage increase to Franklin's customers.

2. In 1982 Franklin and Simpson District negotiate a Supplement Agreement. Changes are made to quantity and billing provisions. All other provisions are reaffirmed.

3. In 1986 Second Supplement Agreement is executed. Agreement is necessary to construct a new water treatment plant "to provide larger quantities of water to all of its customers, including the District." Under the terms of Agreement, Simpson District agrees to pay a share of the debt service on municipal bonds that will be issued to finance the new plant's construction in exchange for increased quantity of water.

a. The new rate is \$0.8478 per 1,000 gallons. It becomes effective on the first month following the issuance of revenue bonds. This rate remains in effect and **is not subject to change** for 5 years. Franklin may change rate within the 5-year period "should it be necessary for the City to increase its rates to **each of its customers solely because of debt service obligations on long-term financing for construction of raw water supply improvements to the City's water treatment plant.**"

b. After 5 years Franklin may automatically increase the rate to Simpson District if it increases its rates to each of its customers. Rate of increase to Simpson District will be the "same percentage as that percentage increase charged such customer of the City, whose rate is increased the small percentage."

4. In June 1990 Franklin raises its rate to Simpson District from 84.78 cents per 1,000 gallons to \$1.3478 per 1,000 gallons. It also raised rates to its retail customers. Simpson District refuses to pay increase and continues to pay \$.8478 per 1,000 gallons.

5. On May 13, 1991 Franklin raised its rate to Simpson District from \$1.3478 to \$1.68 per 1,000 gallons. No change is made to city resident

rates. Simpson District refuses to pay increase and continues to pay \$.8478 per 1,000 gallons.

6. In discussions with Franklin, Simpson District relies upon the recent decision in City Utility Commission of Owensboro v. East Daviess County Water Association (Daviess Cir. Ct. Ky. April 2, 1991). Unpublished opinion holds that before a city's contract with a utility can be changed or modified a hearing before PSC must be held.

7. On May 21, 1991, Franklin requests an opinion from PSC on the need for PSC approval of its rate change. In its request for opinion, Franklin sets forth both parties' positions.

8. On June 12, 1991, PSC, through its Executive Director, responds:

You are correct that the City, as a municipal utility, is specifically exempted by KRS 278.010(3) from Commission jurisdiction. (See also McClellan v. Louisville Water Co. et al., (1961) 351 S.W.2d 197; Foley v. Kinnett et al., (1972) 486 S.W.2d 705; and City of Georgetown v. Public Serv. Comm'n (1974) 516 S.W.2d 842. **As the city is exempt from Commission jurisdiction, the Commission has no authority to regulate its rates.**

. . .

It is unclear from your letter what grounds the District relies upon to support its position that the City must obtain Commission approval for an increase in rates. As stated above, pertinent statutes and case law appear to be clear on this matter; nonetheless, if the District relies upon other legal authority, it is welcome to submit its position to the Commission for consideration. However, if the City and District are unable to resolve this matter informally, it does not appear that the Commission could provide an official forum in which to entertain the dispute. KRS 278.260 endows the Commission with jurisdiction over complaints as to rates or service of any utility. However, **the City is not a utility within the definition of KRS Chapter 278, and it is clear that the statute would logically apply only to utilities over which the Commission has jurisdiction.**

Letter from Lee M. MacCracken, Executive Director, PSC, to Timothy J. Crocker, Attorney for City of Franklin (June 12, 1991) (emphasis added).



9. On August 21, 1991, Franklin brings suit to collect unpaid charges and to have its contracts with Simpson District declared void.

10. Simpson District moves for dismissal of action for lack of jurisdiction.

B. Simpson Circuit Court Proceeding.

1. Simpson District's Argument:

a. Franklin's actions constituted a change in the rate and service conditions fixed by the three previous agreements between Simpson District and Franklin. Jurisdiction over Franklin's actions rests exclusively with the PSC.

b. Since the statutory definition of "utility" excludes a city, a city is not subject to regulation by PSC **except with regard to the "regulation of rates and service of utilities."**

The jurisdiction of the commission shall extend to all utilities in this state. The commission shall have exclusive jurisdiction over the regulation of rates and service of utilities, but **with that exception** nothing in this chapter is intended to restrict the police jurisdiction, contract rights or power of cities or political subdivisions.

KRS 278.040(2) (emphasis added).

c. KRS 278.200 provides that PSC has jurisdiction over any rate or service standard contained in an agreement between a city and any utility and that no such rate or service standard may be changed without first having a hearing before the PSC.

The commission may, under the provisions of this chapter, originate, establish, change, promulgate and enforce any rate or service standard of any utility that has been or may be fixed by any contract, franchise or agreement between the utility and any city, and all rights, privileges and obligations arising out of any such contract, franchise or agreement, regulating any such rate or service standard, shall be subject to the jurisdiction and supervision of the commission, but no such rate or service standard shall be changed, nor any contract, franchise or agreement affecting it abrogated or changed, until a hearing has been had

before the commission in the manner prescribed in this chapter.

KRS 278.200

d. Simpson District introduces and relies upon City of Owensboro decision.

2. Franklin's Argument:

a. McClellan is controlling. The PSC has no jurisdiction over a city's rates.

b. Franklin introduces PSC's response to its inquiry about PSC jurisdiction.

3. Court's Decision (Nov. 12, 1991):

a. Emphasis placed upon the rates and service exception within KRS 278.040(2).

b. "KRS 278.200 seeks to address those instances where a contract has been made between a utility and a city. . . . [I]t merely provides that where a city and a utility enter into a contract, the terms of which include provisions for rates and services, then by so contracting the City gives up its exemption from PSC regulation and renders itself subject to regulation by the PSC." City of Franklin v. Simpson County Water District, No. 91-CI-00184 (Simpson Cir. Ct. Ky. Nov. 12, 1991) at 5 – 6.

c. "KRS 278.200, read together with KRS 278.040(2) creates what has been called a 'rates and services' exception to a city's exemption from PSC regulation." Id.

d. Court refused to strike references to City of Owensboro decision. "While the Court finds same to be well-reasoned and articulate, they neither strengthen nor weaken this Court's reasoning and conclusions . . . and they have not swayed the Court either way in its disposition of the pending motion." Id. at 9.

C. Kentucky Court of Appeals' Opinion (Jan. 8, 1993).

1. Franklin appeals Simpson Circuit decision. Court of Appeals reverses on a 2-1 decision.

2. Majority Position:

a. Absent a clear indication by the Legislature to the contrary, the term “utility” should be given uniform meaning throughout Chapter 278. Accordingly, absent clear evidence of a contrary intent, the City should not be deemed a utility while interpreting KRS 278.040(2).

b. The exception clause of KRS 278.040(2) cannot come into play unless the general jurisdictional clause to which it refers is applicable. The dispute in the present case concerns the price of treated water charged by a city to a utility-customer. As a city is by definition not a utility, the general clause is not applicable and the exception does not come into operation.

c. Trial Court ignores the definition of “rate” and “service.” “As the definition of ‘rate’ refers to the term ‘utility’, then the contractual price of treated water sold by the City cannot be considered a ‘rate’ because the City is not within the definition of a ‘utility.’ “

"Rate" means any individual or joint fare, toll, charge, rental, or other compensation for service **rendered or to be rendered by any utility**, and any rule, regulation, practice, act, requirement, or privilege in any way relating to such fare, toll, charge, rental, or other compensation, and any schedule or tariff or part of a schedule or tariff thereof;

KRS 278.010(12) (emphasis added).

"Service" includes any practice or requirement in any way relating **to the service of any utility**, including the voltage of electricity, the heat units and pressure of gas, the purity, pressure, and quantity of water, and in general the quality, quantity, and pressure of any commodity or product used or to be used for or in connection with the business of **any utility**;

KRS 278.010(13) (emphasis added).

d. Trial Court’s interpretation would make KRS 278.015(2) meaningless. “There would be no need for such a provision if the City, acting as a wholesale supplier to the District, were precluded from raising its prices under KRS 278.040(2).” City of Franklin, Ky. v. Simpson County Water District, No. 91-CA-002675-MR (Ky.App. Jan. 8, 1993) at 5.

e. Trial Court's reliance on KRS 278.200 is mistaken. References to rate and service refer to rates and service of a utility, not a city. "[I]t would not apply to the City's action as the City is not a "utility," nor does the action involve a "rate" or "service." Id. at 6. Rate or service standard "can only refer to a "utility" and does not encompass the operations of the City when it acts as a wholesale supplier of water to the District." Id.

f. Purpose of KRS 278.200 is to prevent a city from usurping powers which the Legislature granted to the PSC to regulate rate and service standards of its utility-supplier by means of a contract, franchise or agreement.

g. If Legislature had intended to depart from the statutory definition of a utility and place cities acting as suppliers to utilities within the exclusive jurisdiction of the PSC it could have done so by writing statute as granting exclusive jurisdiction to the PSC over "rates and services of all utilities including cities." It did not.

3. Dissenting Opinion:

a. The rates and service exception is intended to prohibit cities from exercising any control whatsoever over the rates charged and the services provided to customers of local utilities, as jurisdiction over the regulation of such rates and services is exclusively vested in the PSC.

b. Doubling of rates by Franklin within a 2-year period unquestionably affected utility's rates and services, thereby amounting to the city's exercise of a power reserved exclusively to the PSC.

c. PSC's jurisdiction was intended to exclusively encompass any action, including that taken by a city or other governmental entity, which "in any way" relates to or affects rates and services "rendered or to be rendered" by a utility.

D. PSC Proceeding.

1. On March 4, 1992, Franklin filed a petition and complaint with the PSC.

2. Relief Sought:

a. Declaration that Franklin had the right and authority to increase its wholesale rates to Simpson District.

b. Authorization for a purchased water adjustment to Simpson District to increase the water district's rates.

c. Imposition of a surcharge on Simpson District's customers to permit recovery of all water costs from the date that Franklin first imposed the rate increases.

d. Order directing Simpson District to pay the surcharge revenues to Franklin and to pay the increased Franklin rates.

e. (Alternatively Pleaded) If PSC has jurisdiction over Franklin's rates, then an Order approving a rate adjustment from \$.8478 to \$1.68 per 1,000 gallons of water and imposing a surcharge on Simpson District's retail rates to recover lost wholesale revenues.

3. Simpson District's Response: PSC lacks jurisdiction and should dismiss the Complaint. In the alternative, PSC should hold proceeding in abeyance pending completion of appeals of Simpson Circuit Court decision.

4. PSC Decision (May 26, 1992).

a. Key Issue: Does PSC have jurisdiction over the rates charged by Franklin?

b. Holding: No jurisdiction.

KRS 278.010(3) defines a utility as any person except a city, who owns, controls, or operates or manages any facility used to provide water to the public for compensation. Franklin is an incorporated city in Simpson County, Kentucky, which owns and operates a municipal water plant under the provisions of KRS Chapter 96. As a municipality, the city is specifically exempted from Commission jurisdiction under KRS Chapter 278, thus, the Commission has no authority to regulate Franklin's rates. The relief requested by Franklin – that the Commission declare Franklin had the right and authority to increase its rates or, alternatively, that Franklin's rate increase be approved, cannot be granted.

City of Franklin v. Simpson County Water District, Case No. 92-084 (Ky.PSC May 26, 1992) at 3-4.

c. PSC dismisses Complaint.

5. Franklin Circuit Court affirms PSC Decision. City of Franklin v. Kentucky Pub. Serv. Com'n, No. 92-CI-00850 (Franklin Cir. Ct. Ky. April 21, 1993). Holds that PSC acted properly in deferring any decision pending completion of other proceedings pending before the Court of Appeals.

E. Supreme Court Opinion (Jan. 31, 1994).

1. Supreme Court reverses Court of Appeals Opinion (4-3).

2. Majority Opinion:

a. Recognizes a “rates and service exception” to the statutory exemption of municipalities from PSC regulation. Refers to KRS 278.040(2). “The legislature has conferred upon cities an exemption from the PSC’s power to regulate local utilities in every area except as to rates and service.” Simpson County Water Dist. v. City of Franklin, Ky., 872 S.W.2d 460, 462 (1994).

b. Rejects argument that KRS 278.200 applies only to contracts where the utility is providing service to a city. “[T]he statute makes no such distinction. The statute has but one meaning – the City waives its exemption when it contracts with a regulated utility upon the subjects of rates and service.” Id.

c. “[W]here contracts have been executed between a utility and a city, . . . KRS 278.200 is applicable and requires that by so contracting the City relinquishes the exemption and is rendered subject to PSC rates and service regulation.” Id. at 463.

d. Distinguishes McClellan by noting that at the time of the issuance of that opinion, water districts were not subject to PSC jurisdiction.

e. Statutory exception is viewed as mechanism to protect “public utilities” from municipal utilities:

The statutory exception applicable to rates and service as provided will prohibit cities from exercising control over rates charged and the service provided to customers of local utilities. Jurisdiction to regulate such rates and service has been exclusively vested in the PSC. The record in this case discloses a doubling of the wholesale water rates charged to the District

within a two-year period, with a direct impact upon the District's utility rates and service. Added to the force which the City sought to apply was a call to terminate service by declaring the parties' contract null and void. It is apparent that the City, through its enhanced water sale ordinances, did not direct the setting of any particular rate schedule, but its action profoundly and directly impacts the District's general revenue level, which is one of the first steps in rate making. **The City's action is an improper engagement in rate making and strongly supports PSC jurisdiction. The statutory definition of utility is not to serve as an impenetrable shield to afford the City immunity.**

. . .

The rates and service exception effectively insures, throughout the Commonwealth, that any water district consumer/customer that has contracted and become dependent for its supply of water from a city utility is not subject to either excessive rates or inadequate service.

Id. at 464.

f. Notes that a contract between municipal utility and public utility will always exist where a sale occurs. Further notes that in such instances PSC will always have jurisdiction. "Once established by contract such service can only be abrogated or changed after a hearing before the PSC." Id. at 465.

3. Dissenting Opinion:

a. The PSC has jurisdiction only over the rates and services of a "utility," publicly or privately owned as distinguished from city-owned.

b. Purpose of § 4(n) of PSC Act of 1934 was not to grant the PSC jurisdiction over the rates of city-owned utilities, rather the statute was intended to transfer jurisdiction to the PSC over public utility rates which had been fixed initially by a city at the time a utility franchise was granted.

c. Historical background does not support majority's position. Prior to adoption of the PSC Acts, cities regulated the rates charged by utilities for services inside the city limits. In exercising

its power to grant a franchise to use the public streets, a city could establish a utility's initial rates in the franchise agreement. During the existence of the franchise agreement, the city and the utility were free to modify those rates by additional contractual agreement. KRS 278.040(2) merely gave PSC exclusive authority to set those utilities' rates.

d. Terms "rate" and "service" within KRS 278.200 refer only to the rates and service of a jurisdictional utility, not to a city-owned utility.

e. Nothing in the legislative history of KRS Chapter 278 that evidences any attempt for PSC regulation of city-owned utilities.

(1) No legislative attempt to overrule McClellan.

(2) No attempt to include cities with water districts when 1964 amendments were enacted.

(3) No need for 1986 Amendments that allow for automatic purchased water adjustment if PSC regulated the wholesale rates of city-owned utilities.

f. [T]he city as a supplier is expressly excluded from the definition of a utility in KRS 278.010(3). In view of the fact that the city is specifically excluded from the definition of a utility in the statute, there is no ambiguity or conflict giving the courts a vehicle to construe the city as subject to PSC regulation and exclude its right to file in circuit court to determine the contractual obligations if any to the Simpson County Water District.

Id. at 467.

#### F. Conclusion.

1. Based upon Simpson County Water District, Court of Appeals reversed PSC's dismissal of Franklin's Complaint and remanded to PSC for further consideration. City of Franklin v. Kentucky Pub. Serv. Com'n, No. 93-CA-001072-S (May 6, 1994).

2. Upon remand, PSC found that Franklin had violated KRS 278.160(2) by assessing a rate that was neither on file with PSC nor approved after a hearing. PSC directed Franklin to pay \$196,033 to



Simpson District plus interest. City of Franklin v. Simpson County Water District, Case No. 92-084 (Ky.PSC Feb. 23, 1996) at 2.

3. Matter subsequently settled.
4. Simpson District subsequently contracted with another water supplier to furnish its water supply needs.

#### **IV. IMPLEMENTING SIMPSON COUNTY WATER DISTRICT**

##### **A. Unanswered Questions.**

1. What provisions of KRS Chapter 278 apply to municipal utilities?
2. What is the PSC's role – Rate Regulator or Contract Arbitrator?
3. Is the PSC bound by the contract between the municipal utility and the public utility?
4. How does a municipal utility apply for a rate adjustment?
5. How should the PSC establish rates for a municipal utility?
6. How far does PSC jurisdiction extend?

##### **B. Application of KRS Chapter 278 to Municipal Utilities.**

###### **1. Filing of Rates and Contracts with PSC.**

###### **a. KRS 278.160(1).**

Under rules prescribed by the commission, each utility shall file with the commission, within such time and in such form as the commission designates, schedules showing all rates and conditions for service established by it and collected or enforced. The utility shall keep copies of its schedules open to public inspection under such rules as the commission prescribes.

###### **b. Submission of Contracts and Rates of Municipal Utilities, Administrative Case No. 351 (Ky.PSC Aug. 10, 1994) (All municipal utilities directed to file their wholesale contracts with public utilities with the PSC).**

- c. Commission practice to refuse to permit a municipal utility to place its rates into effect prior to having an effective rate schedule on file with the PSC.
2. Notice Requirements for Rate Adjustment.
  - a. KRS 278.180(1): “[N]o change shall be made by any utility in any rate except upon thirty (30) days’ notice to the commission, stating plainly the changes proposed to be made and the time when the changed rates will go into effect.”
  - b. Submission of Contracts and Rates of Municipal Utilities, Administrative Case No. 351 (Ky.PSC Aug. 10, 1994) at 2 (“Any municipal utility wishing to change or revise a contract or rate for wholesale utility service to a public utility shall, no later than 30 days prior to the effective date of the revision, file with the Commission the revised contract and rate schedule.”)
3. Procedures for applying for rate adjustment (KRS 278.190). Bowling Green Municipal Utilities, Case No. 95-044 (Ky.PSC April 7, 1995) (when applying for a rate adjustment, a municipal utility must comply with the provisions of KRS 278.190 and Administrative Regulation 807 KAR 5:001).
4. Burden of proof in a rate adjustment proceeding.
  - a. KRS 278.190(3) provides that “[a]t any hearing involving the rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the utility . . .”
  - b. City of Franklin v. Simpson County Water District, Case No. 92-084 (Ky.PSC Jan. 18, 1996) at 6 (municipal utility’s proposed rate adjustments “are not presumptively valid and reasonable . . . their reasonableness must be adequately demonstrated.”).
5. Time in which to rule upon proposed rate adjustment.
  - a. KRS 278.190(3) holds that the PSC must decide on the proposed rate adjustment “not later than ten (10) months after the filing of such [rate] schedules.”
  - b. City of Warsaw, Kentucky, Case No. 99-131 (Ky.PSC Nov. 8, 1999) (stating that KRS 278.190(3) governs the time in which the PSC must rule on proposed municipal rate).

6. Assessments.
- C. PSC's Role: Arbitrator or Regulator.
1. Conflicting Models.
    - a. Arbitrator: PSC merely substitutes for the courts. It applies the terms of the contract to the facts before it. It may not rewrite terms of the contract unless contract law permits. PSC does not sit as a rate-making authority when adjudicating contract issues.
    - b. Regulator: By contracting with a public utility, the municipal utility loses its exemption from PSC regulation. It thus becomes a utility and is subject to PSC's authority to charge rate and service provisions within the contract. PSC may change the terms that result in unjust, unreasonable, or unfair rates or conditions of service.
  2. Arbitrator Role – PSC acts only when the parties are in dispute.
    - a. Unlike a public utility's request for rate adjustment, where a formal review is always conducted, the PSC generally has not conducted a formal review of a municipal utility's proposed rate adjustment unless the affected wholesale customer or other interested party files an objection or otherwise requests a formal review. The PSC's tendency not to formally investigate municipal rate proposals in the absence of such requests suggests that where parties are in agreement, PSC sees no pressing need to act.
    - b. Limited filing requirements for municipal utilities. In comparison with public utilities, municipal utilities are not required to submit a substantial amount of information about the proposed rate adjustment or their operations when making an initial filing. Only when a wholesale customer objects will heightened PSC scrutiny be triggered.
    - c. PSC's response when wholesale customers withdraw their objections. In Mount Sterling Water and Sewer Com'n, Case No. 95-193 (Ky.PSC Sep. 1, 1995), after initially suspending the city utility's rates upon the objection of its wholesale customers, the PSC approved the rates without further examination when the wholesale customers withdrew their objections.

In the case at bar, this purpose [purpose for  
PSC regulation] has been served. The affected public

utilities made clear their objections to the proposed rate adjustment. Addressing the concerns of each public utility, Mount Sterling convinced each of the reasonableness of the proposed adjustment.

As the proposed rates on their face appear neither unreasonable nor unconscionable, the Commission sees no need to conduct further proceedings in this matter.

Id. at 1 – 2.

3. Regulator Role - PSC had held that municipal contracts should be considered in the same manner as the contracts of public utilities. The rate is examined for reasonableness and the contract is not controlling.

a. Design and Use of System Development Charges, Administrative Case No. 375 (Ky.PSC Sep. 25, 2000) (“If a municipal utility’s sales to public utilities are subject to Commission regulation in the same manner as those of a public utility, then it possesses the same rights as a public utility.”)

b. City of Owenton, Ky., Case No. 98-283 (Ky.P.S.C. Feb. 22, 1999) (“Assuming arguendo that the parties had reached some agreement upon cost methodology, such agreement is not binding upon the Commission. The Commission has “the right and duty to regulate rates and services, no matter what a contract provided.” Board of Ed. of Jefferson County v. William Dohrman, Inc., 620 S.W.2d 328, 329 (Ky.App. 1981). While the Commission should give weight to the intent of the parties, its ultimate obligation is to establish rates that are fair, just and reasonable.”)

c. Under this model, the benefit of PSC jurisdiction may shift to a municipal. The PSC may permit rates that are in excess of those allowed by the water purchase contract but reflect the actual cost of service.

D. How far does PSC Jurisdiction Extend?

1. Rates charged to other municipal utilities. PSC has disclaimed any jurisdiction over the rates charged to other municipal utilities. See Mount Sterling Water and Sewer Com’n, Case No. 95-193 (Ky.PSC May 31, 1995) at 1 (“The Commission’s jurisdiction over municipally owned utilities extends only to rates charged and services provided to public utilities. It does not extend to the retail rates of such utilities or to the rates which a

municipally owned utility may assess to another municipally owned utility.”)

2. Territory disputes between municipal utilities and public utilities. See City of Lawrenceburg v. South Anderson Water District, Case No. 96-256 (Ky.PSC June 11, 1998) (held that PSC is not expressly authorized to address such issues).

3. Construction of new facilities. Is a municipal utility required to obtain a certificate of public convenience and necessity if its construction of new facilities will increase a public utility’s rates? See City of Danville, Kentucky, Case No. 99-353 (issued raised but not resolved).

4. Service issues.

a. Service includes “any practice or requirement in any way relating to the service of any utility, including . . . the purity, pressure, and quantity of water, and in general the quality, quantity, and pressure of any commodity or product used or to be used for or in connection with the business of any utility.” KRS 278.010(13).

b. KRS 278.200 mentions the “service standards.”

c. Issues falling within service standards.

(1) Quantity (including excessive consumption)

(2) Water Pressure

(3) Discontinuance of Service (including emergency shutdowns).

## V. SUMMARY

A. Dramatic swings of the pendulum since 1934.

B. Key Concern: Protection of those lacking voting power (extra-territorial customers or county water districts).

C. Legal foundations of Simpson County Water District are not stable and are subject to attack. If Louisville Water Company’s approach to Olive Hill is any example, a sustained, long-term challenge to Simpson County Water District could result in same fate. Municipal and public utilities should not be totally dependent upon Simpson County Water District in developing their relationships with their customers or suppliers. Contingency planning is necessary.

- D. Possibility of legislative action should be considered.
- E. PSC's role continues to evolve. The full extent of PSC jurisdiction is being developed on a case-by-case basis.
- F. Simpson County Water District is a double-edged sword. If originally intended to protect wholesale water customers, it may also serve to protect municipal utilities by permitting the PSC to change existing contracts to ensure that fair and reasonable rates are established.

**278.010 Definitions for KRS 278.010 to 278.450 and KRS 278.990.**

As used in KRS 278.010 to 278.450, and in KRS 278.990, unless the context otherwise requires:

- (1) "Corporation" includes private, quasipublic, and public corporations, and all boards, agencies, and instrumentalities thereof, associations, joint-stock companies, and business trusts;
- (2) "Person" includes natural persons, partnerships, corporations, and two (2) or more persons having a joint or common interest;
- (3) "Utility" means any person except, for purposes of paragraphs (a), (b), (c), (d), and (f) of this subsection, a city, who owns, controls, operates, or manages any facility used or to be used for or in connection with:
  - (a) The generation, production, transmission, or distribution of electricity to or for the public, for compensation, for lights, heat, power, or other uses;
  - (b) The production, manufacture, storage, distribution, sale, or furnishing of natural or manufactured gas, or a mixture of same, to or for the public, for compensation, for light, heat, power, or other uses;
  - (c) The transporting or conveying of gas, crude oil, or other fluid substance by pipeline to or for the public, for compensation;
  - (d) The diverting, developing, pumping, impounding, distributing, or furnishing of water to or for the public, for compensation;
  - (e) The transmission or conveyance over wire, in air, or otherwise, of any message by telephone or telegraph for the public, for compensation; or
  - (f) The collection, transmission, or treatment of sewage for the public, for compensation, if the facility is a subdivision collection, transmission, or treatment facility plant that is affixed to real property and is located in a county containing a city of the first class or is a sewage collection, transmission, or treatment facility that is affixed to real property, that is located in any other county, and that is not subject to regulation by a metropolitan sewer district or any sanitation district created pursuant to KRS Chapter 220;
- (4) "Retail electric supplier" means any person, firm, corporation, association, or cooperative corporation, excluding municipal corporations, engaged in the furnishing of retail electric service;
- (5) "Certified territory" shall mean the areas as certified by and pursuant to KRS 278.017;
- (6) "Existing distribution line" shall mean an electric line which on June 16, 1972, is being or has been substantially used to supply retail electric service and includes all lines from the distribution substation to the electric consuming facility but does not include any transmission facilities used primarily to transfer energy in bulk;
- (7) "Retail electric service" means electric service furnished to a consumer for ultimate consumption, but does not include wholesale electric energy furnished by an electric supplier to another electric supplier for resale;

- (8) "Electric-consuming facilities" means everything that utilizes electric energy from a central station source;
- (9) "Generation and transmission cooperative," or "G&T," means a utility formed under KRS Chapter 279 that provides electric generation and transmission services;
- (10) "Distribution cooperative" means a utility formed under KRS Chapter 279 that provides retail electric service;
- (11) "Facility" includes all property, means, and instrumentalities owned, operated, leased, licensed, used, furnished, or supplied for, by, or in connection with the business of any utility;
- (12) "Rate" means any individual or joint fare, toll, charge, rental, or other compensation for service rendered or to be rendered by any utility, and any rule, regulation, practice, act, requirement, or privilege in any way relating to such fare, toll, charge, rental, or other compensation, and any schedule or tariff or part of a schedule or tariff thereof;
- (13) "Service" includes any practice or requirement in any way relating to the service of any utility, including the voltage of electricity, the heat units and pressure of gas, the purity, pressure, and quantity of water, and in general the quality, quantity, and pressure of any commodity or product used or to be used for or in connection with the business of any utility;
- (14) "Adequate service" means having sufficient capacity to meet the maximum estimated requirements of the customer to be served during the year following the commencement of permanent service and to meet the maximum estimated requirements of other actual customers to be supplied from the same lines or facilities during such year and to assure such customers of reasonable continuity of service;
- (15) "Commission" means the Public Service Commission of Kentucky;
- (16) "Commissioner" means one (1) of the members of the commission;
- (17) "Demand-side management" means any conservation, load management, or other utility activity intended to influence the level or pattern of customer usage or demand;
- (18) "Affiliate" means a person that controls or that is controlled by, or is under common control with, a utility;
- (19) "Control" means the power to direct the management or policies of a person through ownership, by contract, or otherwise;
- (20) "CAM" means a cost allocation manual which is an indexed compilation and documentation of a company's cost allocation policies and related procedures;
- (21) "Nonregulated activity" means the provision of competitive retail gas or electric services or other products or services over which the commission exerts no regulatory authority;
- (22) "Nonregulated" means that which is not subject to regulation by the commission;
- (23) "Regulated activity" means a service provided by a utility, the rates and charges of which are regulated by the commission;



- (24) "USoA" means uniform system of accounts which is a system of accounts for public utilities established by the FERC and adopted by the commission;
- (25) "Arm's length" means the standard of conduct under which unrelated parties, each party acting in its own best interest, would negotiate and carry out a particular transaction;
- (26) "Subsidize" means the recovery of costs or the transfer of value from one (1) class of customer, activity, or business unit that is attributable to another;
- (27) "Solicit" means to engage in or offer for sale a good or service, either directly or indirectly and irrespective of place or audience;
- (28) "USDA" means the United States Department of Agriculture;
- (29) "FERC" means the Federal Energy Regulatory Commission; and
- (30) "SEC" means the Securities and Exchange Commission.

**Effective:** July 14, 2000

**History:** Amended 2000 Ky. Acts ch. 101, sec. 5, effective July 14, 2000; ch. 118, sec. 1, effective July 14, 2000; and ch. 511, sec. 1, effective July 14, 2000. -- Amended 1998 Ky. Acts ch. 188, sec. 1, effective July 15, 1998. -- Amended 1994 Ky. Acts ch. 238, sec. 1, effective July 15, 1994. -- Amended 1982 Ky. Acts ch. 82, sec. 1, effective July 15, 1982. -- Amended 1978 Ky. Acts ch. 379, sec. 1, effective April 1, 1979. -- Amended 1974 Ky. Acts ch. 118, sec. 1. -- Amended 1972 Ky. Acts ch. 83, sec. 1. -- Amended 1964 Ky. Acts ch. 195, sec. 1. -- Amended 1960 Ky. Acts ch. 209, sec. 1. -- Recodified 1942 Ky. Acts ch. 208, sec. 1, effective October 1, 1942, from Ky. Stat. sec. 3592-1.

**Legislative Research Commission Note (7/14/2000).** This section was amended by 2000 Ky. Acts chs. 101, 118, and 511, which do not appear to be in conflict and have been codified together.

**278.200 Power to regulate rates and service standards fixed by agreement with city.**

The commission may, under the provisions of this chapter, originate, establish, change, promulgate and enforce any rate or service standard of any utility that has been or may be fixed by any contract, franchise or agreement between the utility and any city, and all rights, privileges and obligations arising out of any such contract, franchise or agreement, regulating any such rate or service standard, shall be subject to the jurisdiction and supervision of the commission, but no such rate or service standard shall be changed, nor any contract, franchise or agreement affecting it abrogated or changed, until a hearing has been had before the commission in the manner prescribed in this chapter.

**Effective:** July 15, 1982

**History:** Amended 1982 Ky. Acts ch. 82, sec. 25, effective July 15, 1982. -- Amended 1978 Ky. Acts ch. 379, sec. 27, effective April 1, 1979. -- Recodified 1942 Ky. Acts ch. 208, sec. 1, effective October 1, 1942, from Ky. Stat. sec. 3952-27.

\*68 203 S.W.2d 68

305 Ky. 249

**CITY OF OLIVE HILL**  
v.  
**PUBLIC SERVICE COMMISSION et al.**

Court of Appeals of Kentucky.  
June 20, 1947.

Appeal from Circuit Court, Franklin County; William B. Ardery, Judge.

Proceedings by the Public Service Commission of Kentucky against the City of Olive Hill, the Fleming-Mason Rural Electric Co-operative Corporation and the Kentucky West Virginia Power Company to show cause why the city should not cease selling and distributing electric current to patrons residing outside city and why the co-operative corporation and power company should not extend their electric lines to serve such patrons. From a judgment sustaining the commission's order directing the city to discontinue distribution of electric current outside its corporate limits and granting the co-operative corporation and power company certificates of convenience and necessity to construct lines to serve such patrons, the city appeals.

Reversed.

1. PUBLIC UTILITIES ☞120

317A ----

317AII Regulation

317Ak119 Regulation of Charges

317Ak120 Nature and extent in general.

Formerly 317Ak6

[See headnote text below]

1. PUBLIC UTILITIES ☞147

317A ----

317AIII Public Service Commissions or Boards

317AIII(A) In General

317Ak145 Powers and Functions

317Ak147 Statutory basis and limitation.

Formerly 317Ak7

Ky. 1947

The public service commission's powers are purely statutory and limited to regulation of utilities' rates and services. KRS 278.040(2).

2. MUNICIPAL CORPORATIONS ☞277

268 ----

268IX Public Improvements

268IX(A) Power to Make Improvements or Grant Aid Therefor

268k277 Improvements and works beyond boundaries of municipality.

Ky. 1947

The public service commission was without jurisdiction to determine that city had no legal right or authority to supply electric current purchased by it to patrons residing beyond city limits and to order city to cease doing so. KRS 278.040(2).

3. MUNICIPAL CORPORATIONS ☞277

268 ----

268IX Public Improvements

268IX(A) Power to Make Improvements or Grant Aid Therefor

268k277 Improvements and works beyond boundaries of municipality.

Ky. 1947

On appeal from judgment sustaining public service commission's order directing city to cease supplying electric current to patrons residing beyond city limits, only question presented is whether commission acted within its powers. KRS 278.040(2).

4. ELECTRICITY ☞11.3(1)

145 ----

145k11.3 Regulation of Charges

145k11.3(1) In general.

Formerly 145k11

Ky. 1947

A city's statutory exemption from regulation by public service commission as to rates charged for and service rendered by it in furnishing electricity to its citizens ceased when it supplied electric current to patrons outside its corporate limits. KRS 96.190, 278.010(3).

5. ELECTRICITY ☞8.1(4)

145 ----

145k8.1 Franchises and Privileges in General

145k8.1(4) Proceedings and review; injunction.

Formerly 145k4

Ky. 1947

In proceeding for order to show cause why city should not cease sale and distribution of electric current to patrons without city limits, who filed petitions with public service commission, complaining of rates charged and services rendered by city and asking permission to contract with others for electric service, commission should have required city to make its rates reasonable and service adequate, instead of granting electric co-operative corporation and private power company certificates of convenience and necessity to supply such patrons, in absence of holding by court of competent jurisdiction that city was acting ultra vires in rendering such service. KRS

96.190, 278.010(3).

6. PUBLIC UTILITIES ☞111

317A ----

317AII Regulation

317Ak111 In general.

Formerly 317Ak6

[See headnote text below]

6. PUBLIC UTILITIES ☞120

317A ----

317AII Regulation

317Ak119 Regulation of Charges

317Ak120 Nature and extent in general.

Formerly 317Ak7

Ky. 1947

The purposes of public service commission are to require fair and uniform utilities rates and prevent unjust discrimination, unnecessary duplication of plans, facilities and service, and ruinous competition.

7. ELECTRICITY ☞8.1(1)

145 ----

145k8.1 Franchises and Privileges in General

145k8.1(1) In general; convenience and necessity in general.

Formerly 145k4

Ky. 1947

Courts generally deny utilities right to duplicate service.

8. ADMINISTRATIVE LAW AND PROCEDURE☞

760

15A ----

15AV Judicial Review of Administrative Decisions

15AV(D) Scope of Review in General

15Ak754 Discretion of Administrative Agency

15Ak760 Wisdom, judgment or opinion.

Formerly 317Ak32

[See headnote text below]

8. PUBLIC UTILITIES ☞194

317A ----

317AIII Public Service Commissions or Boards

317AIII(C) Judicial Review or Intervention

317Ak188 Appeal from Orders of Commission

317Ak194 Review and determination in general.

Ky. 1947

While courts will not substitute their judgment for that of public service commission as to necessity for extensions or additional service by public utilities, they consider advantages to public, cost and effect on utilities'

income, and due process clause of constitution, and where commission's right to regulate is so used as to pass beyond reasonable judgment and infringe on rights of ownership, commission's order will be set aside.

**\*69** [305 Ky. 250] H. R. Wilhoit, of Grayson, and R. T. Kennard, of Olive Hill, for appellant.

Ora F. Duvall, of Olive Hill, Dennis B. Wooton, Asst. Atty. Gen., and Pritchard & Ardery, C. L. Hobson and Smith & Leary, all of Frankfort, for appellees.

SIMS, Justice.

This appeal presents two questions: (1) Whether or not the Public Service Commission (hereinafter referred to as the Commission) had jurisdiction to order the City of Olive Hill (hereinafter referred to as the City) to cease selling and distributing electric current to patrons outside but contiguous to the city limits, and (2) whether or not the Commission should have issued certificates of convenience and necessity to the Fleming-Mason Electric Co-operative Corporation (hereinafter referred to as REC) and the Kentucky West Virginia Power Company (hereinafter referred to as the Company) to serve these customers outside the city. The Franklin Circuit Court answered both questions in the affirmative and the City appeals.

The record shows that Olive Hill, a fourth-class city, originally owned and operated an electric plant from which it sold surplus current to patrons residing just outside of the city limits through lines which these patrons constructed. About the year 1926, the City discontinued its generating plant and purchased electricity from the Company, with which it supplies its citizens as well as its patrons who reside without the city. At the time this controversy arose the City was furnishing electricity to some 805 customers, of whom 446 resided within and 359 outside the city; thus, about 45% of the customers resided beyond the corporate limits. It further appears that the sale of electricity was quite a profitable enterprise and one from which the City derived much of the revenue with which it met its municipal obligations.

**\*70** In 1946, some 80 patrons residing without the city filed petitions with the Commission complaining of the rates charged and service rendered by the City. They asked the Commission to conduct a hearing and to allow them to contract with some other source of supply which would render adequate service at a lower rate. Whereupon, [305 Ky. 251] the Commission on July 17, 1946, issued a 'show cause order' directed to the City to answer on or before Aug. 22, 1946, and at a hearing on that date to show its legal authority to sell and distribute current without the city. The order further directed REC and the Company to show cause why they should not be

required to extend their lines to serve these patrons who resided beyond the city limits.

In answer to this 'show cause order' the City pleaded that the Commission had no jurisdiction over it; that it had legal authority to furnish current to patrons residing beyond its boundary and was doing so in a satisfactory manner, and there was no necessity to require any other firm or corporation to furnish service, and to do so would result in great harm to the City. The petitioners replied to the City's answer and pleaded it was furnishing inadequate service at excessive rates and asked that the 'show cause order' be amended so as to require the City to show cause why its rates should not be reduced. The REC and the Company both answered the 'show cause order' and pleaded they were ready and able to furnish service to these patrons and asked authority from the Commission so to do. The City's response to the answer of REC contained practically the same averments as its original answer, but we do not see where it replied to the Company's pleading.

After this hearing, the Commission entered an order on Dec. 13, 1946, holding that the City was without authority to purchase electricity at wholesale and distribute same outside its corporate limits, and ordered the City to discontinue so doing as soon as the REC and the Company constructed lines to serve these patrons, which the latter were granted certificates of convenience and necessity to do. The patrons who resided beyond its corporate limits were divided by the order between REC and the Company upon certain terms and conditions set out in the order, which are not necessary to here state. The Franklin Circuit Court sustained the order of the Commission and it is from it that this appeal is taken.

The City insists that the powers of the Commission are purely statutory and are limited to the regulation of the rates and service of utilities; that under KRS 278.010(3) utilities operated by cities are exempt from [305 Ky. 252] regulation by the Commission, and that the latter is without jurisdiction to determine whether the City was acting ultra vires in selling electricity to suburban patrons; that the Commission was without authority to conduct a hearing on granting certificates of convenience and necessity to REC and the Company without notice to the City.

The Commission, as well as the attorney representing the complainants who filed the petitions against the City, frankly admit that under KRS 278.010(3) the City is exempt from regulation by the Commission while furnishing electricity to patrons within its boundary. But relying upon KRS 96.190 and City of Henderson v. Young, 119 Ky. 224, 83 S.W. 583, 26 Ky.Law Rep. 1152; Dyer v. City of Newport, 123 Ky. 203, 94 S.W. 25, 29 Ky.Law Rep. 656; City of Mayfield v. Phipps, 203 Ky.

532, 263 S.W. 37; Jefferson County Fiscal Court v. Jefferson County, 278 Ky. 785, 129 S.W.2d 554, 122 A.L.R. 1151; Smith v. City of Raceland, 258 Ky. 671, 80 S.W.2d 827; Fleming-Mason Rural Elec. Co-op. Corp. v. City of Vanceburg, 292 Ky. 130, 166 S.W.2d 269; Board of Councilmen v. White, 224 Ky. 570, 6 S.W.2d 699, they urge that the City is without legal authority to operate and maintain a distribution system by which electricity is furnished to patrons outside the corporate limits, therefore the Commission has authority to order the City to cease rendering such service.

[1] [2] [3] We agree with the City that the Commission's powers are purely statutory and are limited to the regulation of rates and service of utilities. KRS 278.040(2); Public Service Commission v. Blue Grass Natural Gas Co., 303 Ky. 310, 197 S.W.2d 765, and authorities therein cited. It follows that the Commission was without \*71. jurisdiction to determine that the City has no legal right or authority to supply patrons beyond the corporate limits and to order it to cease so doing. This is a question for a court of original jurisdiction and not the Commission; therefore, the Franklin Circuit Court erred in holding that the Commission possessed this authority. On this appeal the only question presented is whether or not the Commission acted within its powers. Federal Trade Commission v. Eastman Kodak, 274 U.S. 619, 47 S.Ct. 688, 71 L.Ed. 1238, and the authorities therein cited.

[4] [5] [305 Ky. 253] We cannot agree with the City that it had no notice that the Commission would conduct a hearing on whether or not certificates of convenience and necessity would be granted to REC and the Company. The pleadings, to which reference has been made in the fore part of this opinion, show that the City had such notice--indeed, whether or not certificates of convenience and necessity would be issued to appellees was one of the two principal issues before the Commission at the hearing, as is shown by the pleadings. When the City supplied current outside its corporate limits, its exemption from regulation as to rates and service by the Commission ceased, and the City came within the jurisdiction of the Commission and was subject to such regulation by it. Milligan v. Miles City, 51 Mont. 374, 153 P. 276, A.L.R.A.1916C, 395; Star Investment Co. v. City & County of Denver, P.U.R.1920B, p. 684; Re City of Laurel, P.U.R.1921D, p. 817. This being true, the Commission should have required the City to make its rates reasonable and its service adequate rather than to have granted certificates to appellees to enter the field in which the City was already operating.

Whether or not the City was acting ultra vires in supplying current beyond its boundaries is a question not now before us and one upon which we express no opinion. While the Commission is without jurisdiction to determine whether the City is exceeding its authority in

furnishing electricity to these nonresidents, it does have jurisdiction to regulate rates and service on the current the City supplies nonresidents, and this it should do so long as the City continues such service. Should a court of competent jurisdiction hold that the City was acting *ultra vires* in rendering this service, then it will be proper for the Commission to grant certificates of convenience and necessity to another, or to others.

[6] [7] [8] The manifest purpose of a public service commission is to require fair and uniform rates, prevent unjust discrimination and unnecessary duplication of plants, facilities and service and to prevent ruinous competition. The courts generally deny the right of utilities to duplicate service. *People of State of New York ex rel. Woodhaven Gas Light Co. v. Public Service Commissioner of New York*, 269 U.S. 244, 46 S.Ct. 83, 70 L.Ed. 255. [305 Ky. 254] While courts will not substitute their judgment for that of a public service commission as to the necessity for extensions or additional service, they do consider the advantages to the public, the cost and the effect on the company's income and the due process clause, and if it appears that the right

to regulate was so used as to pass beyond a reasonable judgment and infringe upon the rights of ownership, the order of the commission will be set aside. *People of State of New York ex rel. New York & Q. Gas Co. v. McCall*, 245 U.S. 345, 38 S.Ct. 122, 62 L.Ed. 337; *United States Fuel & Gas Co. v. Public Service Commission*, 103 W.Va. 306, 138 S.W. 388, 52 A.L.R. 1104.

As the Commission was without jurisdiction to order the City to cease this service, which was a question that could only be decided by a court of competent original jurisdiction, and as the Commission (so long as the City is not prevented by a court from operating beyond its boundaries) should have regulated the rates and compelled the City to give adequate service to patrons residing without its limits rather than to have issued certificates of convenience and necessity to appellees, the judgment of the Franklin Circuit Court upholding the order of the Commission is hereby reversed, and the case is sent back to the Commission for action in conformity with this opinion.

The judgment is reversed.

\*537 318 S.W.2d 537

28 P.U.R.3d 150

**LOUISVILLE WATER COMPANY, a Corporation,**  
**Appellant,**  
**v.**  
**PUBLIC SERVICE COMMISSION of Kentucky et**  
**al., Appellees (two cases).**

Court of Appeals of Kentucky.  
 Feb. 21, 1958.  
 Rehearing Denied Dec. 12, 1958.

Action by water company challenging orders of the Public Service Commission and actions by complainants also challenging the order which actions were consolidated. From the judgment entered in the Franklin Circuit Court, William B. Ardery, J., the water company appealed. The Court of Appeals, Cullen, C., held that a municipally owned water company was unauthorized to make charges to customers outside the city limits within a five mile radius for meters, service connections, laterals and main extensions but was authorized to make such charges as to territory beyond the five mile limit.

Affirmed in part and reversed in part.

1. WATERS AND WATER COURSES ☞202  
 405 ----  
 405IX Public Water Supply  
 405IX(A) Domestic and Municipal Purposes  
 405k202 Regulations of supply and use.

[See headnote text below]

1. WATERS AND WATER COURSES ☞203(6)  
 405 ----  
 405IX Public Water Supply  
 405IX(A) Domestic and Municipal Purposes  
 405k203 Water Rents and Other Charges  
 405k203(6) Establishment and regulation by public authority in general.

Ky. 1958

The Louisville Water Company is in the category of a municipally owned utility and exempted from general regulatory powers of the Public Service Commission but such does not extend to furnishing of service outside the city limits and the commission has power to regulate rates and service to outside customers. KRS 278.010(3).

2. PUBLIC UTILITIES ☞113  
 317A ----  
 317AII Regulation  
 317Ak113 Certificates, permits, and franchises.

Formerly 317Ak6.3

Ky. 1958

The statutes do not disclose an intent to exempt municipally owned utilities from regulation in rendering service outside the city. KRS 278.010(3).

3. WATERS AND WATER COURSES ☞203(6)  
 405 ----  
 405IX Public Water Supply  
 405IX(A) Domestic and Municipal Purposes  
 405k203 Water Rents and Other Charges  
 405k203(6) Establishment and regulation by public authority in general.

Ky. 1958

A charge imposed by a municipally owned water utility for the installation of a service facility to customers outside the city limits involves a matter of "service" within the jurisdiction of the Public Service Commission to regulate. KRS 278.010(5, 6).

See publication Words and Phrases for other judicial constructions and definitions.

4. PUBLIC UTILITIES ☞115  
 317A ----  
 317AII Regulation  
 317Ak115 Contracts.

Formerly 317Ak6.8

Ky. 1958

Where the rates and service of a public utility are subject to regulation by the Public Service Commission, the utility cannot by contract abrogate the regulatory powers.

5. WATERS AND WATER COURSES ☞203(7)  
 405 ----  
 405IX Public Water Supply  
 405IX(A) Domestic and Municipal Purposes  
 405k203 Water Rents and Other Charges  
 405k203(7) Contract depriving municipality of right to establish rates.

Ky. 1958

Fact that service installation charges outside city limits were made in accordance with a written contract with the individual customer by municipally owned utility did not abrogate the regulatory power of the Public Service Commission over such installation charges on the theory that since the company had no duty to serve such customers any relations between them must be considered as strictly contractual. KRS 278.010(5, 6).

6. WATERS AND WATER COURSES ☞201  
 405 ----  
 405IX Public Water Supply  
 405IX(A) Domestic and Municipal Purposes  
 405k201 Supply to private consumers.

Ky. 1958

Under the statute authorizing a city water company to extend its facilities into territory within five miles of the city limits, such a company is authorized to incur the expense of furnishing or installing the facilities in such territory. KRS 96.150.

7. WATERS AND WATER COURSES ⚓203(1)  
 405 ----  
 405IX Public Water Supply  
 405IX(A) Domestic and Municipal Purposes  
 405k203 Water Rents and Other Charges  
 405k203(1) Right to make charge and liability therefor in general.

[See headnote text below]

7. WATERS AND WATER COURSES ⚓203(8)  
 405 ----  
 405IX Public Water Supply  
 405IX(A) Domestic and Municipal Purposes  
 405k203 Water Rents and Other Charges  
 405k203(8) Water meters and charges for reading or inspection thereof.

Ky. 1958

A municipally owned water company was unauthorized to make charges to customers outside the city limits within a five mile radius for meters, service connections, laterals and main extensions but was authorized to make such charges as to territory beyond the five mile limit. KRS 96.150.

**\*538** Morris & Garlove, Charles W. Morris, Louisville, Funk, Chancellor & Marshall, Thomas F. Marshall, Frankfort, for appellant.

Jo M. Ferguson, Atty. Gen., J. Gardner Ashcraft, Asst. Atty. Gen., for Public Service Commission.

W. Scott Miller, W. Scott Miller, Jr., Louisville, for Home Builders of Louisville, Inc. and others.

CULLEN, Commissioner.

The Louisville Water Company has appealed from a judgment of the Franklin Circuit Court which held invalid, in part, an order of the Public Service Commission of Kentucky concerning the right of the water company to make charges to customers outside the city limits of Louisville, for meters, service connections, laterals, and main extensions.

In proceedings brought before the Public Service Commission by certain home builders and contractors, it was contended that the water company was wrongfully requiring new customers outside the City of Louisville to pay the cost of the water meter and a charge for making a connection or tap to the water main. In hearing the

matter, the commission also considered the validity of charges made by the water company for a service pipe from the water main to the customer's curb line, and for extensions of the water main. Outstanding regulations of the commission, which had been in effect for more than 20 years prohibited a water company from making a charge: (1) For furnishing or installing a water meter or meter accessories, 'except by mutual agreement in special cases;' (2) for making a connection or tap to its mains; (3) for furnishing and installing a service pipe from its main to the customer's curb line; and (4) for an extension of its main a distance of 50 feet or less for a customer who would contract to use water for at least one year.

Being of the opinion that under certain decisions of this Court a municipally owned water company cannot lawfully provide the **\*539** facilities for conveying water beyond the corporate limits of the city, the Public Service Commission held that its regulations, except as to water meters, were invalid as applied to customers outside the city limits. The effect of this holding was that the water company charges were valid, except the charge for water meters, which the commission considered not to be 'facilities for conveying water.'

The water company brought action in the Franklin Circuit Court, challenging the order of the commission. Some of the original complainants also brought an action challenging the order. The two actions were consolidated, and one judgment was entered, from which this appeal is taken. The judgment was that the regulations all were valid, and that the order of the commission be set aside to the extent that it held some of the regulations invalid. The effect of the judgment was to preclude the water company from imposing any of the charges in question.

The water company has maintained throughout the proceedings that the Public Service Commission has no jurisdiction of the matter, because, first, municipally owned utilities are exempt by statute from regulation by the commission, and second, in any event the commission has authority only to regulate rates and service, and the matter in issue here is not one of rates or service, but of 'facilities.'

[1] The Louisville Water Company is in the category of a municipally owned utility. See *Rash v. Louisville & Jefferson County Metropolitan Sewer District*, 309 Ky. 442, 217 S.W.2d 232. By virtue of KRS 278.010(3), municipally owned utilities are exempted from the general regulatory powers of the Public Service Commission. However, this Court has held that the exemption does not extend to the furnishing of service outside the limits of the city, and the commission has power to regulate rates and service to outside customers. *City of Olive Hill v. Public Service Commission*, 305 Ky. 249, 203 S.W.2d 68; *Louisville Water Co. v. Preston Street Road Water*



District, Ky., 256 S.W.2d 26; Fraley v. Beaver-Elkhorn Water District, Ky., 257 S.W.2d 536; City of Covington v. Sohio Petroleum Company, Ky., 279 S.W.2d 746; City of Richmond v. Public Service Commission, Ky., 294 S.W.2d 513.

The appellant contends that in the cases above cited the Court overlooked KRS 96.150, which has been in force since 1936, and which specifically authorizes a municipally owned water company to extend its system into, and serve, any territory within a five-mile radius of the city limits. The argument is, that when the legislature amended the Public Service Commission Act, in 1936, so as to exempt municipally owned utilities, the legislature must have had in mind the provision of KRS 96.150, enacted earlier at the same session, and therefore must have intended to exempt a municipally owned water company in all areas in which it is authorized by law to render service. The appellant points out that prior to 1936 it was held that a municipally owned utility could not extend its own service lines or facilities outside the city limits. See *Smith v. City of Raceland*, 258 Ky. 671, 80 S.W.2d 827.

The difficulty with this argument is that in the *Olive Hill* case, and in the other cases which have followed it, the question of whether the city had power to furnish service facilities outside the city limits was not considered to be a determining factor. In fact, in the *Olive Hill* case, the question of whether the city had power to render service outside its limits was expressly held not to be before the court.

[2] Residents of a city have some means of protection against excessive rates or inadequate service of a utility owned by the city, through their voting power. However, customers outside the city have no such means of protection, and unless their interests are protected by the Public Service Commission they are at the mercy of the utility. This consideration, we think, was the basis for the decisions that the legislature \*540 did not intend to exempt municipally owned utilities from regulation in rendering service outside the city.

It is our opinion that KRS 96.150 has no bearing on the question decided in the *Olive Hill* case, and in the cases which have followed it, and that those cases are controlling here so as to uphold the jurisdiction of the Public Service Commission.

[3] The water company maintains that in any event the Public Service Commission has power of regulation only as to 'rates' and 'service,' and that the question here is one of 'facilities,' over which the commission has no jurisdiction. To say that a charge imposed for installation of a service facility is not a matter of rates and service is to us wholly unacceptable. KRS 278.010(5) defines 'rate'

to include, among other things, any 'charge \* \* \* or other compensation for service rendered or to be rendered,' and KRS 278.010(6) defines 'service' to include any 'requirement in any way relating to the service of any utility \* \* \*.' The circuit court held that regulation of 'service' was involved, and we think not only that this was correct, but that regulation of 'rates' also was involved.

[4] The water company points out that in each instance the service installation charges have been made in accordance with a written contract with the individual customer. It is argued that since the water company had no duty or obligation to serve customers outside the city, any relation between the company and the complainants in this case must be considered as strictly contractual, and the complainants have no rights that may be asserted except those that rest upon contract. This is indeed a specious argument. If, as is the case here, the rates and service of a public utility are subject to regulation by a body such as the Public Service Commission, it is beyond question that the utility cannot by contract abrogate the regulatory power. Obviously, if the Public Service Commission has fixed one rate, the utility cannot contract for another one. So, if the Public Service Commission has by regulation forbidden that a certain charge be imposed, the utility cannot by contract impose the charge. The company here makes some contention that the meter installation contracts are valid because of a clause in the regulations that permits an installation charge 'by mutual agreement in special cases.' However, the contracts here have been made with every customer, and obviously the regulation does not mean that all cases are special cases.

[5] The water company makes a further contention based on certain language in *Board of Commissioners of Louisville Extension Water District v. Yunker*, Ky., 239 S.W.2d 984. Prior to 1936, this Court had held in a number of cases that, in the absence of express statutory authority, a municipally owned water company could not sell water to customers outside the city limits unless the facilities for conveying the water beyond the limits were constructed by the customers without expense to the company. See *Dyer v. City of Newport*, 123 Ky. 203, 94 S.W. 25; *Smith v. City of Raceland*, 258 Ky. 671, 80 S.W.2d 827. In 1936 the legislature enacted what is now KRS 96.150 (referred to at a previous point in this opinion) which expressly authorizes a municipally owned water company to extend its service facilities into any territory within a five-mile radius of the city limits. In the *Yunker* case, decided in 1951, the holding in the former cases was referred to as a 'well settled' rule. KRS 96.150 was not mentioned in the *Yunker* opinion and apparently was not brought to the attention of the court.

The water company argues that, in view of the holding in the *Yunker* case, the company cannot install facilities outside the city limits except at the expense of the

customer, and therefore the regulations of the Public Service Commission prohibiting the company from charging the expense to the customer are invalid. This argument was accepted by the Public Service \*541. Commission and was the basis for the commission's holding invalid all of its regulations except the one relating to meters, which the commission ruled were not 'facilities for conveying water.' The circuit court, in setting aside the order of the commission and holding the regulations all to be valid, was of the opinion that the Yunker case was not intended to, and did not, nullify KRS 96.150.

[6] We see no reason for not facing up to the simple fact that KRS 96.150 was not considered in the Yunker case. Since that statute expressly authorizes a city water company to extend its facilities into territory within five miles of the city limits, there is no basis for a holding that the company cannot incur the expense of furnishing or installing the facilities in such territory. Accordingly, to the extent that the Yunker case may be considered authority for the proposition that a water company cannot incur such expense, it is overruled.

The water company urges that the Public Service Commission has full authority to adopt reasonable

regulations, and when the commission by its order in this case amended its regulations so as to eliminate the prohibition against making charges for connections, service lines and main extensions, the commission acted within its authority, so that the circuit court had no basis on which to hold the amendment of the regulations to be unlawful or unreasonable. However, the order of the commission makes it clear that the commission was amending its regulations only because it felt compelled to do so by the opinion in the Yunker case, and that the commission was not voluntarily changing its regulatory policy.

[7] It is our ultimate conclusion that the judgment of the circuit court is correct, as concerns territory within a five-mile radius of the city limits of Louisville. However, it was stipulated that some of the territory involved was beyond the five-mile limit. As to this latter territory, we think that the rule referred to in the Yunker case is applicable, and the order of the Public Service Commission was proper.

The judgment is affirmed, except to the extent that it relates to territory beyond five miles from the city limits of Louisville; to that extent it is reversed, with directions to enter judgment upholding the order of the Public Service Commission.

\*197 351 S.W.2d 197

42 P.U.R.3d 98


**Carl McCLELLAN et al., Appellants,**  
**v.**  
**LOUISVILLE WATER COMPANY et al., Appellees.**

Court of Appeals of Kentucky.  
 March 24, 1961.  
 Rehearing Denied Dec. 15, 1961.

Action to have water rate increases imposed by a city water company upon users outside the territorial limits of the city declared void. The Circuit Court, Chancery Branch, Second Division, Jefferson County, Stuart E. Lampe, J., rendered judgment for the defendants and the plaintiffs appealed. The Court of Appeals, Waddill, C., held that the statutory exemption from public service commission regulation for facilities owned, controlled, operated or managed by a city extends to all municipally owned water utility operations whether within or without the territorial bounds of the city.

Affirmed.

Montgomery, J., and Bird, C. J., dissented.

WATERS AND WATER COURSES  202  
 405 ----

405IX Public Water Supply

405IX(A) Domestic and Municipal Purposes

405k202 Regulations of supply and use.

Ky. 1961

Statutory exemption from public service commission regulation for facilities owned, controlled, operated or managed by a city extends to all municipally owned water utility operations whether within or without territorial limits of city; overruling cases. KRS 278.010 et seq., 278.010(3).

\*198 Clay Shackelford, A. R. Burnam, III, James E. Thompson, Shackelford & Burnam, Richmond, Leon J. Shaikun, Louisville, R. P. Moloney, Donald Moloney, Moloney & Moloney, F. Selby Hurst, Lexington, for appellants.

Charles W. Morris, Frank A. Garlove, Matt L. Garlove, Irwin G. Waterman, Morris & Garlove, Louisville, for Louisville Water Co.

Alan Neil Schneider, Herman E. Frick, Louisville, for City of Louisville.

Arthur W. Grafton, Edward A. Zingman, Wyatt, Grafton & Grafton, Harris W. Coleman, Louisville, for Comrs. of Sinking Fund of City of Louisville.

WADDILL, Commissioner.

Appellants reside outside the Louisville city limits and are consumers of water sold by appellee, Louisville Water Company. In 1939 and in 1946 appellee substantially increased its water rates for nonresident consumers without seeking or obtaining approval of the Kentucky Public Service Commission. In July, 1955, appellee decreased the discount it allowed its customers for the prompt payment of their water bills.

On August 12, 1957, appellants filed this action against appellee in Jefferson Circuit Court seeking: (1) To have the unapproved rate increases declared illegal and void; (2) injunctive relief prohibiting the further collection of such increases; and, (3) refunds of the sums unlawfully collected. The trial judge refused to grant the relief sought and entered judgment accordingly.

Chapter 278, KRS, empowers the Public Service Commission to regulate utilities. However, in defining 'utility,' KRS 278.010(3) reads:

"Utility" means any person, *except* a water district organized under Chapter 74 or *a city*, who owns, controls, operates or manages any facility \* \* \*.

This subsection has been construed as not exempting a city-owned utility from regulation of its extraterritorial operations by the Public Service Commission. City of Olive Hill v. Public Service Commission, 305 Ky. 249, 203 S.W.2d 68; Louisville Water Company v. Preston Street Road Water District, Ky., 256 S.W.2d 26; Fraley v. Beaver Elkhorn Water District, Ky., 257 S.W.2d 536; City of Covington v. Sohio Petroleum, Ky., 279 S.W.2d 746; City of Richmond v. Public Service Commission, Ky., 294 S.W.2d 513; Louisville Water Company v. Public Service Commission, Ky., 318 S.W.2d 537. Appellee is in the category of a municipally owned utility. Louisville Water Company v. Public Service Commission, Ky., 318 S.W.2d 537; Rash v. Louisville & Jefferson County Metropolitan Sewer District, 309 Ky. 442, 217 S.W.2d 232.

The public interest affected by the farreaching consequences of our former construction of KRS 278.010(3), in City of Olive Hill v. Public Service Commission, *supra*, and in cases which followed it, has \*199. caused us to reconsider once again the soundness of that construction. As a result of our re-examination of Chapter 278, KRS, specifically the exemption from the regulatory control of the Public Service Commission granted to cities by the plain language of subsection (3) of KRS 278.010, we have reached the conclusion that our construction of this subsection is erroneous, and we hold that the exemption provided therein extends to all

operations of a municipally owned utility whether within or without the territorial boundaries of the city. Therefore, insofar as the above cited cases are in conflict with this opinion they will no longer be followed. While we recognize that this decision deprives nonresident utility customers of the protection afforded by the Public Service Commission against excessive rates or inadequate service, nevertheless matters of this character are of legislative rather than judicial concern.

This ruling effectively decides that the alleged increases in rates are not illegal and void on the grounds set forth in the complaint. While we are not adopting the reasoning of the trial judge, the ultimate conclusion he reached (which denied appellants relief) is correct.

The judgment is affirmed.

MONTGOMERY, Judge (dissenting).

This Court has considered and reconsidered the principle first set forth in the Olive Hill case as shown by the cases cited in the majority opinion. The General Assembly has met in several regular and extra sessions since the original decision in 1947 without taking any legislative action to change the rule of law thus established. A bill to change the rule was unsuccessful in passage at one session. It has thus become firmly established in the body of our law.

The doctrine of the Olive Hill case is sound, in that it affords the only protection to the extraterritorial customers of a city-owned utility against unfair rates and faulty service. Therefore, I feel that it is unwise in the absence of legislative action to abrogate this rule; hence, this dissent.

BIRD, C. J., joins with me.

\*842 516 S.W.2d 842

7 P.U.R.4th 299

**CITY OF GEORGETOWN, Kentucky, Appellant,**  
**v.**  
**PUBLIC SERVICE COMMISSION of the**  
**Commonwealth of Kentucky**  
**and Kentucky American Water Company, Appellees.**

Court of Appeals of Kentucky.  
 Dec. 13, 1974.

Private water company filed complaint with Public Service Commission seeking cease and desist order to preclude city from extending water supply beyond city limits into service area of the private water company. City's motion to dismiss was overruled and the Franklin Circuit Court, Henry Meigs, II, J., denied motion for temporary injunction sought by the city and city appealed. The Court of Appeals, Stephenson, J., held that city, which was specifically exempt from definition of utility in statute giving Public Service Commission power to regulate utilities, was not a 'person' within meaning of statute requiring any person to obtain a certificate from the Public Service Commission before building a utilities plant, so that Public Service Commission was without jurisdiction to hear the dispute.

Temporary injunction granted.

**PUBLIC UTILITIES** ⚡ 113

317A ----

317AII Regulation

317Ak113 Certificates, permits, and franchises.

Formerly 317Ak6.3

[See headnote text below]

**WATERS AND WATER COURSES** ⚡ 202

405 ----

405IX Public Water Supply

405IX(A) Domestic and Municipal Purposes

405k202 Regulations of supply and use.  
 Ky. 1974.

City, which was expressly exempted from definition of utility which is subject to the jurisdiction of the Public Service Commission, was not a "person" within meaning of statute requiring any person to obtain certificate from Public Service Commission before constructing any utilities plant, so that Public Service Commission did not have jurisdiction over dispute between city, which sought to expand its water service beyond city limits into a contiguous area and private water company which sought to prohibit city from extending its service into areas being served by the water company; overruling City of Cold

Spring v. Campbell County Water District, 334 S.W.2d 269 and City of Covington v. Board of Commissioners, 371 S.W.2d 20. KRS 96.150, 278.010(3), 278.020(1).

\*843 Joseph J. Leary, Frankfort, for appellant .

Morris Burton, Robert T. Harrod, Frankfort, C. Gibson Downing, Lexington, for appellees.

STEPHENSON, Justice.

This appeal poses the question of whether the Public Service Commission has jurisdiction to resolve a territorial dispute between a city-owned water supply system and a privately owned water supply system where the area in dispute lies outside the corporate boundaries of the city and no question exists as to the legal right of either system to serve the disputed area.

The city of Georgetown undertook to extend its water supply system into territory contiguous to the city and within fifteen miles of the city pursuant to KRS 96.150.

Kentucky American Water Company filed a complaint with the Public Service Commission in which it sought a cease and desist order which would have precluded the city from the extension of its water supply system into the service area of the Kentucky American Water Company.

The city of Georgetown moved to dismiss the complaint on the ground that the Public Service Commission had no jurisdiction to regulate the authority granted the city by the General Assembly pursuant to KRS 96.150, which provides:

'Any city that owns or operates a water supply system may extend the system into, and furnish and sell water to any person within, any territory contiguous to the city (that lies within fifteen miles of the corporate limits,) and may install within that territory necessary apparatus. For this purpose the city may condemn or otherwise acquire franchises, rights and rights of way, as private corporations may do. (FN1)

The Public Service Commission overruled the motion to dismiss, and the city filed suit in the Franklin Circuit Court for a declaration of rights and injunctive relief. The Franklin Circuit Court denied the motion for a temporary injunction and the city seeks an injunction here under CR 65.07.

The city argues that KRS 96.150 read together with KRS 278.010(3), which provides, "Utility' means any person except a city, who owns, controls, or operates or manages any facility used or to be used for or in connection with \* \* \*, excepts a city-owned water supply system from the jurisdiction of the Public Service

Commission which receives its authority to regulate utilities from Chapter 278, KRS. (FN2)

The city relies on our opinion in *McClellan v. Louisville Water Company, Ky.*, 351 S.W.2d 197 (1961), wherein the Louisville Water Company, without seeking or obtaining approval of the Public Service Commission, had substantially increased its water rates for non-resident consumers. The opinion noted that KRS 278.010(3) had been construed as not exempting a city-owned utility from regulation of its extraterritorial operations by the Public Service Commission citing *City of Olive Hill v. Public Service Commission*, 305 Ky. 249, 203 S.W.2d 68 (1947), and a series of cases involving the exception in the statute. Overruling *Olive Hill*, we said at page 198 of 351 S.W.2d of *McClellan*:

'The public interest affected by the far-reaching consequences of our former construction of KRS 278.010(3), in *City of Olive Hill v. Public Service Commission*, supra, and in cases which followed it, has caused us to reconsider once again the soundness of that construction. As a result of our re-examination of Chapter 278, KRS, specifically the exemption from the regulatory control of the Public Service Commission granted to cities by the plain language of subsection (3) of KRS 278.010, we have reached the conclusion that our construction of this subsection is erroneous, and we hold that the exemption provided therein extends to all operations of a municipally owned utility whether within or without the territorial boundaries of the city. Therefore, insofar as the above cited cases are in conflict with this opinion they will no longer be followed.' (Emphasis added)

As authority for the contention that the Public Service Commission possesses jurisdiction in this dispute, the Public Service Commission and Kentucky American Water Company rely on *City of Cold Spring v. Campbell County Water District, Ky.*, 334 S.W.2d 269 (1960), wherein a dispute arose between the city of Cold Spring and a water district over which one should provide water service to an unincorporated area of Campbell County. The jurisdiction of the Public Service Commission to resolve that dispute was contested as it is here. The opinion recited that the trial court in adjudging that the water district had a preferential right to serve the area was in effect granting a certificate of convenience and necessity to construct facilities and furnish the service and that this invaded the jurisdiction of the Public Service Commission. KRS 278.020(1) was cited, which provides:

'No person shall begin the construction of any plant, equipment, property or facility for furnishing to the public any of the services enumerated in KRS 278.010, except ordinary extensions of existing systems in the usual course of business, until such person has obtained

from the public service commission a certificate that public convenience and necessity require such construction. Upon the filing of an application for such a certificate, and after a public hearing of all parties interested, the commission may issue or refuse to issue the certificate, or issue it in part or refuse it in part.'

The opinion further states:

'While both cities and water districts are by KRS 278.010(2) expressly exempted from the definition of 'utilities', this statute uses the word 'person', and such public corporations are subject to its provisions. *City of Covington, Kentucky v. Public Service Commission of Kentucky, Ky.*, 327 S.W.2d 954.

'Clearly in a case such as the one before us, the Commission is pre-eminently qualified to determine which of these two competing political subdivisions is best qualified to, and should serve the Johns Hill area. That is the business of the Commission, and is not a matter for the original jurisdiction of courts. This fundamental principle was recognized in the *Olive Hill* case (*City of Olive Hill v. Public Service Commission*, 305 Ky. 249, 203 S.W.2d 68), and in the following cases: *City of Vanceburg v. Plummer*, 275 Ky. 713, 122 S.W.2d 772 \* \* \*.'

*City of Cold Spring*, though recognizing that KRS 278.010(3) expressly excepts cities from the definition of 'utilities,' the statutory basis for jurisdiction of the Public Service Commission, bases the jurisdiction of the Public Service Commission on the word 'person' used in KRS 278.020(1). This holding was rested on *City of Olive Hill* and *City of Covington v. Public Service Commission, Ky.*, 327 S.W.2d 954 (1959). *City of Covington* found authority for its holding that the Public Service Commission had jurisdiction to resolve a dispute between two cities as to who should furnish water to a water district in *City of Vanceburg v. Plummer*, 275 Ky. 713, 122 S.W.2d 772 (1938).

It is not possible to follow the logic in the reasoning of the opinion in *City of Cold Spring* which recognizes that cities are excepted from the definition of 'utilities' in the statute, yet holds they are 'persons' within the meaning of the statute and are therefore covered by the statute. We conclude that this strained reasoning was adopted to reach what this court then considered to be a desirable result to prevent 'ruinous competition' as stated in the opinion and because the Public Service Commission is 'pre-eminently qualified to determine the issues.'

While it can be argued that it would be desirable to leave this type dispute within the jurisdiction of the Public Service Commission, we are of the opinion that *City of Cold Spring* is not supported by the plain intent of the

General Assembly which excepted city water systems from the definition of 'utilities,' nor by the reasoning that KRS 278.020(1) by implication cancelled out the exemption. We illustrate this by pointing out that McClellan overruled City of Olive Hill. In subsequent cases City of Mt. Vernon v. Banks, Ky., 380 S.W.2d 268 (1964), cited McClellan in a controversy over the reasonableness of rates fixed by the city and stated: 'In the operation of a water plant a municipal corporation is not under the jurisdiction of the Public Service Commission. KRS 278.010(3)'. In City of Flemingsburg v. Public Service Commission, Ky., 411 S.W.2d 920, 923 (1967), it is stated: 'It is our view that the decision in McClellan v. Louisville Water Company, Ky., 351 S.W.2d 197, overruled the Plummer (City of Vanceburg v. Plummer, supra) case. It would be entirely inconsistent with the McClellan ruling to require a municipal water plant to obtain a certificate from the Commission \* \* \*'.

The opinion stated that a similar situation to City of Cold Spring was not presented in that 'ruinous competition' was not involved; however, we believe that to be a distinction without a real difference. City of Cold Spring has had its foundation completely removed; City of Olive Hill and related cases were overruled by McClellan; City of Flemingsburg expressed the view that McClellan overruled City of Vanceburg v. Plummer, and City of Covington v. Public Service Commission cited in City of Cold Spring relied on City of Vanceburg. We observe that all of the case authority relied on in City of Cold Spring has been overruled and we think that City of Cold Spring should now be specifically overruled and quietly laid to rest. It is our view that the plain intent of the General Assembly as expressed in KRS 278.010(1) should prevail and not be circumscribed by a strained reasoning process bringing into play KRS 278.020(1). While it may be desirable that the Public Service

Commission resolve this type dispute because of its expertise in this area, this is of legislative, not judicial, concern, and we feel compelled to follow the clear language of KRS 278.010(3).

City of Covington v. Board of Commissioners, Ky., 371 S.W.2d 20 (1963), is called to our attention wherein a water district sought a certificate of convenience and necessity to expand its water plant. This was resisted by the City of Covington at a time when both cities and water districts were excepted from the definition of 'utility.' We held the Public Service Commission had jurisdiction to decide the merits of the controversy citing KRS 278.020(1). The exclusion of KRS 278.010(3) was not argued. We conclude that City of Covington v. Board of Commissioners should also be overruled.

The trial court should have granted the city's motion for a temporary injunction on the ground that the Public Service Commission was without jurisdiction.

Under CR 65.07 the city's application to this court for a temporary injunction is granted.

All concur.

FN1. H.B. 117, 1974 General Assembly amended KRS 96.150, deleting that portion of the Act which limited such extension to territory that lies within fifteen miles of the corporate limits, so that the Act as amended imposes no limit on such extensions.

\*845\_ FN2. Prior to 1964, water districts created under KRS Chapter 74 were excepted from the definition of 'utility.' The 1964 General Assembly by amendment deleted that exemption thus subjecting water districts to regulations under KRS, Chapter 278.

\*460 872 S.W.2d 460

Supreme Court of Kentucky.

**SIMPSON COUNTY WATER DISTRICT, Appellant,**  
**v.**  
**CITY OF FRANKLIN, Kentucky, Appellee.**  
**No. 93-SC-47-DG.**

Jan. 31, 1994.

Rehearing Denied April 21, 1994.

City sued water district seeking damages for delinquent payments under contract to supply water and declaratory judgment that three water purchase agreements were void. The Circuit Court, Simpson County, dismissed action on ground that it lacked subject matter jurisdiction. City appealed. The Court of Appeals rendered split decision reversing and remanding case to circuit court. Water district appealed. The Supreme Court, Reynolds, J., held that under Public Service Commission Act, city waived its exemption from Public Service Commission (PSC) regulation by contracting to supply water to PSC-regulated utility, and thus, PSC had exclusive jurisdiction over city's action.

Court of Appeals reversed; Circuit Court affirmed.

Wintersheimer, J., dissented and filed opinion joined by Leibson and Spain, JJ.

West Headnotes

[1] Waters and Water Courses ☞203(7)  
 405 ----

405IX Public Water Supply  
 405IX(A) Domestic and Municipal Purposes  
 405k203 Water Rents and Other Charges  
 405k203(7) Contract Depriving Municipality of Right to Establish Rates.

[See headnote text below]

[1] Waters and Water Courses ☞203(15)  
 405 ----

405IX Public Water Supply  
 405IX(A) Domestic and Municipal Purposes  
 405k203 Water Rents and Other Charges  
 405k203(15) Payment, Collection, and Recovery Back.

Under Public Service Commission Act, city waived its exemption from Public Service Commission (PSC) regulation by contracting to supply water to PSC-regulated utility; thus, PSC had exclusive jurisdiction over city's claim for damages for delinquent payments under three water purchase agreements and declaratory judgment that agreements were void; although city, through its enhanced water sale ordinances, did not direct

setting of any particular rate schedule, its action profoundly and directly impacted district's general revenue level, which was one of the first steps in rate making, so that city's action was improper engagement in rate making and was within PSC jurisdiction. KRS 74.010 et seq., 96.320-96.510, 278.010 et seq., 278.010(3), 278.015, 278.020(1), 278.040(2), 278.200.

[2] Public Utilities ☞121

317A ----

317AII Regulation

317Ak119 Regulation of Charges

317Ak121 Service Within Municipalities; Charges Fixed by Contract or Ordinance.

Rates and service exception to city's exemption from Public Service Commission (PSC) regulatory jurisdiction is not avoidable by contract; thus, where contracts have been executed between utility and city, statute prohibiting change of rate or service standard, or any contract franchise or agreement affecting it, until hearing has been had before PSC is applicable and requires that by so contracting city relinquishes PSC exemption and is rendered subject to PSC rates and service regulation. KRS 278.010(3), 278.040(2), 278.200.

[3] Public Utilities ☞119.1

317A ----

317AII Regulation

317Ak119 Regulation of Charges

317Ak119.1 In General.

There is nothing in Public Service Commission Act intended or to be construed to limit police jurisdiction, contract rights, or powers of municipalities or political subdivisions, except as to regulation of rates and service, exclusive jurisdiction over which is lodged in Public Service Commission. KRS 278.010(3), 278.015.

[4] Public Utilities ☞111

317A ----

317AII Regulation

317Ak111 In General.

Statutory definition of "utility" in Public Service Commission Act is not to serve as impenetrable shield to afford city immunity from Public Service Commission jurisdiction. KRS 278.010(3), 278.040(2), 278.200.

[5] Public Utilities ☞119.1

317A ----

317AII Regulation

317Ak119 Regulation of Charges

317Ak119.1 In General.

Manifest purpose of Public Service Commission is to require and insure fair and uniform rates, prevent unjust discrimination, and prevent ruinous competition.

[6] Waters and Water Courses ☞201

405 ----



## 405IX Public Water Supply

## 405IX(A) Domestic and Municipal Purposes

## 405k201 Supply to Private Consumers.

Once established by contract, city's supplying of water to utility can only be abrogated or changed after hearing before Public Service Commission. KRS 278.020(1), 278.040(2), 278.200.

## [7] Public Utilities ☞ 146

## 317A ----

## 317AIII Public Service Commissions or Boards

## 317AIII(A) In General

## 317Ak145 Powers and Functions

## 317Ak146 Legislative and Judicial Powers and Functions.

Public Service Commission acts as quasi-judicial agency using its authority to conduct hearings, render findings of fact and conclusions of law, and using its expertise in area and to merits of rates and service issues. KRS 278.020(1), 278.040(2), 278.200.

## [8] Waters and Water Courses ☞ 201

## 405 ----

## 405IX Public Water Supply

## 405IX(A) Domestic and Municipal Purposes

## 405k201 Supply to Private Consumers.

[See headnote text below]

## [8] Waters and Water Courses ☞ 203(10)

## 405 ----

## 405IX Public Water Supply

## 405IX(A) Domestic and Municipal Purposes

## 405k203 Water Rents and Other Charges

## 405k203(10) Reasonableness of Charges.

Rates and service exception from Public Service Commission (PSC) jurisdiction effectively insures, throughout Commonwealth, that any water district consumer/customer that has contracted and become dependent for its supply of water from city utility is not subject to either excessive rates or inadequate service. KRS 74.010 et seq., 96.320-96.510, 278.010 et seq., 278.010(3), 278.015, 278.020(1), 278.040(2), 278.200.

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Timothy J. Crocker, Robert D. Wilkey, Crocker & Wilkey, Franklin, for appellee.

Christina A. Heavrin, City Law Director, Joseph B. Helm, Charles S. Cassis, Brown, Todd & Heyburn, Louisville, James Park, Jr., Katherine Randall, Brown, Todd & Heyburn, Lexington, amici curiae.

REYNOLDS, Justice.

The issue for decision is whether the Public Service Commission (PSC) has exclusive jurisdiction over the regulation of utility rates and service which extends to a city contracting for the sale and supply of water to a PSC-regulated county water district.

As background:

The Simpson County Water District (District) is a statutorily created public water district operated and regulated pursuant to KRS Chapter 74 and is expressly subject to the Kentucky Public Service Commission, which is operative under KRS Chapter 278. The City of Franklin (City) has heretofore established and now operates and maintains a municipal waterworks by virtue of the provisions of KRS Chapter 96.320-96.510.

On April 5, 1967, both parties entered into and executed their first Water Purchase Agreement whereby the price for treated water to the District was at a rate of 21 1/2 cents per 1,000 gallons per month.

Thereafter two supplemental agreements (August 26, 1982 and April 3, 1986), were executed which increased the price of water to the District to the rate of 84.78 cents per 1,000 gallons per month. Subsequently, on June 25, 1990, the City adopted an ordinance which increased the water rate to all customers and specifically increased the water rate charged the District from 84.78 cents to \$1.3478 per 1,000 gallons. On May 13, 1991, the City passed a second ordinance which increased only the rate charged the District from \$1.3478 to \$1.68 per 1,000 gallons. The District, however, continued to pay only the 1986 rate.

The City filed this action seeking damages for delinquent payments and a declaratory judgment that the three water purchase agreements were void. The trial court dismissed the action and concluded that it lacked subject matter jurisdiction. A three- **\*462** judge panel of the Court of Appeals rendered a split decision reversing and remanding the case to Simpson Circuit Court. The majority opinion reasoned that the city was not a utility nor did its relationship acting as a supplier to a PSC-regulated utility bring it within the PSC's jurisdiction.

[1] The appellee forthrightly states that cities are specifically exempted from regulation by the Public Service Commission under the definitional term of KRS 278.010(3) which provides as follows:

"Utility" means any person except a city, who owns, controls or operates or manages any facility used or to be used for or in connection with: ... (d) The diverting, developing, pumping, impounding, distributing or furnishing of water to or for the public, for

compensation; ....

The City states that there are no exceptions to the exemption afforded a city under the foregoing statutory provision. However, the legislature provides a rates and service exception specifically set forth in KRS 278.040(2), which states:

The jurisdiction of the commission shall extend to all utilities in this state. The commission shall have exclusive jurisdiction over the regulation of rates and service of utilities, but with that exception nothing in this chapter is intended to limit or restrict the police jurisdiction, contract rights or powers of cities or political subdivisions.

It is acknowledged by the parties that the PSC has only such authority that is granted to it by the legislature and it is clear that the legislature vested the PSC with exclusive control of rates and service of utilities. The legislature has conferred upon cities an exemption from the PSC's power to regulate local utilities in every area except as to rates and service.

Profoundly, reference to a "city" under the statutory scheme includes city-owned utilities. We give no validity to the argument that since the City is exempt from regulation by the PSC, KRS 278.200 should be interpreted to apply only when the regulated utility is the provider, not the recipient, of the service. Simply put, the statute makes no such distinction. The statute has but one meaning--the City waives its exemption when it contracts with a regulated utility upon the subjects of rates and service.

Effective regulation of rates and service of public utilities resulted from the Kentucky General Assembly's passage of the Public Service Commission Act of 1934. The primary issue on appeal is whether, under the act, a city waives its exemption from PSC regulation by contracting to supply a commodity to a PSC-regulated utility. The section of the original act creating the rates and service exception appeared in Carroll's Code, 1936 Revised Version, Section 3952-27 which provided as follows:

**Authority of the commission to change contract rates.**--The commission shall have power, under the provisions of this act, to enforce, originate, establish, change and promulgate any rate, rates, joint rates, charges, tolls, schedules or service standards of any utility, subject to the provisions of this act, that are now fixed or that may in the future be fixed, by any contract, franchise or otherwise, between any municipality and any such utility, and all rights, privileges and obligations arising out of any such contracts and agreements regulating any such rates, charges, schedules or service

standards, shall be subject to the jurisdiction and supervision of the commission; provided, however, that no such rate, charge, schedule or service standard shall be changed, nor any contract or agreement affecting same shall be abrogated or changed until and after a hearing has been had before the commission in the manner prescribed in this act.

Nothing in this section or elsewhere in this act contained is intended or shall be construed to limit or restrict the police jurisdiction, contract rights, or powers of municipalities or political subdivisions, except as to the regulation of rates and service, exclusive jurisdiction over which is lodged in the Public Service Commission.

Thus, any contract as to rates and service arising between a city and a utility required PSC authority. As the PSC, by express language, retained exclusive jurisdiction over regulation of rates and service, this simply \*463 created the rates and service exception which the trial court found as vesting the PSC with exclusive jurisdiction over a city's attempt to affect utility rates or service. *Benzinger v. Union Light, Heat, & Power Co.*, 293 Ky. 747, 170 S.W.2d 38 (1943), acknowledged the legislative intent of the act as to place the regulation of rates and service under the exclusive jurisdiction of the PSC. The aforementioned Carroll's Code was revised and codified in 1942. The first paragraph resultantly appears in KRS 278.200, and the second paragraph reappears as KRS 278.040(2). Irrespective of subsequent codification, the effect and meaning of the rates and service exception continues to exist without modification. Simply put, both current sections of the statute are compatible.

The second sentence of KRS 278.040(2) is the "exception" to the general rule which exempts cities from PSC regulation. It provides:

The commission shall have *exclusive jurisdiction* over the regulation of *rates* and *service* of utilities, but with that *exception* nothing in this chapter is intended to limit or restrict the police jurisdiction, contract rights or powers of *cities* or political subdivisions. (Emphasis added).

Thus, when a city is involved, the sentence reflects unequivocally the legislature's intent that the PSC exercise exclusive jurisdiction over utility rates and service.

Significantly, this sentence or subsection (2) of KRS 278.040 was addressed in *Peoples Gas Co. of Kentucky v. City of Barbourville*, 291 Ky. 805, 165 S.W.2d 567 (1942). As the initial sentence of KRS 278.040(2) directs that PSC jurisdiction extends to all utilities, there could be no reason to provide for the "exception" for the regulation of rates and service as pronounced in the second sentence

of the statute if that exception were not intended to apply to cities which are otherwise plainly exempted from PSC jurisdiction by virtue of KRS 278.010(3) which has defined "utility" as "any person except a city."

[2] The rates and service exception to a city's exemption from PSC regulatory jurisdiction is not avoidable by contract because of the following provisions of KRS 278.200:

*The commission may, under the provisions of this chapter, originate, establish, change, promulgate and enforce any rate or service standard of any utility that has been or may be fixed by any contract, franchise or agreement between the utility and any city, and all rights, privileges and obligations arising out of any such contract, franchise or agreement, regulating any such rate or service standard, shall be subject to the jurisdiction and supervision of the commission, but no such rate or service standard shall be changed, nor any contract, franchise or agreement affecting it abrogated or changed, until a hearing has been had before the commission in the manner prescribed in this chapter.* (Emphasis added).

We find that where contracts have been executed between a utility and a city, such as between the City of Franklin and Simpson County Water District, KRS 278.200 is applicable and requires that by so contracting the City relinquishes the exemption and is rendered subject to PSC rates and service regulation.

The City argues that the courts of the Commonwealth have jurisdiction to entertain the issues raised by appellee in this action. *Kentucky Utilities Co. v. Carter*, 296 Ky. 30, 176 S.W.2d 81 (1943), and *Louisville Extension Water Dist. v. Diehl Pump & Supply Co.*, Ky., 246 S.W.2d 585 (1952), are cited to demonstrate that there is no "exception to the exemption." Such authority produces scant support for such reasoning as neither case concerned a rates and service issue for the supplying of a utilitarian product. To the contrary, one action involved unsatisfactory work arising from an oral contract, and the other arose from the execution of a contract for the furnishing of materials and the repair of pumps.

[3] Neither do we accede to the City's interpretation of *Southern Bell Telephone & Telegraph Co. v. City of Louisville*, 265 Ky. 286, 96 S.W.2d 695 (1936), but rather determine that there is nothing in the act intended or to be construed to limit police jurisdiction, contract rights, or powers of municipalities or political subdivisions, except as to the regulation of rates and service, exclusive jurisdiction \*464 over which is lodged in the Public Service Commission.

The City claims that rates charged by a municipality to

its customers, including water districts, fall outside the PSC regulatory jurisdiction and offers *McClellan v. Louisville Water Co.*, Ky., 351 S.W.2d 197 (1961), in support of its argument. This case and the additional cited authority involve the water rate charged by the municipally-owned utility to nonresident customers. The City's argument is not supported by *McClellan*, *supra*, insofar as a municipality was not selling water to a PSC-regulated utility. At the time the *McClellan* opinion was rendered, water districts were exempt from PSC regulation. This court subsequently expressed the need for PSC regulation in cases dealing with city utilities, and the legislature, by its amendment of KRS 278.010(3), brought water districts within the PSC's jurisdiction. Additionally, the legislature enacted KRS 278.015 which, of itself, removes any doubt that water districts were subject to PSC regulation.

[4] The statutory exception applicable to rates and service as provided will prohibit cities from exercising control over rates charged and the service provided to customers of local utilities. Jurisdiction to regulate such rates and service has been exclusively vested in the PSC. The record in this case discloses a doubling of the wholesale water rates charged to the District within a two-year period, with a direct impact upon the District's utility rates and service. Added to the force which the City sought to apply was a call to terminate service by declaring the parties' contract null and void. It is apparent that the City, through its enhanced water sale ordinances, did not direct the setting of any particular rate schedule, but its action profoundly and directly impacts the District's general revenue level, which is one of the first steps in rate making. The City's action is an improper engagement in rate making and strongly supports PSC jurisdiction. The statutory definition of utility is not to serve as an impenetrable shield to afford the City immunity.

The City urges that the circuit court should bear the jurisdiction of this case for no other reason than it is one of contract interpretation. Were this the sole issue, we would state that matters of contract interpretation are well within the court's expertise and not that of utility regulatory agencies. *Texas Gas Transmission Corp. v. Shell Oil Co.*, 363 U.S. 263, 80 S.Ct. 1122, 4 L.Ed.2d 1208 (1960). But, again, the issue is whether Simpson Circuit Court has jurisdiction over the matters raised in the City's complaint or whether jurisdiction was vested within the province of the PSC by the legislature and with the authority to do so flowing from the exercise of the police power of the state. *See Southern Bell*, *supra*.

[5] The City's unilateral adoption of the two water-rate ordinances doubled the water charge and, in no uncertain terms, was an act that directly related to the rate charged by the water district. The City's declaration to hold the

parties' contracts null and void constitutes a practice relating to the service of the water district. The City's analogy of comparing its sale of treated water to coal supplied to an electric utility bears little relationship to the issue herein. The manifest purpose of the Public Service Commission is to require and insure fair and uniform rates, prevent unjust discrimination, and prevent ruinous competition. *City of Olive Hill v. Public Service Commission*, 305 Ky. 249, 203 S.W.2d 68 (1947). Also, the service regulation over which the Commission was given jurisdiction refers clearly to the quantity and quality of the commodity furnished as contracted for with the facilities provided. *Peoples Gas Co. of Kentucky v. City of Barbourville*, *supra*.

While the city finds comfort in relying on *City of Georgetown v. Public Service Commission*, Ky., 516 S.W.2d 842 (1974), in its argument against the rates and service exception, we clearly discern that there is no existing support. The parties were engaged in a dispute of territorial jurisdiction, between a private utility and a city utility and the issue therein affected neither rates or service as it does in this case. Additionally, jurisdiction over the city was rejected because it was a "person" as defined by KRS 278.020(1). Thus, secondly, the rates and service exception had no relationship to the issue raised in *City of Georgetown*, *supra*.

**\*465** [6][7] The City candidly admits that the Public Service Commission has expertise in resolving disputes over rates and service but that construction of KRS 278.040(2) and KRS 278.200, as maintained by the District, creates a paradox and serves to illustrate that where no contract exists between a city and a regulated utility, the courts would be called upon to resolve rates and service disputes. However, from a practical point of view, there has always been a contract/agreement in place and in operation at the time a City supplied water to a utility. Once established by contract, such service can only be abrogated or changed after a hearing before the PSC. KRS 278.200. *Fern Lake Co. v. Public Service Commission*, Ky., 357 S.W.2d 701 (1962). The PSC acts as a quasi-judicial agency utilizing its authority to conduct hearings, render findings of fact and conclusions of law, and utilizing its expertise in the area and to the merits of rates and service issues.

[8] The rates and service exception effectively insures, throughout the Commonwealth, that any water district consumer/customer that has contracted and become dependent for its supply of water from a city utility is not subject to either excessive rates or inadequate service.

The Court of Appeals' opinion is reversed and the opinion and order of Simpson Circuit Court is affirmed.

STEPHENS, C.J., and LAMBERT and STUMBO, JJ.,

concur.

WINTERSHEIMER, J., dissents by separate opinion in which LEIBSON and SPAIN, JJ., join.

WINTERSHEIMER, Justice, dissenting.

I respectfully dissent from the majority opinion because the Court of Appeals correctly determined that the Simpson Circuit Court had jurisdiction over a contract dispute between the City of Franklin and the water district. The Public Service Commission has jurisdiction only over the rates and services of a "utility," publicly or privately owned, as distinguished from city-owned.

KRS 278.010(3) clearly provides that "utility means any person except a city, who owns, controls or operates or manages any facility used or to be used in connection with ... the impounding, distribution or furnishing of water to or for the public for compensation." The majority opinion should not ignore the plain meaning of the statute.

Contrary to the argument of the water district, the PSC act was intended only to transfer the city's preexisting power over rates for services rendered by a utility within the city limits. The statute does not grant the PSC jurisdiction over the rates charged by a city-owned utility which is not a utility as defined in KRS 278.010(3).

*Southern Bell Telephone & Telegraph Co. v. City of Louisville*, 265 Ky. 286, 96 S.W.2d 695 (1936), held that the provisions of Section 4(n) of the PSC act did not conflict with Sections 163 and 164 of the Kentucky Constitution. The case carefully distinguished between the rights of city-owned utilities and publicly owned private utilities. The purpose of Section 4(n) of the original PSC act was not to grant the commission jurisdiction over the rates of city-owned utilities, rather the statute was intended to transfer jurisdiction to the commission over public utility rates which had been fixed initially by a city at the time a utility franchise was granted.

This exemption of city-owned water utilities from commission regulation has been a part of the law for at least 58 years. 1936 Kentucky Acts, Chap. 92 § 1(c). *McClellan v. Louisville Water Company*, Ky., 351 S.W.2d 197 (1961), held that the exemption provided for cities extends to all operations of a municipally-owned utility.

*McClellan*, *supra*, followed a line of cases including *City of Olive Hill v. Public Service Com'n*, 305 Ky. 249, 203 S.W.2d 68 (1947); *Louisville Water Co. v. Preston Street Road Water Dist.*, Ky., 256 S.W.2d 26 (1953) and *Louisville Water Co. v. Public Service Com'n*, Ky., 318 S.W.2d 537 (1958). *McClellan* was followed in *City of Georgetown v. Public Service Com'n*, Ky., 516 S.W.2d

842 (1974) in which the court stated, "We feel compelled to follow the clear language of KRS 278.010(3)."

The Court of Appeals decision does not leave the water district and its customers at \*466 the complete mercy of the city. The circuit court has jurisdiction to adjudicate all issues arising out of the contract on the merits, including any claim that the rates charged by the city are arbitrary or unreasonable.

The rates and services exception has nothing to do with the rates charged by a city-owned utility. The history of the Public Service Commission Acts indicates that the rates and services exception is simply a statutory exception to the power of a city to fix by contract the rates charged by a utility for services inside the city limits. Prior to the adoption of the PSC Acts, cities regulated the rates charged by utilities for services inside the city limits. In exercising its power to grant a franchise to use the public streets pursuant to Sections 163 and 164 of the Kentucky Constitution, a city could establish a utility's initial rates in the franchise agreement. *Cf. Frankfort Natural Gas Co. v. City of Frankfort*, 204 Ky. 254, 263 S.W. 710 (1924). During the existence of the franchise agreement, the city and the utility were free to modify those rates by additional contractual agreement. *Johnson County Gas Co. v. Stafford*, 198 Ky. 208, 248 S.W. 515 (1923).

From a historical perspective, Chapter 278 was adopted in the early 1930's when many utilities had contracts with cities which obligated the utilities to furnish services to the citizens of the city under uniform rates and conditions. The utility was permitted to place its lines along the public ways, and in return, the utility paid an annual flat franchise fee or percentage of revenues to the city.

It is essential to recognize the fact that it is the City, which is not a private or public utility, that is furnishing the service and arbitrarily or by negotiation prescribing a rate. It is not the promulgated service rate of a resale customer of a city that would be an issue. It has been general policy that because the PSC has no jurisdiction over the former, it has no jurisdiction over its rate problems.

KRS 278.040(2) gave the PSC exclusive jurisdiction over the regulation of rates and utilities, but by definition, excluded the city. There was a period of time when cities filed certain reports with the PSC. The remainder of KRS 278.040(2) reserves the rights of a city or other political subdivision, such as a county, to effectuate safety and environmental protection regulations.

*Benzinger v. Union Light, Heat & Power Co.*, 293 Ky. 747, 170 S.W.2d 38 (1943), considered the intention of the legislature as stated in Section 4(n) of the PSC act to

the effect that it was expressly stated that the intention was to confer jurisdiction only over the matter of rates and service. *Peoples Gas, supra*, and *Benzinger* indicate that the original Section 4(n), now KRS 278.200 and 278.040(2), created an exception to the authority of cities to regulate the rates of a utility for services rendered inside the city limits. There is nothing in the statutory language which creates an exception to the exemption of city-owned utilities from PSC jurisdiction. The PSC jurisdiction was limited to the rates and services of a utility.

By statutory definition, the City of Franklin is not a public utility subject to the jurisdiction of the PSC. KRS 278.010(3). However, the Simpson County Water District, which is organized under KRS Chapter 74 is considered to be a public utility subject to the jurisdiction of the PSC. KRS 278.015.

The only public utility in this dispute is the Simpson County Water District. The wholesale rates for water sold by the city to the water district do not constitute a charge or other compensation for services rendered by the district. Accordingly, they are not rates within the statutory definition provided in KRS 278.010(11).

In addition, the rates charged by the water district do not relate to the "quality" or "quantity" of the water sold by the district so as to fall within the statutory definition of service. *Cf. Benzinger* 170 S.W.2d at page 41.

KRS 278.200, which gives the PSC jurisdiction over rates of any utility that has been or may be fixed by any contract, franchise or agreement between the utility and any city fails to consider that this contract does not purport to fix the rates charged by the District which is the only public utility in question. The contract sets only the rates \*467 charged by a city-owned utility. KRS 278.200 does not apply in this situation.

The legislative history of the regulatory acts indicates that sales by a city-owned utility to a water district are exempt from PSC regulation. From approximately 1936 to 1964, both cities and water districts were excepted from the definition of a "utility." In 1964, the General Assembly deleted the exception for water districts and expressly provided that districts were public utilities subject to the jurisdiction of the PSC. *City of Georgetown v. Public Service Com'n*, Ky., 516 S.W.2d 842 (1974). This Court held in the *McClellan* case that a city's exemption from PSC regulation extended to all operations of a city-owned utility, whether within or without city limits. Approximately three years later, in the 1964 amendments to the PSC act, the legislature did not attempt to overrule *McClellan* by subjecting any of the activities of a city-owned utility to commission regulation. The legislature only granted the PSC jurisdiction over rates

charged by the water districts.

After that time, a water district could not pass on a wholesale rate increase to its customers without filing a rate case in which the imposition of the new rates by the district could be delayed for five months. KRS 278.190(2). Again, in 1986, the General Assembly considered the problem of regulatory lag by permitting a water district to pass on an increase in wholesale rates to its customers immediately without commission approval. KRS 278.015(2). Once again, in addressing the problem of regulatory lag, the General Assembly did not subject city-owned utilities to PSC regulation so that the commission could consider the increased wholesale rates of a city-owned utility simultaneously with new retail rates of a water district. There would be no necessity for the 1986 legislation if the wholesale rates of a city-owned utility had been subject to PSC regulation.

KRS 278.200 recognizes the fact that at the time of the enactment of Chapter 278 some utilities had contracts with cities for the rendition of utility services. This section prevents a sudden arbitrary abrogation of a utility contract with a city until a hearing has been held before the PSC in the manner prescribed by the statute. Consequently, the commission could change any rate that has been fixed by contract between the utility and the city for services by a utility within the city as to its citizens but only after a public hearing. In this manner it appears that a legal issue of constitutional proportions, the abrogation of contracts affecting the public, would be avoided by reason of affording due process. The days of city control over public utilities are long past.

Under Section 200, it is clear that because the commission is not bound by any contract, franchise or agreement for service between a utility and the city in

which it operates, it can prescribe reasonable rates for a utility to charge within a city. However, because the city itself is not a utility as defined in KRS 278.010(3), a municipal water plant sets its own rates. Accordingly, the city no longer has the power to regulate rates of privately-owned utilities. It has been superseded by the PSC.

A city does retain inherent police power under KRS 278.040(2) over all public utility lines within the city limits and it has statutory jurisdiction by exclusion as a utility under KRS 278.010(3) over any utility plant owned and operated by itself. Therefore it can set its own rates without PSC approval, but not the rates of privately-owned utilities. Moreover, city-owned water or electric plants are not subject to PSC safety or health regulations. Such is the regulatory province of the Kentucky Division of Water (DOW), EPA and other agencies. Cities file no reports with the PSC. Neither can the PSC be an arbitrator of city matters.

In this situation, the city as a supplier is expressly excluded from the definition of a utility in KRS 278.010(3). In view of the fact that the city is specifically excluded from the definition of a utility in the statute, there is no ambiguity or conflict giving the courts a vehicle to construe the city as subject to PSC regulation and exclude its right to file in circuit court to determine the contractual obligations if any to the Simpson County Water District.

In my view the circuit court, and not the PSC, is the proper forum for the adjudication \*468. of the merits of this dispute. I would affirm the Court of Appeals and reverse the trial court.

LEIBSON and SPAIN, JJ., join in this dissent.

BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

In the Matter of:

AUG 11 1994

SUBMISSION OF CONTRACTS AND RATES OF )  
 MUNICIPAL UTILITIES PROVIDING )  
 WHOLESALE UTILITY SERVICE TO PUBLIC )  
 UTILITIES )

GENERAL COUNSEL

ADMINISTRATIVE  
 CASE NO. 351

O R D E R

On January 31, 1994, the Kentucky Supreme Court in Simpson County Water District v. City of Franklin, Ky., 872 S.W.2d 460, held that this Commission has jurisdiction over the wholesale rates and service of municipal utilities which provide utility service to any public utility.

The Court's holding reverses a longstanding interpretation of public utility laws. Since 1936, municipal utilities have been exempted from the statutory definition of "utility." 1936 Kentucky Acts, Chap. 2, §1. In a long series of cases beginning in 1961, Kentucky's highest court had previously held that this exemption "extends to all operations of a municipally owned utility . . . ." McClellan v. Louisville Water Co., Ky., 351 S.W.2d 197, 199 (1961); See also City of Flemingsburg, Kentucky v. Pub. Serv. Comm'n, Ky., 411 S.W.2d 920 (1966); City of Georgetown, Kentucky v. Pub. Serv. Comm'n, Ky., 516 S.W.2d 842 (1974).

As its first step to implementing the Simpson County decision and to exercising jurisdiction over the wholesale rates and services of municipal utilities, the Commission finds that all municipal utilities providing wholesale utility service to a public utility should, within 30 days from the date of this Order, file

with the Commission a copy of their contracts with the public utility and a schedule of their rates for wholesale service.

The Commission further finds that, 30 days prior to placing into effect any change in these contracts or in the rates or service provided to a public utility, a municipal utility should file the revised contract or rate revision with the Commission. Failure to make such filing will render the revision void.

IT IS THEREFORE ORDERED that:

1. Within 30 days of the date of this Order, each municipal utility providing wholesale utility service to a public utility shall submit to the Commission a copy of its contract for such service and a schedule of its wholesale rates.

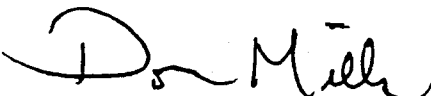
2. All rate schedules submitted shall conform to Commission Regulation 807 KAR 5:011.

3. Any municipal utility wishing to change or revise a contract or rate for wholesale utility service to a public utility shall, no later than 30 days prior to the effective date of the revision, file with the Commission the revised contract and rate schedule.

Done at Frankfort, Kentucky, this 10th day of August, 1994.

By the Commission

ATTEST:

A handwritten signature in dark ink, appearing to read "Don Miller", is written over a horizontal line.

Executive Director