

EXHIBIT 7

RENDERED: July 19, 1996; 2:00 p.m.
NOT TO BE PUBLISHED

NO. 95-CA-2127-MR

COLUMBIA GAS OF KENTUCKY, INC.

APPELLANT

V. APPEAL FROM BOYD CIRCUIT COURT
HONORABLE C. DAVID HAGERMAN, JUDGE
ACTION NO. 93-CI-458

CITY OF ASHLAND, KENTUCKY,
A CITY OF THE SECOND CLASS

APPELLEE

OPINION AFFIRMING

* * * * *

BEFORE: WILHOIT, Chief Judge, DYCHE, and GUDGEL, Judges.

GUDGEL, JUDGE: This is an appeal from a declaratory judgment entered by the Boyd Circuit Court. The issue is whether the court erred by finding that appellee City of Ashland (City) was entitled to reject as unresponsive the bid of appellant Columbia Gas of Kentucky, Inc. (Columbia Gas) because Columbia Gas proposed to charge back to its customers on their bills the amount which was bid for the franchise. We are of the opinion that it did not. Hence, we affirm.

The relevant facts are uncomplicated and undisputed. Columbia Gas has provided natural gas service to the City and its residents since 1913 although its franchise to do so expired in

1922. Despite the provisions of KRS 96.010(1), the City never undertook to sell a new franchise until after it enacted Ordinance No. 155, providing for the advertisement and sale of a gas company franchise, in December 1992. That ordinance states in pertinent part as follows:

SECTION 12. As consideration for the rights conferred by the granting of this franchise, and to compensate the City for its superintendence of the franchise, the successful bidder shall pay to the City a fee, the minimum of which shall be equal to 36% of the charges paid for gas services by the City of Ashland upon the following conditions:

- (a) Such fees shall be initially fixed by separate ordinance which shall state the City's acceptance of the Company's bid.
- (b) The Company shall remit to the City, quarterly, all amounts due under this franchise. The first such remittance shall be based upon revenues received by the Company during the first three (3) months following the effective date of the franchise as set forth in Section 19 hereof, and shall be paid within forty-five (45) days following such period. Thereafter, payments shall be made within forty-five (45) days after each subsequent three (3) month period. The final payment shall be paid within forty-five (45) days following the expiration of this franchise.
- (c) In the event the City of Ashland makes no payments to a company as defined by this ordinance, the bid for a ten (10) year franchise shall be a minimum of \$3,000.00 payable

within forty-five (45) days of the granting of a franchise.

. . . .

SECTION 15. (1) Bids and proposals for the purchase and acquisition of the franchise and privileges hereby created shall be in writing and shall be delivered to the City Clerk or designated subordinate upon the date and at the time fixed in said advertisement for the receipt of such.

(2) Bids offered for purchase of this franchise shall state the bidder's acceptance of the conditions set forth in this ordinance.

(3) Any cash or check remitted by an unsuccessful bidder shall be returned.

SECTION 16. At the first regular meeting of the City Commission following the receipt of such bids, the City Manager shall report and submit to the City Commission all bids and proposals for acceptance of bids. Acceptance of a bid shall be expressed by an ordinance. The City Commission reserves the right, for and in behalf of the City, to reject any and all bids for said franchise and privilege. In case the bids reported by the City Manager shall be rejected by the City Commission, it may direct, by resolution or ordinance, that said franchise and privilege be again offered for sale, from time to time, until a satisfactory bid therefore shall be received and accepted.

Columbia Gas thereafter submitted two bids for the franchise, each of which stated in relevant part as follows:

Section 12 In consideration of the granting of this franchise to distribute gas within the City of Ashland, Columbia Gas of Kentucky, Inc. will pay an annual franchise fee equal to two percent (2%) of the annual gross service revenues received by Columbia

Gas of Kentucky, Inc. from the sale of gas within the corporate limits of the City of Ashland, Kentucky. Columbia Gas of Kentucky, Inc. will collect, as a separate item on the periodic bills of its customers served within the corporate limits of the City of Ashland, Kentucky, and pay over to the Ashland municipal government, an amount equal to the total of each customers' proportionate part of the franchise fee set forth above. In the event Columbia Gas of Kentucky, Inc. is prohibited by any regulatory body or court from collecting such proportionate amounts from customers receiving service within the corporate limits of Ashland, Kentucky, then to that extent, Columbia Gas of Kentucky, Inc. shall be relieved from any obligation under this Section. For the purposes of the foregoing paragraph, the franchise shall be effective March 1, 1993, and calculation of amounts payable hereunder shall commence with all bills tendered to customers by the Company on and after said date. Payment of said amount to the City of Ashland, after approval by the Kentucky Public Service Commission, shall be made quarterly on the 15th day after the end of each quarter without certification of the amount of gross service revenues by a public accountant.¹

The City both rejected Columbia Gas's bids as unresponsive and filed a civil action seeking a declaration of rights to that effect. Columbia Gas responded with a counterclaim, seeking an adjudication that the City's rejection of its bids was arbitrary and void.

¹Columbia Gas's bids also requested other provisions or conditions relating to subjects besides those set forth in the City's bid documents. However, as the parties did not address these differences in either their pleadings or their arguments to the court below, we assume they can be resolved amicably.

Eventually, the case was submitted to the court for decision on the parties' briefs. On July 7, 1995, the court entered a judgment which stated in relevant part as follows:

The main hang up appears to be that the Defendant wants to include a line item on the bills of customers in the City of Ashland for collection of the franchise fee back from those who receive the service. The City takes the position that if Columbia can pass the cost of the franchise onto the customers of Ashland, then Columbia has essentially received the valuable privilege of using the City's rights-of-way for free which would be unfair to city taxpayers. The City feels that the utility must absorb the cost of the franchise as a part of doing business since it is receiving something valuable for it.

The Defendant on the other hand argues that the bids submitted were responsive in that they would generate more revenue for the City than the ordinances would have and that the City's interpretation of the ordinance is arbitrary, capricious and oppressive. The Defendant makes a strong argument that if utilities have to go to the Public Service Commission and seek rate increases to offset the cost of franchise fees, the net effect will be that customers in our area of the state will be paying higher rates because of a franchise fee in a different area of the state. . . .

The Defendant is probably correct as to where the current course is leading, that being the request to the PSC for a rate increase to offset the franchise fee. However, the fact remains that if the Defendant is allowed to pass the cost of the franchise along to the customers then it will have gotten the valuable privilege of using the city's rights-of-way for free. Surely, this cannot be right. Section 164 of the Kentucky Constitution

empowers the City to reject any and all bids. The fact that the City selected an ordinance that does not provide for a line item charge in order to protect its taxpayers from the additional charge does not make it unreasonable, arbitrary or capricious.

This appeal followed.

Given the relevant factual background and the court's ruling, we believe the posture of this case on appeal raises a single narrow issue regarding the sale of utility franchises by cities, i.e. whether a city possesses the legal right to force a utility, when submitting a bid for the purchase of a franchise, to contractually agree to absorb the cost of the franchise as a normal operating expense. We conclude that a city does possess such a right. Hence, we affirm.

Sections 163 and 164 of the Kentucky Constitution and KRS 96.010(1) authorize cities such as Ashland to sell utility franchises. Specifically, Section 163 of the constitution in effect provides that no utility shall be permitted or authorized to construct facilities along, over, under, or across a city right-of-way without the consent of the proper legislative body, while Section 164 forbids any city from granting a franchise for a term exceeding twenty years and directs that the award of such a franchise must occur only after there has been public advertisement and the receipt of bids therefor. Moreover, although Section 164 states that a franchise shall be awarded "to the highest and best bidder," the section also authorizes a city "to reject any or all bids." In addition, KRS 96.010(1) provides

that the sale of a new franchise to the highest and best bidder shall be on "terms that are fair and reasonable to the city," to the purchaser, and to the utility's customers, and that such "terms" shall specify the quality of the service which is to be rendered.

Having reviewed the applicable constitutional and statutory provisions, it is immediately apparent that nothing in the language of those provisions expressly authorizes a city to dictate the source of the funds which must be utilized by a utility to pay a franchise fee. Indeed, KRS 278.040(2) expressly states that the Public Service Commission (PSC) possesses exclusive jurisdiction over the regulation of utility rates. Nevertheless, it does not follow that the City's actions herein are illegal and void, as the law to the contrary is well settled.

In Peoples Gas Co. of Kentucky v. City of Barbourville, 291 Ky. 805, 165 S.W.2d 567 (1942), our highest court was asked to interpret and harmonize the constitutional and statutory provisions regarding a municipality's authority to sell utility franchises in light of certain newly-enacted statutes (now embodied, substantially unchanged, in KRS Chapter 278) which created the PSC. The court resolved the issues relating to the attachment and extent of the PSC's jurisdiction as follows:

That language is an express limitation upon the powers of the Commission, with a like preservation of the power and authority of municipalities theretofore possessed by them, from the time our state was admitted into the Union. Such power and authority was and is the right of municipalities upon installing a

utility within its borders to prescribe for the character of service to be rendered by it and the rates to be charged therefor at the beginning. The statute nowhere indicates a purpose to entirely take from municipalities such authority or to diminish their power in such respects, but only to modify it by prescribing that from time to time thereafter the "regulation" of rates and service was conferred upon the Public Service Commission. The language itself assumes that there were already existing provided rates, facilities and terms of service to be regulated by the Commission in the exercise of the jurisdiction conferred upon it by the act; but nowhere in the statute, either in the section referred to or any other part of it, is there any intimation that it was the purpose of the legislature to strip and take away from the municipality, in the granting of such franchise, the power and authority to enact and prescribe beginning terms and conditions, but which nevertheless might thereafter be regulated as applicable to both rates and services performed.

165 S.W.2d at 570-71. Hence contrary to Columbia Gas's contention, it is clear that the PSC's jurisdiction does not attach until after a city awards a utility franchise. Until then, the city has sole jurisdiction to determine the franchise's terms regarding both rates and services. Moreover, it is of no significance herein that Columbia Gas was previously awarded a franchise and that it has been conducting its business without a franchise for many years, as any rights Columbia Gas acquired under the old franchise have long since expired. Hence, the City is entitled to offer the new franchise on different terms and conditions if it wishes. Cf. Kentucky Utilities Co. v. Board of

Commissioners of City of Paris, 254 Ky. 527, 71 S.W.2d 1024 (1933).

Further, in a case such as this where a city has exercised its constitutional authority in rejecting a bid, the courts may not interfere in the city's exercise of its discretion absent very limited circumstances. Indeed, the applicable rule is well stated in Groover v. City of Irvine, 222 Ky. 366, 300 S.W. 904, 905 (1927), as follows:

Here there is presented for the first time the question whether the discretion vested in the board of council of the municipality is subject to the control of the courts in the circumstances presented. In granting franchises for the public benefit, a city council acts in a legislative capacity. In the exercise of this power a discretion is vested, which cannot be taken away by the courts. Inasmuch, however, as the members of the city council act as trustees for the public to the end that the latter may obtain such conveniences as telephones, electric lights, and the like, they may not, after the sale of a franchise, arbitrarily or corruptly reject all bids and thereby escape the obligation to award the franchise to the highest and best bidder. However, when the exercise of the power and discretion to reject bids is attacked in the courts, the presumption will be indulged that the council has not abused its discretion, but has acted with reason and in good faith for the benefit of the public. To proceed upon any other theory would be to substitute the judgment and discretion of the courts for the judgment of the members of the council with whom the lawmakers have seen fit to lodge the power. Little Rock Railway & Electric Company v. Dowell, 101 Ark. 233, 142 S.W. 165, Ann. Cas. 1913D, 1086. Hence it is incumbent on one who calls in question the

discretion of the council to allege and prove facts showing that the council acted arbitrarily or corruptly, and was therefore guilty of a clear and palpable abuse of discretion.

Here, Columbia Gas urges that the City's rejection of its bids was arbitrary because, although a municipality may set a reasonable fee for granting a franchise, nothing in the applicable constitutional or statutory provisions authorizes a municipality to dictate how a utility company raises the necessary funds for purchasing a franchise. We disagree.

As noted above, KRS 96.010(1) dictates that the sale of any new franchise, even to a utility such as Columbia Gas which held a previous but now expired franchise, must be on terms which are fair and reasonable "to the city, to the purchaser of the franchise and to the patrons of the utility." Here, the record shows that the City requested a minimum bid for the franchise of \$18,810. Columbia Gas in response offered to pay approximately \$123,000 for the franchise, disclosing that it would recoup this sum from its customers through line item charges added to their monthly bills. The City objected to the plan as being unfair and unreasonable to the customers of Columbia Gas, especially since the amount bid for the franchise was significantly higher than the minimum amount which the City had indicated it would accept. Nothing in the record establishes that the City's efforts to protect its residents from additional monthly charges by exercising its constitutionally-authorized discretion to reject Columbia Gas's bid was not done "with reason and in good faith

for the benefit of the public." Groover v. City of Irvine, 300 S.W. at 905. Absent any showing that the City's conduct constituted a clear and palpable abuse of discretion, it follows that the City did not act arbitrarily by rejecting Columbia Gas's bid. Hence, the court did not err by denying Columbia Gas's request for relief.

The court's judgment is affirmed.

ALL CONCUR.

BRIEF AND ORAL ARGUMENT
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