

EXHIBIT 3

RENDERED: NOVEMBER 7, 2014; 10:00 A.M.
NOT TO BE PUBLISHED

MODIFIED: MARCH 13, 2015; 10:00 A.M.

Commonwealth of Kentucky

Court of Appeals

NO. 2013-CA-001112-MR

CITY OF FLORENCE, KENTUCKY;
CITY OF WINCHESTER, KENTUCKY;
CITY OF GREENSBURG, KENTUCKY;
CITY OF MAYFIELD, KENTUCKY;
AND KENTUCKY LEAGUE OF
CITIES, INC.

APPELLANTS

v.

APPEAL FROM FRANKLIN CIRCUIT COURT
HONORABLE PHILLIP J. SHEPHERD, JUDGE
ACTION NO. 11-CI-01418

LORI HUDSON FLANERY, IN
HER OFFICIAL CAPACITY AS
SECRETARY OF THE FINANCE
AND ADMINISTRATION CABINET
FOR THE COMMONWEALTH OF
KENTUCKY; THOMAS B. MILLER,
IN HIS OFFICIAL CAPACITY AS
COMMISSIONER OF THE
DEPARTMENT OF REVENUE FOR
THE COMMONWEALTH OF KENTUCKY;
AND KENTUCKY CATV ASSOCIATION, INC.

APPELLEES

OPINION
REVERSING AND REMANDING

** ** *

BEFORE: CLAYTON, MOORE, AND TAYLOR, JUDGES.

TAYLOR, JUDGE: City of Florence, Kentucky, City of Winchester, Kentucky, City of Greensburg, Kentucky, City of Mayfield, Kentucky, and Kentucky League of Cities, Inc. (collectively referred to as appellants) bring this appeal from a June 5, 2013, Opinion and Order of the Franklin Circuit Court dismissing their petition for declaratory judgment. We reverse and remand.

The relevant facts were set forth by the circuit court as follows:

In 2005 the Kentucky General Assembly enacted the Multichannel Video Programming and Communications Services Tax (hereinafter the “Telecommunications Tax”). This law became effective January 1, 2006. The Telecommunications Tax altered the way by which telecommunications companies, cable providers, and direct broadcast service providers were taxed at both the state and local levels. The Telecommunications Tax imposes a 3% excise tax on all retail purchase of multichannel video programming services (hereinafter “MVP service”), as well as a 2.4% tax on the gross revenues received by all providers of MVP services, and 1.3% tax on the gross revenues received by providers of communications services. [Kentucky Revised Statutes] KRS 136.604(1-2); KRS 136.616(1-2). These provisions effectively import a 5.4% tax on total charges for MVP services and a 4.3% tax on total charges for telecommunications services. These funds are held and administered by the Finance and Administration Cabinet, and all revenue from the Telecommunications Tax is part of the General Fund which is budgeted and appropriated by the General Assembly in each biennial budget.

The 2005 legislation reflects a dramatic change in the taxation of telecommunications providers, in which, for the first time, the legislature has pre-empted the field and barred local governments from taxing cable television franchises. Prior to enactment, local governments collected franchise fees from telecommunications companies and cable providers pursuant to the Kentucky Constitution Sections 163 and 164. At that time, cable companies were required to obtain the local government's permission to use roads and rights-of-way, and permission was granted by permits to which franchise fees applied. The Telecommunications Tax, by KRS 136.660(1), now prohibits local governments from:

- (a) Levying any franchise fee or tax on multichannel video programming service or communications service, or collecting any franchise fee or tax from providers or purchasers of multichannel video programming service or communications service;
- (b) Requiring any provider to enter into or extend the term of any provision of a franchise or other agreement that requires the payment of a franchise fee or tax; or
- (c) Enforcing any provision of any ordinance or agreement to the extent that the provision obligates a provider to pay the political subdivision a franchise fee or tax.

KRS 136.660(1). "Franchise fee or tax" is defined in KRS 136.660(2) to include "any tax, charge, or fee, that is required by ordinance or agreement to be paid to a political subdivision through a provider" no matter if the tax, charge, or fee is designated as a franchise fee or intended as compensation for the use of public rights-of-way.

Circuit Court order at 1-3 (footnote omitted).

Consequently, on September 23, 2011, appellants filed a petition for declaratory relief in the Franklin Circuit Court. Therein, they argued that the Telecommunication Tax violated Kentucky Constitution Sections 163 and 164.¹ In support thereof, appellants maintained that Kentucky Constitution Sections 163 and 164 delegated to local government the right to grant franchises and collect franchise fees therefrom. Lori Hudson Flanery, in her official capacity as Secretary of the Finance and Administration Cabinet for the Commonwealth of Kentucky, Thomas B. Miller, in his official capacity as Commissioner of the Department of Revenue for the Commonwealth of Kentucky, and Kentucky CATV Association, Inc. (collectively referred to as appellees) answered, and subsequently, both parties filed motions for judgment on the pleadings. Kentucky Rules of Civil Procedure (CR) 12.03.

In its June 5, 2013, Opinion and Order, the circuit court held that Telecommunications Tax was not violative of Kentucky Constitution Sections 163 and 164. The circuit court granted appellees' motion for judgment on the pleadings and dismissed the petition. This appeal follows.

To begin, the circuit court rendered a judgment on the pleadings. Upon review of the record, we observe that exhibits were attached to the various memoranda filed in support of motions for judgment on the pleadings. These exhibits constituted matters outside the pleadings per CR 12.03. Where matters outside the pleadings are presented to a circuit court, the motion must be treated as

¹ The Multichannel Video Programming and Communications Services Tax (Telecommunications Tax) is codified in Kentucky Revised Statutes 136.600 – 660.

a motion for summary judgment. Summary judgment is proper where there exists no material issue of fact and movant is entitled to judgment as a matter of law. CR 56; *Steelvest, Inc. v. Scansteel Service Center, Inc.*, 807 S.W.2d 476 (Ky. 1991). As the material facts of this case are undisputed, resolution is dependent upon a question of law – whether the Telecommunications Tax violates Kentucky Constitution Sections 163 and 164.

Kentucky Constitution Section 163 reads:

No street railway, gas, water, steam heating, telephone, or electric light company, within a city or town, shall be permitted or authorized to construct its tracks, lay its pipes or mains, or erect its poles, posts or other apparatus along, over, under or across the streets, alleys or public grounds of a city or town, without the consent of the proper legislative bodies or boards of such city or town being first obtained; but when charters have been heretofore granted conferring such rights, and work has in good faith been begun thereunder, the provisions of this section shall not apply.

And, Kentucky Constitution Section 164 reads:

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

It is undisputed that the Telecommunications Tax expressly forbids appellants from collecting franchise fees. KRS 136.660(1)(a). The power and

authority to grant franchises and charge fees therefrom are attributes of the sovereign state and remain vested in the state except to the extent that such power has been constitutionally or statutorily delegated to local governments. *Ky. Utilities Co. v. Bd. of Comm'rs of City of Paris*, 254 Ky. 527, 71 S.W.2d 1024 (1933).

Our case law has consistently interpreted Section 163 of the Kentucky Constitution as a delegation to local government of the right to grant utility franchises within its boundaries. *Paris*, 71 S.W.2d 1024; *City of Florence v. Owen Elec. Coop., Inc.*, 832 S.W.2d 876 (Ky. 1992). Through enactment of Section 163, the framers of our Constitution intended “to prevent the [state] legislature from authorizing the indiscriminate use of the streets of the city by utilities without the city being able to control the decision as to what streets and public ways were to be occupied by the utility.” *City of Florence* at 832 S.W.2d at 881. While Kentucky Constitution Section 163 has been viewed as a delegation of the authority to grant a utility franchise to local government, Section 164 has been interpreted as a limit upon that delegated authority. *Paris*, 71 S.W.2d 1024. Section 164 mandates that local government may only grant a utility franchise for twenty years and only after a competitive bidding process. Through enactment of Section 164, the drafters of our Constitution envisioned that local governments would receive valuable consideration in exchange for the granting of the utility franchises:

Further illustrating the intention of the section, the limitation of 20 years upon the time for which franchises might be granted was added, as what would be an

adequate price for a franchise granted to a public utility corporation to use the streets of a city to-day might be a mere pittance 20 years hence. The value to the owners of the right granted would keep pace with the growth, wealth, and population of the city, and unless at some future time the city had the right to obtain additional compensation for the privilege it would give the grantees of the franchise undue advantage, and deny to the city the right to exact a consideration in keeping with the value of the privilege bestowed.

Paris, 71 S.W.2d at 1029 (citation omitted).

Our case law has also recognized the retained authority of the Commonwealth to regulate by legislative enactment a utility franchise granted by local government. *Southern Bell Tel. & Tel. Co. v. City of Louisville*, 265 Ky. 286, 96 S.W.2d 695 (Ky. 1936); *Paris*, 71 S.W.2d 1024. But, the Telecommunications Tax is unique – it seeks to impose state taxes at the expense of franchise fees historically imposed and collected by appellants. While the Commonwealth has retained considerable power to regulate local utility franchises, Section 163 of the Kentucky Constitution delegated to local government the right to grant utility franchises and necessarily the concomitant right to collect franchise fees. *See Cumberland Tel. & Tel. Co. v. City of Calhoun*, 151 Ky. 241, 151 S.W. 659 (1912). The Commonwealth may not by legislative fiat abrogate appellants' constitutionality delegated prerogative to grant a franchise and collect franchise fees. The Telecommunications Tax has effectively frustrated the ability of local governments to collect franchise taxes, which this Court believes can only be accomplished through constitutional amendment.

Accordingly, we hold that the Telecommunications Tax violates Kentucky Constitution Sections 163 and 164 by prohibiting appellants from assessing and collecting franchise fees. We, thus, believe the circuit court improperly granted summary judgment to appellees. Rather, we are of the opinion that appellants are entitled to summary judgment as the Telecommunications Tax is unconstitutionally void.

For the foregoing reasons, the Opinion and Order of the Franklin Circuit Court is reversed and remanded for proceedings consistent with this Opinion.

ALL CONCUR.

BRIEFS FOR APPELLANTS:

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ORAL ARGUMENT FOR
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BRIEF AND ORAL ARGUMENT
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BRIEF FOR APPELLEE
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Eric S. Tresh (*pro hac vice*)
Maria Todorova (*pro hac vice*)
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ORAL ARGUMENT FOR
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