COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

[*Electronically Filed*]

In the matter of:

ELECTRONIC APPLICATION OF THE CITY OF EARLINGTON FOR DECLARATORY ORDER	))	CASE NO. 2025-00299

CITY OF EARLINGTON'S
RESPONSE IN OPPOSITION TO MADISONVILLE'S MOTION TO DISMISS

The City of Earlington, Kentucky ("***Earlington***"), by counsel, submits this Response pursuant to 807 KAR 5:001 in opposition to the City of Madisonville ("***Madisonville***") Motion to Dismiss filed December 2, 2025. The Motion should be denied because Earlington's Application and Formal Complaint present a federally conditioned wholesale wastewater rate dispute that falls within this Commission's statutory and regulatory authority. Madisonville's unilateral, non-transparent rate increase implicates the EPA 201-Grant user-charge regime and proportional cost-allocation requirements that Kentucky has assigned the Commission to enforce economically. Madisonville's monopoly control over Earlington's wastewater service makes Commission oversight essential to prevent arbitrary pricing and cross-subsidization. Further, the issues turn on specialized wholesale ratemaking methodology squarely within the Commission's expertise rather than a circuit court's contract lens. Finally, the informal pre-docket staff correspondence Madisonville cites is not a Commission order, is not final or appealable, and has no preclusive effect. Accordingly, Earlington has stated a prima facie claim for declaratory and complaint relief, and dismissal at the pleading stage is unwarranted.

REGULATORY STANDARD

The Commission's Rules do not establish a separate or heightened test for a motion to dismiss. Such motions are governed by the Commission's general motion practice rule. See 807

KAR 5:001 §5. A formal complaint must state fully and clearly the act or omission alleged and the facts supporting relief. See 807 KAR 5:001 §20(1)(c).

In ruling on a motion to dismiss, the Commission evaluates only the facial legal sufficiency of the Application/Complaint. Consistent with Kentucky practice under CR 12.02(f), the Commission must accept the well-pleaded allegations as true, draw all reasonable inferences in favor of the complainant, and may grant dismissal only where (i) the pleading states no prima facie claim within the Commission's authority or (ii) the Commission lacks jurisdiction as a matter of law on the face of the pleadings. If the resolution of the motion depends on factual disputes, technical proof, or record development, dismissal at the pleading stage is improper, and the matter should proceed to investigation, discovery, and/or a hearing.

ARGUMENTS

Applying the foregoing standard, Madisonville's Motion to Dismiss fails. Madisonville asks the Commission to resolve disputed jurisdictional and ratemaking facts on an undeveloped record. But at this stage, Earlington's well-pleaded allegations must be taken as true, and dismissal is warranted only if no legal entitlement to relief exists, even assuming those allegations. Earlington alleges a federally conditioned wholesale wastewater rate dispute involving proportional cost allocation, transparency, and cross-subsidy—matters that fall within the Commission's economic oversight. Earlington further alleges monopoly circumstances that leave it without market or political recourse, and that Madisonville relies only on informal staff correspondence rather than any Commission order. Because those allegations, if true, state a prima facie claim within this Commission's authority and do not reveal a clear jurisdictional bar as a matter of law, the Motion should be denied.

A. Federal Regulations Governing the EPA 201-Grant User-Charge Regime Mandates PSC Economic Oversight Over Wholesale Rates

At the motion-to-dismiss stage, Earlington's allegations regarding the EPA 201-Grant conditions and proportional user-charge requirements must be accepted as true, and Madisonville's contrary factual narrative cannot support dismissal without a record. Madisonville's Motion to Dismiss rests on the premise that this case is "simply a breach of contract" belonging exclusively in circuit court. That premise collapses under the federal grant framework that governs these wholesale charges. The Madisonville Wastewater Treatment Plant was constructed with EPA Title II/"201" grant funds, and as a condition of that grant, Madisonville was required to adopt and maintain a proportionate user-charge system for all recipients of treatment service—retail and wholesale alike.

Federal law is explicit. Under 33 U.S.C. § 1284(b)(1)(A), EPA may not approve a treatment-works grant unless the applicant has adopted (or will adopt) a system of charges ensuring that each recipient pays its proportionate share of operation and maintenance costs, including replacement. The implementing regulations reinforce that mandate: EPA's user-charge guidelines require a rate system that distributes O&M costs to each user or user class in proportion to that user's contribution to total wastewater loading, considering strength, volume, and flow characteristics—i.e., a transparent proportional cost-allocation methodology.

The Western District of Kentucky[1] has already interpreted these grant conditions in litigation involving the same Madisonville plant and the same inter-municipal sewer agreement that resulted in the 1995 Amendment and Settlement Agreement. In its April 5, 1993 Memorandum Opinion, the court held that Madisonville's receipt of the EPA grant was conditioned

[1] This Court Record is public record and its incorporation is appropriate for consideration under the analogous CR 12 standard without converting it summary judgment.

on establishing a proportionate-share user-charge system and agreeing to maintain it over time. The court further recognized that while EPA must make a pre-grant proportionality determination, post-grant enforcement of user-charge compliance is discretionary with EPA, and Congress therefore intended to "leave to state law … the method of enforcement." Copies of these Orders and Opinion are attached as **Exhibits A** and **B**.

Madisonville is expected to construe Judge Russell's reference to state "contract law" as meaning enforcement must occur only in circuit court. That is not what the federal court held. Judge Russell's point was limited to federal jurisdiction: the Clean Water Act and its regulations do not create a federal cause of action, so enforcement must proceed through state remedies. In Kentucky, those remedies include both contract principles and the Commonwealth's designated utility-rate regulator. The parties' agreement supplies the vehicle for implementing the federally required proportional-share system; but whether the resulting wholesale rate is lawful—i.e., proportional to actual O&M costs, transparent, and free of cross-subsidy—is an economic ratemaking determination committed to the Commission. Thus, contract law may inform the content of the user agreement, but Commission oversight remains the required state mechanism for enforcing the federal proportionality standard and Kentucky's "fair, just, and reasonable" rate duties.

Accordingly, the wholesale rate at issue is a federally compelled proportional-cost charge, not a discretionary municipal price. Madisonville's authority to bill wholesale customers flows from accepting the EPA grant and its proportional-share conditions. A unilateral wholesale rate increase untethered to proportional actual treatment costs—or incapable of audit because Madisonville refuses to disclose its cost-of-service calculations—presents a federal user-charge compliance problem as much as a contract dispute.

Kentucky implemented the federal delegation by splitting oversight along the same federal lines: technical adequacy to the Division of Water and economic sufficiency/wholesale rate enforcement to the Commission. When the dispute concerns whether a wholesale municipal sewer rate remains proportional to actual treatment costs under the federally mandated system, the Commission is the Commonwealth's expert body empowered to review and correct that rate.

In short, this administrative action is not about whether Madisonville "performed" its contract. It is about whether Madisonville's wholesale sewer rate complies with a federally required proportional user-charge regime and has been calculated using transparent, cost-based methods consistent with that regime. The CFR and related federal opinions confirm that such compliance disputes are enforced through state regulatory mechanisms, and Kentucky has assigned that economic enforcement role to this Commission. The Motion to Dismiss should, therefore, be denied.

B. Madisonville's Monopoly Demands Oversight

Madisonville argues that it may set whatever wholesale wastewater rate it chooses and that Earlington must pay it. That position ignores the economic and legal reality that Madisonville is a sole-provider monopoly for Earlington's wastewater treatment. As alleged, Earlington's residents lack any political recourse in Madisonville and require Commission protection against excessive extraterritorial wholesale rates. Earlington has no practical or lawful alternative disposal option, no competing supplier it can turn to, and no ability to self-provide treatment for the sewage flows at issue without going through a permitting and construction regime that would defeat the regional-treatment structure the EPA grant required. The 201-Grant framework created a regional facility precisely because duplicative competing plants would be inefficient and contrary to the public interest. But that efficiency bargain presupposes regulatory accountability—not unilateral pricing power.

Nothing in the 201-Grant system, or in the intermunicipal agreements executed to satisfy it, contemplates that service would be provided at any price Madisonville later elects to impose. The federal user-charge regime requires proportional, cost-based allocation of actual O&M costs among users. A monopoly provider cannot convert that proportionality mandate into a discretionary "take-it-or-leave-it" rate. When the only supplier refuses to disclose the calculation of its rate, and the customer has no alternative source of service, the core concern is not contract performance—it is, as alleged, an abuse of monopoly rate power and the consequent risk of over-collection and cross-subsidization.

Kentucky law tolerates natural monopolies in utility service only because they are subject to meaningful oversight. For municipal utilities, that oversight ordinarily occurs through two possible channels: (1) regulation by the Public Service Commission in matters within its jurisdiction, and/or (2) political accountability to the municipality's own voters. Here, the second channel is absent. Earlington is not part of Madisonville's electorate. It cannot vote to change Madisonville's leadership. It cannot compel open rate-making through local politics. And it cannot protect itself through the normal democratic checks that substitute for Commission review in purely retail municipal settings. That structural gap is exactly why Commission oversight is necessary when a municipality exercises monopoly power over non-voting wholesale customers.

Accordingly, because Madisonville's monopoly position leaves Earlington without market choice or political recourse, and because the dispute concerns the fairness, transparency, and proportionality of a wholesale utility rate, Commission review is not merely appropriate—it is essential to prevent unchecked monopoly pricing and to ensure rates remain fair, just, and reasonable. Because monopoly status and lack of alternative service are pleaded facts, the Commission must accept them as true for purposes of this motion, and it must be denied.

C. The Commission is the Expert on Utility Rates and Service, not Circuit Courts

This administrative action presents a rate-design and cost-of-service dispute, not a simple contract-performance claim. The question now is not whether Earlington will ultimately prove these ratemaking defects, but whether its pleading states a plausible wholesale rate-methodology claim within the Commission's authority. It does.

Kentucky has entrusted that category of controversy to the Commission. The Commission is the Commonwealth's specialized, statutory expert in developing, evaluating, and enforcing utility rates—retail and wholesale—using accepted cost-allocation principles, technical evidence, and administrative procedures. Circuit courts, by contrast, are forums of general jurisdiction; they do not conduct cost-of-service proceedings, test rate methodologies through utility-rate experts, or police cross-subsidization across classes of customers. That institutional difference is decisive here.

The issues in this case turn on whether Madisonville's wholesale wastewater charge reflects Earlington's proportionate share of actual treatment costs, calculated under recognized utility ratemaking standards. Those standards are technical and industry-specific. They require application of specialized guidance—especially the AWWA Manual M-1 and the WEF Manual of Practice No. 27—to allocate O&M, replacement, and capacity costs among users while preventing cross-subsidies. The Commission is familiar with these authorities and with the regulatory imperatives they embody: transparency, proportionality, and the avoidance of one customer class subsidizing another. Circuit courts are not structured to decide, on an evidentiary record, whether a wholesale rate has been derived through those methodologies.

Recent conduct by Madisonville confirms why Commission review is necessary. Madisonville's own 2022 rate study—the 2022 Water and Sewer Technical Memorandum identified in the complaint and prepared by HDR on July 25, 2022—expressly endorses a "stand-

alone" approach as the "prudent and paramount" method for a sustainable utility, and cites the AWWA M-1 Manual and WEF Manual of Practice No. 27 as guiding authorities for rate setting. Yet those same manuals prescribe specialized wholesale-rate methodologies for customers like Earlington and Hanson, and the HDR study does not apply them. Instead, despite recommending only a 50% systemwide increase, Madisonville's staff imposed a dramatically divergent wholesale rate jump on its non-voting wholesale customers: Earlington's wholesale rate increased from $.81to $3.75 per 1,000 gallons (a 463% increase), while Madisonville's own retail rate increased from $7.75 to $11.63 per 1,000 gallons (about 50%). This stark disparity, as alleged, underscores the arbitrariness of and deviation from recognized wholesale-rate standards—exactly the kind of methodological failure the Commission exists to detect and correct.

Industry practice underscores the same point. Utilities ordinarily disclose the basis and calculation of their rates so that customers and regulators can verify proportionality and cost support. When disputes arise, they are resolved in Commission proceedings through public filings, expert testimony, discovery, and evidentiary hearings because the questions are complex and depend on rate-design proof. Wholesale cases routinely require expert analysis of flow, strength, loading, stand-alone cost allocation, and financial segregation, and Commission decisions are reviewed on appeal within the administrative-law framework. That is the established regulatory pathway for disputes of this kind.

Here, Madisonville has refused to provide Earlington with the cost-of-service calculation underlying its wholesale rate increase and has declined to produce sewer-only financial statements, asserting it maintains only combined water-and-sewer records. Without transparent cost support and segregated financial data, neither Earlington nor any reviewing body can test whether the wholesale rate is proportional, cost-based, or instead embeds improper cross-subsidization.

Resolving that question requires the Commission's tools and expertise—not a circuit court's contract lens.

Accordingly, this is not "simply a breach of contract." It is a dispute over whether a monopoly provider has calculated and imposed a wholesale utility rate in a fair, just, reasonable, and industry-standard manner—and whether its own rate study was implemented consistently with the wholesale methodologies it cites. Kentucky has vested that specialized economic and methodological review in the Commission. The Commission is therefore the proper forum to evaluate the rate, compel transparency, and determine the lawful wholesale charge.

D. Madisonville's Cited Case Law and Mount Sterling Decision Are Not Controlling in this EPA-201 Wholesale User-Charge Dispute

Even under Madisonville's cited authorities, dismissal is appropriate only if the lack of jurisdiction is clear as a matter of law on the face of the pleadings. It is not. Madisonville relies on *Simpson County Water District*, *City of Greenup*, and the Commission's 1995 Mount Sterling order to argue that the Commission lacks jurisdiction over wholesale rates between two municipal utilities. That reliance is misplaced. Each authority arises from a materially different legal posture, and none addresses the federally conditioned proportional user-charge regime and enforcement structure presented here.

Simpson County Water District. In *Simpson County*, the Kentucky Supreme Court held that a municipal utility becomes subject to Commission regulation for wholesale service when it contracts to sell to a Commission-regulated public utility, and it emphasized the Commission's power to regulate rates fixed by contract under KRS 278.200. Far from showing that contract rates are insulated from Commission review, *Simpson County* stands for the opposite proposition: contracts do not oust Commission rate jurisdiction when state law assigns the Commission oversight of a wholesale charge. Citizens must have some protection against excessive rates or

inadequate services. The case, therefore, supports Earlington's position that the existence of a wholesale agreement is a jurisdictional trigger, not a jurisdictional barrier.

Here, the controlling question is not whether a contract exists, but whether the wholesale rate is one Kentucky law assigns to Commission economic oversight. Because the rate is federally conditioned by the EPA's 201-grant proportional user-charge regime and enforcement of that economic compliance is left to state mechanisms, Kentucky's assignment of economic enforcement to the Commission brings this wholesale rate within the Commission's review. That federal-delegation point is absent from *Simpson County*, so it cannot be read to foreclose jurisdiction where an independent federal-state enforcement structure applies.

City of Greenup. This case establishes that the Commission can decide its own jurisdiction and that written wholesale contracts are relevant to jurisdictional analysis. The case is routinely cited for the narrow proposition that without a written wholesale agreement, Commission jurisdiction may not attach to a municipal supplier. But that is not the case.

Here, there is a written, long-standing wholesale arrangement specifically adopted to satisfy EPA 201-grant user-charge conditions and maintained for decades. Unlike *Greenup*, the dispute is not "do we have a contract?" but whether the contractual wholesale rate remains lawful under the federally required proportional-share standard and Kentucky's ratemaking duties. *Greenup* neither addressed nor rejected Commission oversight in that circumstance.

Mount Sterling (Case No. 95-193). This order is often paraphrased as "PSC does not regulate a municipal utility's provision of water or sewer service to another municipal utility." But its context matters. *Mount Sterling* applied the general municipal exemption in an ordinary city-to-city wholesale setting; it did not involve:

- an EPA 201 Grant whose conditions require a continuing proportional user-charge system,

- a federal court record holding that post-grant enforcement is left to state regulatory mechanisms, or
- a dispute over wholesale rate design, cost allocation, and cross-subsidy where the supplier refuses to disclose cost-of-service calculations.

In other words, *Mount Sterling* addressed a pure municipal-exemption scenario. This action is not that scenario. The wholesale rate here is not a discretionary municipal price because it is the federally compelled instrument for allocating actual treatment O&M costs proportionally among regional users. When a municipal rate is federally conditioned and state-enforced for economic compliance, the jurisdictional analysis changes. *Mount Sterling* simply did not consider that federal-state enforcement overlay.

Moreover, *Mount Sterling* predates much of the Commission's modern municipal-wholesale jurisprudence following *Simpson County*. The Supreme Court's holding that Commission jurisdiction can extend to municipal wholesale contracts under KRS 278.200, even when rates are contract-based, necessarily limits any earlier, categorical view that municipal wholesale rates are per se beyond Commission review. At a minimum, the Commission must decide jurisdiction in light of the specific statutory and federal-delegation facts now before it, not by applying a generalized exemption case that did not confront those facts. At minimum, those distinctions require factual and legal development, which is a basis to deny dismissal now under the Commission's standard.

E. Any Informal Response is not a Final and Appealable Commission Action

Before filing its Application for Declaratory Order and Formal Complaint, Earlington attempted to resolve this dispute informally. Through its Mayor, Earlington sent a letter to the Commission describing the ongoing wholesale rate controversy. Madisonville submitted a contemporaneous response letter. A Commission staff member, writing on behalf of the Executive Director, issued an informal reply stating that staff believed the Commission lacked jurisdiction

based on the parties' correspondence. Madisonville now treats that staff reply as binding, arguing that "the PSC has specifically declined to exercise jurisdiction over this dispute." That argument is incorrect as a matter of Commission procedure and Kentucky administrative law.

First, the staff letter was not issued in a docketed case. At the time of that correspondence, no proceeding existed before the Commission: no case number had been assigned, no pleadings had been filed under 807 KAR 5:001, no discovery had occurred, no hearings had been scheduled, and no evidentiary record had been developed. Without a docketed case and record, the Commission could not have reached any final findings of fact or conclusions of law—either on jurisdiction or on the legality of the rate itself. In short, the matter was never before the Commission for decision.

Second, only the Commission—not staff—may render jurisdictional determinations or rate decisions. The Commission's authority is exercised through its orders entered in a case, not through staff correspondence. See KRS 278.040. Kentucky courts have long held that informal letters do not constitute Commission orders and carry no binding or appealable effect. *Bee's Old Reliable Shows, Inc. v. Ky. Power Co.*, 334 S.W.2d 765, 766 (Ky. 1960) (a letter is not an order and provides no basis for appeal). Likewise, the Commission is not bound by staff positions or stipulations; it must make its own independent jurisdictional and merits determinations on a developed record. *Ky. Am. Water Co. v. Commonwealth*, 847 S.W.2d 737, 740 (Ky. 1993).

Third, a final Commission action must take the form of an order entered in a proceeding, which is then subject to judicial review in Franklin Circuit Court. See KRS 278.390; 807 KAR 5:001 § 5(1). Because the staff letter was not an order, it is not final, not appealable, and cannot have a preclusive effect. It represents, at most, a preliminary administrative view based on incomplete information and an undeveloped record provided outside any formal case.

Finally, this dispute is now properly before the Commission since originally confirming jurisdiction in 2001 after the Commission accepted the change rate and contract from Madisonville in C62-0009. A copy of this acceptance is attached as **Exhibit C**. The Commission, therefore, retains full authority—and indeed the obligation—to affirm its jurisdiction and review the merits based on the pleadings and any record developed in this case. Madisonville's claim that the Commission has already "declined jurisdiction" is simply untrue.

Because Madisonville's preclusion argument depends on treating an informal staff letter as final agency action—something Kentucky law does not allow—it fails as a matter of law on the face of the pleadings, and cannot justify dismissal. For these reasons, that letter provides no basis for dismissal, and it cannot substitute for the Commission's own adjudication in this proceeding.

CONCLUSION

Under the Commission's motion-to-dismiss standard, the Motion must be denied. Earlington's Application and Formal Complaint plead a federally conditioned wholesale user-charge dispute, monopoly circumstances requiring economic oversight, ratemaking-methodology defects within the Commission's expertise, and the absence of any final Commission order declining jurisdiction. Accepting those allegations as true—as the Commission must at this stage—Earlington has stated a prima facie claim within the Commission's authority, and Madisonville has not shown a clear jurisdictional bar as a matter of law.

If the Commission determines that additional factual development is necessary to resolve jurisdiction or the merits, that determination itself confirms dismissal is inappropriate now; the proper course is to proceed with record development and, if needed, set this matter for an evidentiary hearing.

WHEREFORE, for the foregoing reasons, the Motion to Dismiss should be denied.

RESPECTFULLY SUBMITTED this 8th day of December, 2025.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that the above Response to Motion to Dismiss has been electronically filed with the Public Service Commission, and/or a true and accurate copy of the same has been delivered via United States Mail, postage paid, transmitted via facsimile, or via email, this 8th of December, 2025, to the following:

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