STATE OF KANSAS

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Curt T. Schneider
Attorney General

April 6, 1976

ATTORNEY GENERAL OPINION NO. 76- 124

David J. Waxse
City Attorney
City of DeSoto, Kansas
c/o PAYNE & JONES
Law Offices
P. O. Box 151
Olathe, Kansas 66061

RE: Municipal Corporations--Municipally Owned Utilities--Rate-Making Process

Synopsis: The governing body of the City of DeSoto, Kansas, may in the operation of its municipal utility, legally contribute the electrical energy needed for municipal purposes and thereafter consider the costs of such contribution as one factor in their rate-making process.

* * *

Dear Mr. Waxse:

You have requested my opinion as to whether the City of DeSoto, Kansas, is legally correct in the operation of its municipal electric utility whereby the City contributes the electrical energy needed for municipal purposes and consider the costs of such contribution in the rate-making process.

More accurately, the City of DeSoto, Kansas, pursuant to Article 8 of Chapter 12 of the Kansas Statutes Annotated, owns an electrical

distribution system within the City of DeSoto, Kansas. Pursuant to contract, the Kansas Power & Light Company sells electrical energy to the City of DeSoto for the City's resale to its inhabitants. The rates that the City pays Kansas Power & Light are set by the State Corporation Commission of Kansas and are presently set out in rate schedule WSM-75.

The law is very clear that municipalities have full rights of control over municipally owned public utilities. Such public utilities are specifically excluded from control of the State Corporation Commission by K.S.A. (1975 Supp.) 66-104 which states:

> " . . . The term 'public utility' shall also include that portion of every municipally owned or operated electric or gas utility located outside of and more than three (3) miles from the corporate limits of such municipality, but nothing in this act shall apply to a municipally owned or operated utility, or portion thereof, located within the corporate limits of such municipality or located outside of such corporate limits but within three (3) miles thereof. [Emphasis added.]

K.S.A. (1975 Supp.) 12-808 further provides as follows:

> "Subject to the provisions of K.S.A. 66-104 and 66-131, as amended, any city operating waterworks, fuel, power or lighting plant may sell and dispose of water, fuel, power or light to any person within or without said city."

Where a municipality owns its own electric distribution services, it has a right to charge customers who make use of the services just as does a privately operated public utility. The fixing of rates for such services supplied by municipality-owned utility is a legislative act. See, 12 McQuillan's Municipal Corporations § 35.37 and Holton Creamery Co. v. Brown, 137 Kan. 418, 20 P.2d 503 (1933).

The Kansas Supreme Court further stated in Holton Creamery Co. v. Brown, supra, that the rates charged must be reasonable. The same is stated in 12 McQuillan's Mun. Corp. § 35.37(a) where it goes on to state:

> " . . . reasonable discretion must abide in the officers whose duty it is to fix rates. Their determination should not be disturbed if there is any reasonable basis therefor or unless it is proved that the rates are excessive and the actions of the rate fixing officers illegal and arbitrary. It will be presumed in the absence of any showing to the contrary that the municipality acted properly. A rate lawfully established is assumed to be reasonable in the absence of any showing to the contrary, or a showing or mismanagement, fraud, or bad faith, or that the rate is capricious, arbitrary, or unreasonable. Each case must be decided on its own facts. The burden of proof is on the party claiming unreasonableness or discrimination."

To understand what is involved in the rate setting process used by the City of DeSoto, it is essential that there be a complete understanding of the present electrical distribution system. The system itself, consisting of transmission lines and poles, transformers, meters, and the accessories thereto, has been purchased by the City through the use of revenue bonds issued at various times over the past thirty years. The present electrical distribution system and water system are considered as one unit for the purposes of revenue bonds issued on the system. At the present time, it is estimated that the present value of the system is approximately one-quarter million dollars. There are presently outstanding approximately $143,000.00 in revenue bonds which are paid from the revenues from the electrical distribution system and the water system. The greater part of the income from the two systems comes from the electrical system. The previously described bonds are subject to the conditions set out in K.S.A. 10-1208 which provides as follows:

> "Provision shall be made by appropriate enactment by the governing body or other proper officers having the control and management of the utilities of said bonds by fixing rates, fees, or charges for the use of or services rendered by such utility, which rates, fees, or charges shall be sufficient to pay the cost of operation, improvement and maintenance of the utility, provide an adequate depreciation fund, and pay the principal of the interest upon said bonds when due . . . "

Thus, in establishing electrical rates for the City of DeSoto, I am informed that the costs in the following general categories are considered by the Governing Body:

1. Cost of electrical energy purchased from Kansas Power & Light.
2. Operating costs including salaries and fringe benefits.
3. Maintenance costs, including purchase of equipment and materials.
4. Depreciation costs sufficient to cover additions and replacements to the system.
5. Amortization costs sufficient to cover the principal and interest payments on the outstanding bonds and indebtedness.
6. A reasonable return on the City's capital investment in the system.

Included within the operating costs are the cost of electrical energy lost in transmission within the system and the costs of the electrical energy contributed for municipal use in the street lighting systems and other municipal purposes.

Once all of these costs are determined, a rate must be established which, when applied to the actual amount of electrical energy sold to customers, will provide an amount sufficient to cover the costs in question as is required by statute. As the electrical distribution system was developed in the City of DeSoto, the Governing Body has always taken the position that it will contribute the cost of any municipal use and, therefore, no meters have ever been installed on the various municipal users of electrical energy. It is estimated at the present time to install such meters would have cost approximately $15,000.00.

Customers of the electrical distribution system operated by the City of DeSoto are billed only for the electrical use shown on the meters measuring their specific use. Such customers are not billed for the use of any electrical energy other than that used by them directly. I am told that they do not pay in full or share the cost of electrical service furnished another user.

The question, thus, remains whether the City in the exercise of its legislative power as a rate-making body can use as one factor in establishing such rates the contribution of electrical energy for municipal purposes. According to 12 McQuillan's Mun. Corp. § 35.37(g), it is clear that a municipality may furnish free services for municipal and charitable purposes. The cases dealing with this question have talked often in terms of whether or not it is discriminatory to provide free service. In New York Telephone Company v. Seagull Cooper Co., 96 NE 109 (N.Y. 1911), the Court held, "discriminations, however, in favor of the public are not opposed to public policy because they benefit the people generally by relieving them of part of their burdens." In City of Belfast v. Belfast Water Co., 98 At. 738 (Maine 1916), the Court held:

> " . . . free service to the public is not, at common law, unreasonably, and therefore unlawfully, discriminatory. The law against unreasonable discrimination rests on public policy. It is forbidden because it is opposed to the interest of the public, which requires that all should be treated alike under like circumstances. Discriminations, however, in favor of the public are not opposed to public policy, because they relieve the people generally of part of their burdens. In the absence of legislation upon the subject such discriminations cannot be held illegal as a matter of law without overturning the foundation upon which the rule itself is built." 98 At. at 742

In Fretz v. City of Edmond, 168 P. 800 (Olka. 1917), the Court held:

> "The contention that the city has the power in proper case it give from the resources of its public service plants to public institu-

> tions or public uses without unjustly discriminating against the rights of its inhabitants seems to be supported by reason, logic, and abstract justice. A fire originates within the borders of a city upon the property owned by some person who has never been a user of the city water. The fire is extinguished by water furnished by the city plant. Can it be said that the city is required to install a meter at some place upon the hose line in order to determine the number of thousand gallons for which the owner of the property must pay, or that by failing so to do and giving the water, not only for the benefit of the private individual, but the for benefit of the public, it unjustly discriminated against some person who has paid for all the water that he used? The statement of the proposition, of course, reveals its absurdity, and shows that the conduct of the city must be based, not upon discrimination which is not essentially unjust. The public lavatories, rest rooms, public fountains, and public parks maintained by cities, are all places where water is donated for the public good. So it must seem that water might be given for use in the city hall, or the city's public buildings."
> 168 P. at 803

See, also, Swank v. Village of Shilo, 143 NE 2d 586 (Ohio 1957).

Although there appear to be no cases directly on point in Kansas, there is an analogous situation found in Southwestern Bell Telephone Co. v. State Corporation Commission, 192 Kan. 39, 386 P.2d 515 (1963) where at page 73 the Court concluded that contributions " . . . are necessary if a company, firm or individual is to maintain its standing and goodwill in a community. Such expenditures should be allowed as a legitimate expense in any business." In another vein, there are numerous Kansas cases describing the kind of discretion to be given a city governing body in making legislative determinations.

See, Capitol Cable, Inc. v. City of Topeka, 209 Kan. 152, 495 P.2d 885 (1972), and Gaslight Villa, Inc. v. City of Lansing, 213 Kan. 862, 518 P.2d 410 (1974).

Accordingly, it is my opinion that the governing body of the City of DeSoto, Kansas, may, in the operation of its municipal utility, legally contribute the electrical energy needed for municipal purposes and thereafter consider the costs of such contribution as one factor in their rate-making process.

Sincerely yours,

Curt Schneider

CURT T. SCHNEIDER
Attorney General

CTS:HTW:bv