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September 25, 1979

ATTORNEY GENERAL OPINION NO. 79- 210

The Honorable James H. Guffey
State Representative, Fifth District
1120 West 5th
Chanute, Kansas 66720

Re: Cities--Utilities--Rates

Synopsis: Rates for municipally-owned utility services are not per se unreasonable merely because the revenues thus produced provide a surplus which is transferred to the general fund of the city for application to general municipal expenses.

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Dear Representative Guffey:

You have requested our opinion as to whether under the law of Kansas relating to municipally-owned utilities, a city may increase utility rates (you do not specify for which services) for the sole purpose of generating revenues which may be transferred to the general operating fund of the city.

K.S.A. 1978 Supp. 12-825d provides for the use of revenues generated by municipally-owned utilities, and states, in pertinent part:

> "Except as otherwise hereinafter provided, in any city of the first, second or third class owning a waterworks, fuel, power or lighting plant, the revenue derived from the sale and consumption of water, fuel, power or light shall not be paid out or disbursed except for the purpose of operating,

> renewing or extending the plant or distribution system from which such revenue was derived, the payment of interest on outstanding bonds issued for the construction, extension or purchase thereof, and the payment of the salaries of the employees . . . [A]t any time that there may be a surplus of such fund, it shall, if needed to redeem bonds, be quarterly placed in a sinking fund . . . . [W]hen any surplus of either the operating fund or sinking fund is not needed for any of the above stated purposes, said surpluses:
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> "(a) May be transferred and merged into the city general revenue fund or any other fund or funds of such city . . . ." (Emphasis added.)

K.S.A. 12-826 et seq. authorizes cities of the first and second class to set their own rates for the services provided by any municipally-owned utility. In Holton Creamery Co. v. Brown, 137 Kan. 418 (1933), the Court held, at syllabus para. 1, that:

> "The regulation and control of utility rates and services supplied by an electrical power . . . plant owned and operated by a municipality is vested in the city government, subject to judicial review of the reasonableness of the city ordinances pertaining thereto."

However, "the city cannot exact any rates it sees fit to impose. Such rates must be reasonable; and persons and corporations dependent on these utilities are entitled to judicial protection against excessive or confiscatory rates." 137 Kan. at 419. The Court also quoted with approval from 5 McQuillan, Municipal Corporations, 2d ed., 64, 65, as follows:

> "Where a municipality owns its water or light works, it is settled that it has the right to charge rents against consumers who make use of its service. However, the rates must be reasonable, although the municipality may charge a rate which will yield a fair profit, and need not furnish the supply or service at cost; and the same rules in regard to the reasonableness of rates apply as in case of the rates of private companies owning a public utility." (Emphasis added.)

Courts in other states have also concluded that cities may transfer revenues from municipal utilities to the general fund. In City of Niles v. Union Ice Corp., 133 Ohio St. 169, 12 N.E. 2d 483 (1938), the Court discussed the contention that surplus revenues from a city-owned electric utility should not be transferred to other city accounts:

> "This contention proceeds on the theory that a municipality has no right to charge for its utility service or product a rate in excess of cost, i.e., that it has no right to make a profit. Nevertheless, we are not referred to any statute or constitutional provision denying this right. In the absence of such prohibition, a municipality, no less than a private corporation engaged in the operation of a public utility, is entitled to a fair profit. In the operation of a public utility, a municipality acts, not in a governmental capacity as an arm or agency of the sovereignty of the state, but in a proprietary or business capacity . . . In its proprietary capacity it occupies the same 'posture' as that occupied by a private corporation engaged in business . . . .
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> . . . .
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> "So long as the rate is reasonable, the courts cannot prohibit a municipality from making a profit on the operation of its electric light and power system, in the absence of any restriction in the statute which enables it to operate such system." 12 N.E.2d at 488-489.

See also, San Antonio Indep. School Dist. v. City of San Antonio, 550 S.W.2d 262 (Tex. 1977); Apodaca v. Wilson, 86 N.M. 516, 525 P.2d 876 (1974), and Mitchell v. Mobile, 244 Ala. 442, 13 So.2d 664 (1943), for other cases approving the transfer of utility profits to the general fund of the municipality.

However, even if a city has the power to do so, the rates it imposes must still be reasonable, and not excessive or confiscatory. Holton Creamery Co., supra. As long as the rate is not "disproportionate to the service rendered," a municipal corporation may charge such utility rates as will yield a "fair profit," which, as noted above, may be transferred to the general fund. See Shawnee Hills Mobile Homes, Inc. v. Rural Water Dist., 217 Kan. 421, 537 P.2d 210 (1975), syl. para. 7. While your letter mentions that the present rates are now some thirty percent higher than the average for the area, you do not indicate how much of this is due to the increases designed to produce revenue. Additionally, courts will compare rates between communities only when substantially all of the physical and economic factors affecting the reasonableness of the rates are similar. See, Shawnee Hills Mobile Homes, Inc., supra; State, ex rel. v. Telephone Co., 115 Kan. 236 (1924), Petition of New England Telephone & Telegraph Co., 115 Vt. 494, 66 A.2d 135 (1949); Bd. of Public Utility Comm. v. Elizabethtown Water Co., 43 F.2d 478 (3rd Cir. 1930).

In conclusion, rates for municipally-owned utility services are not per se unreasonable merely because the revenues thus produced provide a surplus which is transferred to the general fund of the city for application to general municipal expenses. The question of whether the rates are excessive or confiscatory may be determined only by a court and only after a number of factors are examined, with comparisons with rates charged by other communities having limited value.

Very truly yours,

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RTS:BJS:JSS:gk