Supreme Court of Kentucky

Case No. 2013-SC-000122-D

COURT OF APPEALS CASE NO. 2011-CA-000121-MR
KENTON CIRCUIT COURT NO. 08-CI-02787

COPPAGE CONSTRUCTION COMPANY, INC. **APPELLANT**

v.

SANITATION DISTRICT NO. 1 AND
DCI PROPERTIES-DKY, LLC **APPELLEES**

REPLY BRIEF FOR APPELLANT COPPAGE CONSTRUCTION COMPANY

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CERTIFICATE OF SERVICE

It is hereby certified that a copy of the foregoing was mailed this 25th day of August, 2014, to J. Stephen Smith, Michael C. Surrey, Lynda H. Mathews, Graydon Head & Ritchey, LLP, 2400 Chamber Center Drive, Suite 300, Fort Mitchell, KY 41017; Jeffrey C. Mando, Jennifer H. Langen, Adams, Stepner, Woltermann & Dusing, PLLC, 40 W. Pike Street, Covington, KY 41012-0861, *Counsel for Appellee-Sanitation District No. 1;* Robert B. Craig, Taft Stettinius & Hollister LLP, 1717 Dixie Hwy, Suite 340, Covington, KY 41011-4704; Chad R. Ziepfel, Taft Stettinius & Hollister, LLP, 425 Walnut Street, Suite 1800, Cincinnati, OH 45202-3957, *Counsel for Appellee-DCI Properties-DKY-LLC;* Clerk, Kentucky Court of Appeals, 360 Democrat Drive, Frankfort, KY 40601; and to the Kenton Circuit Court Clerk, Justice Center, 230 Madison Avenue, Covington KY 41011.

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STATEMENT OF POINTS AND AUTHORITIES

SD1 is a consensually formed municipal corporation that performs a function which this Court has long held to be local and proprietary in nature. SD1 offers no basis for backtracking from this Court's long stated view that sanitary sewer service is ***not*** a function integral to state government. Nor does SD1 dispute that forming a sanitation district requires the petition and consent of affected landowners, and cannot be accomplished by the sovereign will of a county alone. Thus, SD1 satisfies neither prong of the test for sovereign immunity, and the Court of Appeals' opinion must be reversed.

I. SD1 does not perform a function integral to state government.

This Court has instructed that the "more important" prong of the sovereign immunity test is whether the entity performs a "function integral to state government," or instead "exercise[s] proprietary functions addressing purely local concerns."[1] No Kentucky precedent holds that sanitary sewer service is a "function integral to state government." To the contrary, this Court has repeatedly instructed that sanitary sewer districts do ***not*** perform a "function integral to state government," but rather "perform[] services similar to a private corporation," "carry out a limited public purpose in a local area,"[2] and are "proprietary in nature and not protected" by immunity.[3] The absence of a "function integral to state government" ends the inquiry without the need to even consider SD1's "parentage." "In between" entities like SD1 that are not themselves a county government enjoy sovereign immunity only if they ***both*** perform a function integral to state government ***and*** are the direct "offspring" of a clearly immune entity.[4]

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[1] *Comair, Inc. v. Lexington-Fayette Urban Cty. Airport Corp.*, 295 S.W.3d 91, 98-100 (Ky. 2009).
[2] *Calvert Inv., Inc. v. Louisville & Jefferson Cty. Metro. Sewer Dist.*, 805 S.W.2d 133, 135-38 (Ky. 1991).
[3] *Gas Serv. Co. v. City of London*, 687 S.W.2d 144, 147-48 (Ky. 1985).
[4] *Stanford v. United States*, 948 F. Supp. 2d 729, 736 (E.D. Ky. 2013); *Louisville Arena Auth. v. RAM Eng'g & Constr., Inc.*, 415 S.W.3d 671, 683 (Ky. App. 2013); *Transit Auth. of River City, v. Bibelhauser*, 432 S.W.3d 171, 174 (Ky. App. 2013) (holding TARC did not enjoy sovereign immunity because its function is proprietary, despite being the offspring of Louisville Metro Government).

This Court explained in *Comair* that "functions integral to state government" are functions that are ***not*** typically performed by private companies or municipal corporations. That is, "frequently ***only*** an arm of the state can exercise a truly integral governmental function (whereas municipal corporations tend to exercise proprietary functions addressing purely local concerns)."[5] SD1 does not dispute that sanitary sewer service is commonly provided by non-sovereign municipal corporations and private entities. The plaintiff in *Calvert* was a private sewer corporation, challenging MSD's right to serve its customers. Also, Chapter 220 expressly recognizes that the systems operated by a sanitation district are the same systems operated by cities in the absence of such a district.[6] When cities do provide sewer service, Kentucky law is clear that they enjoy no immunity.[7] It defies reason to suggest that a special district providing sewer service is protected by sovereign immunity when municipal governments providing the exact same services are not.

SD1's activities are unquestionably "local" and "proprietary," not "statewide" and "governmental," in nature. Like any public utility corporation, SD1 has a defined service area, and provides services for rates charged to customers.[8] Sewer services are even classified as "proprietary" by the Department of Local Government's accounting rules.[9]

Nothing in *Comair* overruled *Calvert's* express holding that sanitary sewer

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[5] *Comair*, 295 S.W.3d at 99-100 (emphasis added).
[6] KRS 220.135.
[7] *City of Frankfort v. Byrns*, 817 S.W.2d 462 (Ky. App. 1991); *Louisville & Jefferson Cty. Metro. Sewer Dist. v. Kirk*, 390 S.W.2d 182, 185 (Ky. 1965).
[8] *See Calvert*, 805 S.W.2d at 136. *Accord Bostic Packaging, Inc. v. City of Monroe*, 562 S.E.2d 75, 78 (N.C. Ct. App. 2002) ("[O]peration of the defendant's sewer system, for which it charged rates, was a proprietary function.").
[9] KENTUCKY CITIES FINANCIAL MANUAL at 3 ("Proprietary funds include the resources and operations of governmental services that are similar to the commercial sector. For instance, water, gas and sewer utility funds are proprietary.") (http://kydlgweb.ky.gov/Documents/Cities/CitiesFinancialManualpdfonline.pdf). *Accord* KRS 45.305(5).

service is not a "function integral to state government."[10] *Comair* rejected the prior sovereign immunity test insofar as it focused exclusively on state government control and recovery from the state treasury. *Comair* did not question *Calvert's* analysis of whether sewer service is a function integral to state government. To the contrary, *Comair* noted that *Calvert* properly applied the essential state function inquiry.[11] *Comair* also approved the portion of *Berns* that endorsed the functional analysis in *Gas Service Co.* – a decision that offered sewer service as the exemplar of a non-immune "proprietary" function.[12]

SD1's attempt to analogize its "web of pipes" to the state's *transportation* infrastructure is equally off base.[13] SD1's pipes are no more analogous to transportation infrastructure than electrical or telephone lines, water mains, or natural gas pipelines.

Equally unavailing is SD1's reliance on several, mostly unpublished, Court of Appeals decisions finding such activities as nursing home care and local land use planning to be "essential state functions." Those decisions are not binding on this Court. They are also easily distinguished.[14] Also, none of the decisions questions this Court's repeated characterization of sewer service specifically as "local" and "proprietary."

SD1's reliance on the state's interest in protecting water quality similarly does not show sanitary sewer service is an essential state function. The statutory statement of

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[10] *Calvert,* 805 S.W.2d at 136.
[11] *Comair*, 295 S.W.3d at 98.
[12] *Comair*, 295 S.W.3d at 97 (citing *Gas Serv.,* 687 S.W.2d 144).
[13] (Appellees' Br. at 17.)
[14] *Northern Kentucky Area Planning Commission v. Cloyd* relied on the fact that the Commission's function was to advise and assist in the legislative process, which would be subject to immunity regardless of its status as a municipal corporation, "because even cities have immunity in performing legislative or quasi-legislative functions." 332 S.W.3d 91, 95-96 (Ky. App. 2010). In *Metcalf County Nursing Home Corporation v. Roberts*, it was questionable whether the nursing home corporation was even truly separate from the county government itself, insofar as "its Board of Directors is the Metcalf County Fiscal Court and County Judge Executive." 2013 WL 1919542, at *3 (Ky. App. May 10, 2013). *Fryman v. Fleming County Hospital* relied heavily on the fact that county hospitals had been treated as immune from suit under Kentucky law for more than seven decades without any contrary action from the legislature. 2010 WL 1508187, at *2 (Ky. App. April 16, 2010). The same is not true of sanitary sewer districts.

legislative purpose on which SD1 relies, KRS 224.70-100, is from Chapter 224's provisions concerning the state Energy and Environment Cabinet's authority to regulate discharges into state waterways, ***not*** from Chapter 220's provisions concerning sanitary sewer districts. Nothing in Chapter 224's water quality provisions delegates any regulatory authority to sanitary sewer districts, or even specifically mentions Chapter 220 sanitation districts. Sanitation districts are ***subject to*** state and federal regulation because they discharge pollutants of concern into the waterways, just like any public or private enterprise that generates wastewaters, including municipal and private sewer utilities. The fact that SD1 must ***comply*** with environmental regulations does not mean SD1 is ***performing*** the state's environmental regulatory function.

II. SD1 is a consensually formed municipal corporation.

This Court in *Comair* observed that the key distinction between non-sovereign municipal corporations and sovereign entities was that "[m]unicipal corporations proper are called into existence either at the direct solicitation or by the free consent of the persons composing them," whereas sovereign entities are "created by the sovereign power of the state, of its own sovereign will, ***without the particular solicitation, consent or concurrent action of the people who inhabit them.***"[15] An entity is sovereign if it is "***superimposed by a sovereign and paramount authority,***" rather than "asked for, or at least assented to, by the people it embraces."[16] An entity that requires popular consent to come into existence cannot be considered "sovereign"; and only a "sovereign" entity can possess sovereign immunity, which is an attribute of sovereignty itself.[17]

It is undisputed that Chapter 220 sanitation districts cannot be formed "without

[15] *Comair*, 295 S.W.3d at 100 (internal quotation and citation omitted) (emphasis added).
[16] *Id.* (internal quotation and citation omitted) (emphasis added).
[17] *Comair*, 295 S.W.3d at 94-95

the particular solicitation, consent or concurrent action of the people who inhabit them."[18] Both now and at the time of SD1's formation, a sanitation district can only be formed upon a petition showing the consent of a supermajority of residents within the proposed district.[19] A county government is incapable of bringing a sanitation district into existence of its own sovereign will, without such consent. This fact distinguishes SD1 from the air board in *Comair*, which did not require popular consent for its formation.[20]

SD1 places great emphasis on the role of the county in formation of a sanitation district under the historical statutes in force at the time of SD1's formation. But those statutes support Coppage's position, not SD1's. The 1940 Acts imposed an even stricter petition and consent requirement than the modern statute, requiring signatures of ***90%*** of landowners to form a sanitation district,[21] as opposed to the current 60% requirement. The county's role in the petition process was limited to the requirement that the county *Board of Health*[22] – not the fiscal court – certify the propriety and necessity of the petition after a majority of landowners had signed.[23] No action of the county fiscal court was required. What is important is what a county government could ***not*** do (and still cannot do): bring a sanitation district into existence without a petition. Indeed, incorporated municipalities had (and continue to have) far greater authority in this regard than counties, insofar as a municipality could (and still can) satisfy the approval requirement for landowners within its boundaries simply by passing an ordinance,

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[18] *Comair*, 295 S.W.3d at 100 (internal quotation and citation omitted).
[19] KRS 220.040(1)-(2); 1940 Ky. Acts, Ch. 148, §4 (attached as Exh A).
[20] KRS 183.132(1) (county may establish air board by legislative fiat).
[21] 1940 Ky. Acts, Ch. 148, §§4, 8, 9 (attached as Exh A).
[22] Notably, this Court has long held that Boards of Health are themselves municipal corporations that are not entitled to sovereign immunity. *Calvert*, 805 S.W.2d at 138 ("[T]he Board of Health classif[ies] as [a] municipal corporation[] liable for [its] torts..."); *Stephenson v. Louisville & Jefferson County Bd. of Health*, 389 S.W.2d 637, 638 (Ky. 1965) ("***It seems clear that the Board of Health is a municipal corporation.... and consequently cannot claim governmental immunity***.") (emphasis added).
[23] 1940 Ky. Acts, Ch. 148, §4.

without the need to obtain signatures.[24]

Contrary to SD1's argument, the minimal role played by counties in SD1's formation does ***not*** set it apart from the thousands of other special services districts in Kentucky. SD1 ignores the fact that the ***default*** statutory mechanism for creating taxing and non-taxing special districts in the absence of a specific statutory procedure is a petition process very similar to the one prescribed in Chapter 220.[25] In fact, that statutory default procedure gives significantly ***greater*** authority to counties than does Chapter 220, insofar as the default procedure provides for a hearing before the fiscal court once the petition requirement is met, and gives the fiscal court authority to approve or disapprove the formation of the district based on its findings.[26] Under Chapter 220, once the petition requirement is met, any dispute over the propriety of establishing a sanitation district is decided by the circuit court, not the fiscal court.[27]

Thus, while SD1 claims some special districts may be formed without county involvement, these are narrow exceptions to the general rule. Moreover, two of the examples cited by SD1 in fact use the statutory default procedures for formation, which provide greater authority to counties than Chapter 220.[28] Also, most of SD1's examples can be formed by either a city or a county, so districts of these types, if formed by a county, have no less (and likely more) county involvement in their formation than SD1.[29]

Also, while SD1 emphasizes fiscal courts' powers to ***dissolve*** a sanitation district under KRS 220.115, SD1 neglects to mention that a fiscal court may only dissolve a

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[24] *Id.*; KRS 220.040(2).
[25] KRS 65.182; KRS 65.810.
[26] KRS 65.182(6); KRS 65.810(6).
[27] KRS 220.100. *See also* 1940 Ky. Acts, Ch. 148, §§ 10-11.
[28] KRS 75.010 (fire protection district); KRS 216.317-.320 (hospital district).
[29] *See* KRS 65.520(1) (riverport authority); KRS 96A.020(1) (transit authority); KRS 108.100(1) (ambulance district); KRS 154.50-316(1) (industrial development authority); KRS 183.132 (air board).

district under that statute if it has failed to provide service for two years or if its services are being provided by some other entity. SD1 also fails to mention that a Chapter 220 sanitation district can ***also*** be dissolved by a majority vote in a referendum ***without the concurrence of any fiscal court.***[30] An entity that can be "destroyed" by popular vote, without county government concurrence, cannot be considered "sovereign."

Equally unavailing is SD1's emphasis on counties' authority to appoint directors to sanitation district boards. This Court in *Phelps* emphatically stated that a governmental entity's power to appoint board members of a public utility does not make the utility an "agent" or extension of the appointing government.[31] While *Comair* considered appointment of directors as one factor in its origin inquiry, it did not rely on appointment authority as a decisive factor. Instead, *Comair* emphasized that "the most control" granted to LFUCG stemmed from KRS 183.133(6), which gave LFUCG the authority to ***directly prescribe*** regulations to the same extent as the board itself.[32] There is no analogous provision in Chapter 220.

Similarly, although SD1 points to fiscal courts' oversight and approval powers for certain expenditures and acquisitions of a sanitation district under Chapter 220, Kentucky courts have specifically held that these limited oversight powers do not give county governments effective control over sanitation districts.[33]

Indeed, if county governments did exercise true control over sanitation district activities, it would create serious constitutional questions about whether sanitation districts are truly "independent" from county governments for purposes of statutory and

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[30] KRS 65.164; KRS 65.170; KRS 65.172.
[31] *Phelps v. Louisville Water Co.*, 103 S.W.3d 46, 50-51 (Ky. 2003). *See also Kea-Ham Contracting, Inc. v. Floyd County Dev. Auth.*, 37 S.W.3d 703 (Ky. 2000).
[32] Comair, 295 S.W.3d at 100.
[33] *Sanitation Dist. No. 1 of Shelby County v. Shelby County*, 964 S.W.2d 434, 437 (Ky. App. 1998).

constitutional debt limitations, such as KY. CONST. §157. For example, "control by fiscal court of land acquisitions and capital expenditures of separate taxing districts would in effect strike down the autonomy of separate taxing districts as envisioned by §157...."[34]

In light of the foregoing, it should come as no surprise that Kentucky courts have repeatedly recognized that sanitation districts are properly classified as "municipal corporations."[35] Similarly, KRS 220.380(2) directs that sanitation districts are subject to procedures governing "incorporated municipalities" for issuing bonds. *Comair* plainly instructs that "municipal corporations" like SD1 have no sovereign immunity.[36]

III. SD1 has no immunity from contract claims.

Finally, even assuming *arguendo* that SD1 were entitled to some form of governmental immunity from Coppage's tort claims as an indirect agency of a county (which it is not), that immunity still would not extend to Coppage's contract claims. SD1 overstates the immunity afforded to agencies only indirectly affiliated with county governments, and also mischaracterizes Coppage's contract claims.

First, SD1's attempt to distinguish between express and implied contract claims is based on limitations applicable to the Commonwealth's contract liability set forth in KRS 45A.245 and the caselaw interpreting it. But even SD1 acknowledges (in a footnote) that KRS 45A.245 does not apply to counties, only claims against the Commonwealth itself.[37] County governments' liability for contract claims is based on a common-law limitation to

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[34] Ky. OAG 77-433 (July 20, 1977). *See also Lowery v. Jefferson Cty.*, 458 S.W.2d 168, 173 (Ky. 1970).
[35] *City of Covington v. Sanitation Dist. No. 1 of Campbell & Kenton Counties*, 301 S.W.2d 885, 886 (Ky. 1957) (noting SD1 was established "***as a separate municipal corporation***") (emphasis added); *Louisville/Jefferson County Metro Ethics Comm'n v. Schardein*, 259 S.W.3d 510, 512 (Ky. App. 2008) ("[A] ***sanitation district*** 'is a political subdivision, or ***municipal corporation*** .... ' pursuant to KRS Chapter 220....") (quotation omitted) (emphasis added); *Sanitation Dist. No. 1 of Shelby County v. Shelby County*, 964 S.W.2d 434 437-38 (Ky. App. 1998) (Chapter 220 was example of the Legislature's "plenary powers in respect to the establishment and regulation of the government of ***municipalities***....") (emphasis added).
[36] 295 S.W.3d at 97-98.
[37] (Appellees' Br. at 22 n.5.)

county immunity, not on a statutory waiver like KRS 45A.245.[38] SD1 cites no cases holding that the common-law limitation is as narrow as KRS 45A.245.

Second, even if county governments enjoy the same immunity in contract as the Commonwealth, SD1 is not a county government. It is – at best – indirectly affiliated with a county government. The immunity afforded such entities – sometimes called "governmental immunity" – has been described as an immunity from "tort claims;" and is not co-extensive with the immunity of county governments themselves.[39]

Third, even if the limitations prescribed by KRS 45A.245 applied in this case, SD1 ignores the fact that Coppage's claims ***do*** seek payment of a sum certain owing for performance of express written contracts – the Coppage Contract and the SD1 Contract, which expressly incorporates the Coppage proposal.[40] SD1's arguments that Coppage is not a proper third-party beneficiary under the SD1 contract, or that SD1 did not assume any obligations under the Coppage Contract by novation or joint enterprise, are attacks on the merits of Coppage's claims, not arguments about SD1's immunity. These issues have not been adjudicated by the circuit court and are not yet ripe for review. They are precisely the kind of arguments that the *Illinois Central* court declined to consider as "not yet ripe" in an appeal concerning the scope of sovereign immunity.[41]

SD1's cited authorities are all inapposite. *Ammerman* involved claims against a school board, not a local services district, and the "contract" claims were really alleged statutory violations mischaracterized as implied "contract" claims.[42] In *Aubrey*, the court did not find the claims barred by sovereign immunity, but rather found on the merits that

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[38] *Illinois Cent. Gulf R. Co. v. Graves Cty. Fiscal Court*, 676 S.W.2d 470 (Ky. App. 1984).
[39] *Yanero v. Davis*, 65 S.W.3d 510, 526-27 (Ky. 2001).
[40] R. 957-1002, Coppage Third Am. Countercl. and Third Party Compl., ¶¶ 22-23 & Exhibit A.
[41] 676 S.W.2d at 472.
[42] *Ammerman v. Bd. of Educ. of Nicholas Cty.*, 30 S.W.3d 793, 797 (Ky. 2000).

the relevant documents did not "contain all the elements of a contract."[43] *Trace Creek* is unpublished, involved a claim brought directly against a fiscal court, and relied on the fact that the contract was uncertain as to the county's liability for overages.[44] Here, Coppage seeks recovery of the amount promised for performance, not merely overages, and its contractual right to delay damages is expressly protected by the Kentucky Fairness in Construction Act.[45] The *Blankenship* opinion SD1 cites was ***vacated*** by this Court, and the Court of Appeals on remand held the claims ***were not*** barred by sovereign immunity.[46] *Foley* and *Martin* involved claims against the Department of Highways and the University of Louisville, and thus address the scope of the ***Commonwealth's*** immunity, not that of special services districts.[47] Thus, no Kentucky precedent supports SD1's claim to immunity from Coppage's contract claims.

CONCLUSION

SD1 does not perform a function essential to state government, and is not the offspring or alter ego of a clearly immune entity. Thus, it has no immunity from tort or contract claims. Even if it did enjoy some form of governmental immunity, moreover, that immunity would not extend to Coppage's contract claims. The Court of Appeals' opinion, which affirmed the Circuit Court's summary judgment order dismissing all of Coppage's claims on sovereign immunity grounds, should be **REVERSED**.

Counsel for Appellant, Coppage Construction Company, Inc.

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[43] *St. Matthews Fire Prot. Dist. v. Aubrey*, 304 S.W.3d 56, 61 (Ky. App. 2009).
[44] *Trace Creek Constr., Inc. v. Harlan Cty. Fiscal Ct.*, 2008 WL 1991647, at *4 (Ky. App. May 9, 2008).
[45] KRS 371.405(2)(c).
[46] *Blankenship v. LFUCG*, 2012 WL 1557381, at *3 (Ky. App. May 4, 2012), *motion for discretionary review pending*, Case No. 2012-SC-443 (unpublished, attached as Exh. B).
[47] *Foley Constr. v. Ward*, 375 S.W.2d 392 (Ky. 1963); *Univ. of Louisville v. Martin*, 574 S.W.2d 676 (Ky. App. 1978).