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CONTRACT LIABILITY OF WATER COMPANIES TO CITIZENS IN KENTUCKY

It is generally recognized that a third party may maintain an action on a contract made for his benefit. This applies only to cases where the contract is made with the intent of conferring a benefit on the third party. The fact that one may receive a benefit from the performance of the contract is not alone sufficient to give him a right on the contract. Under various situations it is frequently difficult to determine whether a third person who will benefit by the performance of a contract is an intended beneficiary¹ or merely an incidental beneficiary having no right thereon. This is especially true in regard to contracts between municipalities and public utilities. The performance of these contracts by the utilities in furnishing light, power, water, and facilities for communication and transportation at the rates and according to certain standards prescribed in the contracts are certainly beneficial to the citizens of the municipality, but whether the citizens, as individuals, have rights under the contract and may recover for the breach thereof depends upon whether there was an intent by the parties that citizens should be directly benefited.

The real question to be asked is whether the city counsel when making the contract stipulated that there should be a certain water pressure in order to protect the public buildings only or whether they intend that the citizen living on the highest hill in town should have adequate pressure at all times. The majority of the jurisdictions have held the former to be the intent and have denied citizens recovery on the ground that they were incidentally benefited.² Kentucky in *Paducah Lumber Company v. Paducah Water Supply Company*³ held that the citizen was the intended beneficiary. In this case the water company, acting under a franchise, undertook to supply water to the citizens of the city of Paducah. The court in holding the defendant liable said:

"It seems, if the contract before us is not to be treated as meaningless and totally ineffectual for every purpose, the parties to it must be regarded as having contemplated and assented to the consequences of non-performance, and consequently appellee [water company] is liable in this case for such damages as its

¹ 2 WILLISTON, CONTRACTS (rev. ed. 1936) sec. 356.

² RESTATEMENT, CONTRACTS (1932) sec. 147; 2 WILLISTON, CONTRACTS (rev. ed 1936) secs. 402, 403.

³ *Cole v. Arizona Edison Co.*, 53 Ariz. 141, 86 P 2d 946 (1939), *Prindle v. Sharon Water Co.*, 105 Conn. 151, 134 Atl. 807 (1926); *Consolidated Biscuit Co. v. Illinois Iowa Power Co.*, 303 Ill. App. 80, 24 N.E. 2d 582 (1939).

⁴ 89 Ky. 340, 12 S. W 554 (1889).

failure or refusal to perform may have caused to appellant."⁵

The court here assumed that the citizens were the intended beneficiaries of the contract made by the city and that the privity of the parties was an outgrowth of the agreement which, in effect, was made with the citizens individually through their central medium, the officials of the town.⁶ This case has been summarily dismissed by the majority of the courts, either with the statement that it is the minority view and does not apply,⁷ or that there was a private contract between the water company and the lumber company, and hence was decided on this ground.⁸ The first reason results in a curt dismissal of the case without challenging the merits of the Kentucky analysis of the problem; the second is a misnomer, as the court explicitly stated that even if there had been no private contract involved, the case would have rested on the contract between the city and the water company and have been decided the same way

The view and the reasoning propounded by the Kentucky court have been adopted *in toto* by the courts of North Carolina⁹ and Florida.¹⁰

The majority of the courts refusing to allow the citizen to recover, have based their denial upon either or both of the following grounds: (1) that there is lack of privity¹¹ and (2) that it was not the intention of the water company to become an indemnifier in case of harm to an individual citizen.¹²

⁵ 89 Ky. 340, 352, 12 S. W. 554, 557 (1889)

⁶ *Clay v. Catlettsburg, Kenova & Ceredo Water Co.*, 301 Ky. 456, 192 S. W. 2d 385 (1946), *Kentucky Utilities Co. v. Farmer's Co-Op. Stock Yards Co.*, 246 Ky. 40, 54 S. W. 2d 364 (1932), *Harlan Water Co. v. Carter*, 220 Ky. 493, 295 S. W. 426 (1927), *Mountain Water Co. v. Davis*, 195 Ky. 193, 241 S. W. 801 (1922), *Tobin v. Frankfort Water Co.*, 158 Ky. 348, 164 S. W. 956 (1914); *Kenton Water Co. v. Glenn*, 141 Ky. 529, 133 S. W. 573 (1911); *Georgetown Water, Gas, Electric & Power Co. v. Neale*, 137 Ky. 197, 125 S. W. 293 (1910); *Lexington Hydraulic & Manufacturing Co. v. Oots*, 119 Ky. 598, 84 S. W. 774 (1905); *Graves County Water Co. v. Ligon*, 112 Ky. 775, 66 S. W. 725 (1902).

⁷ *Town of Ukiah City v. Ukiah Water & Improvement Co.*, 142 Cal. 173, 75 Pac. 773 (1904).

⁸ *Mott v. Cherryvale Water & Manuf'g. Co.*, 48 Kan. 12, 28 Pac. 989 (1892); *Hone v. Presque Isle Water Co.*, 104 Me. 217, 71 Atl. 769 (1908).

⁹ *Gorell v. Greensboro Water Supply Co.*, 124 N. C. 328, 32 S. E. 720 (1899)

¹⁰ *Mugge v. Tampa Waterworks Co.*, 52 Fla. 371, 42 So. 81 (1906).

¹¹ *Ellis v. Birmingham Waterworks Co.*, 187 Ala. 552, 65 So. 805 (1914); *Blunk v. Dennison Water Supply Co.*, 71 Ohio St. 250, 73 N. E. 210 (1905).

¹² *H. R. Moch Co., Inc. v. Rensselaer Water Co.*, 247 N. Y. 160, 159 N. E. 896 (1928).

The key note case stressing lack of privity, and holding against the citizen, seems to be that of *Nickerson v. Bridgeport Hydraulic Company*.¹³ In this case, the plaintiff's property was destroyed by a fire which could have been extinguished if the pressure stipulated in the franchise had been available. The court held that the property owner was a stranger to the agreement with the municipality, and therefore could not maintain an action against the company for a breach of contract. It is interesting to note that this case, which has been quoted extensively as authority, was decided during the early growth of the rights of enforcement by third party beneficiaries and at the time of the decision no third party beneficiary could enforce an agreement in Connecticut.¹⁴ Furthermore, the court found the pleading insufficient to prove any contract with the city much less one with the plaintiff, and it was primarily on this ground that the case was dismissed.

The federal rule appears to be in accord with the majority. However, the case most extensively quoted as authority is that of *German Alliance Insurance Company v. Home Water Supply Company*¹⁵ which involved the subrogation rights of an insurance company for damage done to one of its policy holder's property by the water company's failure. The court held no liability but the same result would have been reached by the Kentucky court.

In *William Burford & Company v. Glasgow Water Company*,¹⁶ the insurer had paid claims for destruction by fire when the defendant company failed to furnish the pressure agreed upon. The court in denying recovery said:

"The water company is entitled to live and to make a fair return on the investment. To meet the increased liability, higher water rates will be necessary. The added burden will fall on the consumers. The result will be that the citizen and property owners will not only pay for fire protection premiums sufficient to cover the risk assumed, but will also pay higher water rates for the purpose of relieving the insurance companies of the liability which they have been paid to assume."¹⁷

The Kentucky court here has put forward perhaps the best argument in favor of the water company's position. It points out that by allowing the insurance company to recover it would throw the eventual cost upon the individual consumer. This reasoning is equally valid when applied to the property owner for whenever the water company pays a loss it is a deduction of their rate of profit and if a number of such deductions are made, the water rate must

¹³ 46 Conn. 24, 33 Am. Rep. 1 (1878)

¹⁴ Corbin, *Contracts for the Benefit of Third Parties in Connecticut* (1922) 31 YALE L. J. 489.

¹⁵ 226 U. S. 220, 57 L. Ed. 195, 33 Sup. Ct. 32 (1912).

¹⁶ 223 Ky. 54, 2 S. W 2d 1027 (1928).

¹⁷ *Id.* at 57-58, 2 S. W 2d at 1029.

advance to assure the water companies a fair return on their investment. This would place the loss upon the public. However, in view of the nominal cost to the citizen and the benefit to be derived, it is to be questioned if this would not be the most advantageous arrangement that the citizen could make in protecting himself against the water company's failure. The citizen in return for a few cents increase in his water bill each month would be indemnified if his property were destroyed as a result of the water company's failure to perform.

Perhaps the clearest discussion of the majority rule is that of Judge Cardozo in the case of *H. R. Moch Company, Inc. v. Rensselaer Water Company*,¹⁸ where the problem of both contract and tort liability was presented. In this case the defendant water company had contracted with the city of Rensselaer for the supply of water for a term of years. Due to the lack of water pressure, flames which started on an adjoining building spread to the plaintiff's building and destroyed it. The court held that the members of the public are not entitled to maintain an action against a water company which has contracted with a city to furnish water at hydrants for damage resulting from a fire due to the water company's failure to supply sufficient pressure, as no intention appeared in the water company's contract that it should be answerable to individual citizens for losses ensuing from a failure to fulfill its promise.¹⁹ The court here discussed both privity of the parties and the intention as expressed by the contract and decided that both were lacking. The main objection raised however, was that if recovery were allowed here, the door would be left open for all types of suits where a party had contracted to furnish services and a third party would be benefited. It seems that the last objection raised is more of a justification of the conclusion reached than an analysis of the means used.

Although the courts have denied recovery for the destruction of property they have been more lenient when the matter of water for the household is concerned. They have held that the water companies are bound by the agreement if they do not furnish pure

¹⁸ 247 N. Y. 160, 159 N. E. 896 (1928).

¹⁹ *Ellis v Birmingham Waterworks Co.*, 187 Ala. 552, 65 So. 805 (1914), *Cole v. Arizona Edison Co.*, 53 Ariz. 141, 86 P. 2d 946 (1939), *Niehaus Bros. Co. v. Contra Costa Water Co.*, 159 Cal. 305, 113 Pac. 375 (1911), *Gnann v. Costal Public Service Co.* 44 Ga. App. 217, 160 S. E. 807 (1931), *Holloway v. Macon Gaslight & Water Co.*, 132 Ga. 387, 64 S. E. 330 (1909); *Consolidated Biscuit Co. v. Illinois Iowa Power Co.*, 303 Ill. App. 80, 24 N. E. 2d 582 (1939); *Mott v. Cherryvale Water & Manuf'g. Co.*, 48 Kan. 12, 28 Pac. 989 (1892), *Hone v. Presque Isle Water Co.*, 104 Me. 217, 71 Atl. 769 (1908), *Hall v. Passaic Water Co.*, 83 N. J. (54 Vroom) 771, 85 Atl. 349 (1912), *Blunk v. Dennison Water Supply Co.*, 71 Ohio St. 250, 73 N. E. 210 (1905)

water,²⁰ refuse to furnish it at all,²¹ or attempt to raise the rate.²² The similarity between the breaches is readily seen but it is admitted that in the cases of failure to furnish pure water, the action is either founded upon the agreement between the citizen and the water company, or upon neglect of duty. However, where the courts have granted mandamus²³ to force the companies to furnish the citizens water, as provided by the franchise, a different situation is presented for at the time mandamus issues the only contract in existence is that between the city and the water company. Despite this the citizen can enforce the terms of the agreement and compel the water company to furnish him water. If he were an incidental beneficiary he would have no rights at all against the promisor or promisee, therefore he must be an intended beneficiary with the rights thereof. The logical conclusion seems to be that if he is the intended beneficiary for one purpose, he is for all purposes, and therefore the citizen should be able to enforce the contract when the pressure is insufficient as well as when there is a refusal to supply.

The most that can be said for the "lack of privity" is that it is an arbitrary and indefinite term that is applied or rejected as the courts see fit. In the cases of water company franchises, it is applied to force the service to be rendered but is ignored when the water company breaches its agreement to furnish sufficient pressure with which to fight fires, despite the fact that both agreements are within the same contract. The conclusion that there is privity between the water company and the citizenry as a whole but that there is lack of privity between the water company and the individual citizen is a fiction that is as fallacious as it is threadbare and well illustrates the confusion that surrounds the term.

As to the true intention of the parties, little doubt can be entertained. The municipality is the central voice of the people, created by them to serve their best interest as it appears to the majority. In the event of a breach by the municipality²⁴ the pecuniary loss falls upon the citizen as the money must come out of the funds of the city treasury which have been created by the

²⁰ *Martin v. Springfield City Water Co.* —Mo.—, 128 S. W. 2d 674 (1939); *Hamilton v. Madison Water Co.*, 116 Me. 157, 100 Atl. 659 (1917).

²¹ *Home Owners Loan Corporation of Washington, D. C. v. Mayor & City Council of Baltimore*, 175 Md. 676, 3 A. 2d 747 (1939); *Hugen v. Albina Light & Water Co.*, 21 Ore. 411, 28 Pac. 244 (1891).

²² *Pond v. New Rochelle Water Co.*, 183 N. Y. 330, 76 N. E. 211 (1906).

²³ *Hugen v. Albina Light & Water Co.*, 21 Ore. 411, 28 Pac. 244 (1891).

²⁴ *Chisholm Water Supply Co. v. City of Chisholm*, 205 Minn. 245, 285 N. W. 895 (1939).

tax paying inhabitants. The citizens are chargeable if the municipality breaches, and therefore it is logical to conclude that both parties intended that there were to be mutual obligations for which the party breaching the agreement would be liable. It would be a vain contract indeed if one of the parties would be liable in case of a failure to perform while the other could disregard the terms without fear of recompense.

The increased urbanization and industrialization of the United States make it increasingly necessary that adequate fire protection be available at all times. One small fire unchecked can grow to such proportions that the most modern fire-fighting apparatus cannot combat it. This makes it imperative that there be due diligence at all times by the water companies to insure an adequate supply of water to meet such emergencies. Public policy demands that more responsibility be shouldered by the public utilities in order that their vigilance will be increased proportionately to the public need. It is, therefore, submitted that the Kentucky view is the best method of insuring a stricter compliance with the terms of the city's franchise guaranteeing an adequate supply of water in case of fire. This rule does not seem too harsh as there has been no evidence of water companies fleeing the state, but perhaps now they are furnishing the pressure agreed upon. It is equitable and just as it gives the citizen the right to recover if his property is destroyed by the water company's failure, but it places no additional financial burden upon the companies for the citizen is indemnifying them by paying increased water rates. It is not expensive, for the water rates have not risen appreciably in Kentucky in the last ten years and only one case has been litigated during the same period.

The overwhelming majority is opposed to the Kentucky view, but the cases should not be counted but weighed and reason substituted for volume. The welfare of the public in 1947 cannot be protected by 1870 law which is out of step with the trend of the times, therefore the public needs should be substituted for *stare decisis* and the Kentucky view adopted as the best means of accomplishing this end.

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