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August 19, 2013

Hon. Jeff R. Derouen
Executive Director
Kentucky Public Service Commission
211 Sower Blvd.
Frankfort KY 40601-8294

RE: In the Matter of Investigation into the Proposed Water Purchase Agreement between Louisville Water Company and Hardin County Water District No. 1, Case No. 2013-00251

Dear Mr. Derouen:

With this letter I have enclosed one (1) original and ten (10) copies of Louisville Water Company's Response to the Commission's Order dated July 3, 2013 in the above-referenced matter.

Please return a file stamped copy to our courier.

Thank you and if you have any questions, please call me.

Very truly yours,

DINSMORE & SHOHL LLP

Edward T. Depp

ETD/kwi

cc: Barbara Dickens, Esq. (w/enclosure)

Enclosure

1093417v1

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

INVESTIGATION INTO THE PROPOSED WATER	)	
WATER PURCHASE AGREEMENT BETWEEN	)	**CASE NO. 2013-00251**
LOUISVILLE WATER COMPANY AND	)	
HARDIN COUNTY WATER DISTRICT NO. 1	)	

LOUISVILLE WATER COMPANY'S RESPONSE TO THE PUBLIC SERVICE COMMISSION'S ORDER DATED JULY 3, 2013

INTRODUCTION AND BACKGROUND

Louisville Water Company ("LWC") and Hardin County Water District No. 1 ("HCWD1") began a partnership in July 2008 whereby the parties' stated intent was for LWC to provide a supplemental wholesale water supply to HCWD1 and the two utilities partner to pursue the Defense Logistics Agency/Energy ("DLA") effort to privatize the Fort Knox Water System ("FKWS"). HCWD1 won the DLA contract for the FKWS and began operating it, with LWC as an operations subcontractor, on February 1, 2012. Subsequent thereto, the parties finalized negotiations on the wholesale water purchase agreement (the "Agreement") dated May 15, 2012, which is at issue in this matter. HCWD1 had been purchasing its wholesale supply from FKWS. Under the Agreement, the LWC wholesale supply would replace the FKWS supply for HCWD1 at a lower cost than the amount HCWD1 paid FKWS. Additionally, the "Agreement" with LWC would allow HCWD1 to purchase thirty percent (30%) more supply than it could from FKWS.

In order for HCWD1 to purchase wholesale water from LWC, transmission and pumping facilities are necessary to be constructed by both utilities for the two systems to interconnect.

HCWD1 received a grant from the Kentucky Cabinet for Economic Development to fund the construction costs of the necessary facilities. Once all of the necessary facilities are built, the Agreement requires LWC to provide up to 3.5 million gallons per day (MDG), at a specific pressure, meeting specific water quality requirements. The Agreement also commits HCWD1 to rates that are calculated based on the American Water Works Association's M1 Manual of Water Rates, Charges and other Fees standard cost of service methodology, just as they are now for all LWC's wholesale customers, whether regulated by the Commission or not. HCWD1 agrees to pay LWC's then-wholesale rate for any water purchased and to pay a monthly service charge based on the meter size, a charge applied uniformly to LWC customers who are similarly situated. Further, the parties agreed to work together exclusively in regards to the supply of wholesale water to the FKWS.

The Agreement was filed with the Commission on June 13, 2012, but had yet to be accepted by the Commission. Nearly thirteen months later, the Commission issued its Order stating that it should conduct an investigation into the reasonableness and lawfulness of the proposed Agreement pursuant to KRS 278.040 and KRS 278.250, and specifically compelling LWC and HCWD1 to file a written memorandum addressing whether HCWD1 is required by KRS 278.300(1) to apply for Commission approval prior to executing the Agreement. Although both LWC and HCWD1 concur on the issues before the Commission, they each offer unique viewpoints as buyer and seller in the Agreement and, therefore, have chosen to submit separate memoranda in support of their positions.

ARGUMENT

The Commission notes that the Agreement "requires [HCWD1 to] purchase its entire water requirements necessary to serve the Fort Knox Military Installation from Louisville Water Company and [to] incur a monthly service charge throughout the life of the agreement," which is

40 years. It says in its order that the "proposed contract requires [HCWD1] to assume significant financial obligations that may affect price and quality of the water service that [HCWD1] provides to its customers. Moreover, these obligations appear to render the proposed water purchase agreement an evidence of long-term indebtedness that would require Commission approval pursuant to KRS 278.300(1)."

One point must be addressed at the onset of this Brief. The Commission has made an assumption from the reading of paragraph 6 of the Agreement that there is no other entity from which the FKWS obtains its water supply. While such an interpretation is possible, it is an erroneous assumption. The DOD is responsible for obtaining a water supply for the FKWS; however, if that obligation should shift to HCWD1, HCWD1 under the Agreement would get that supply from LWC. This provision in the Agreement may never come to full realization, and therefore, can hardly be binding on the parties. As such, it will not be further addressed in this Brief.

The remainder of the Brief is dedicated to whether a monthly service charge can be considered an "evidence of indebtedness." If the foregoing is accepted as correct, then the Commission has authority pursuant to KRS 278.300(1) to pre-approve the Agreement.

KRS 278.300(1) states:

> No utility shall issue any securities or evidences of indebtedness, or assume any obligation or liability in respect to the securities or evidences of indebtedness of any other person until it has been authorized to do so by order of the commission.

However, the issue of whether a monthly service charge in such a contract is an evidence of indebtedness is not settled, and LWC submits that such provisions in a wholesale water purchase agreement do not constitute evidences of indebtedness under the applicable statute, common law or in practice and that the Commission cannot consider it an evidence of indebtedness.

I. KRS 278.300 DOES NOT COVER THE AGREEMENT.

In order for this statutory provision to apply, and therefore, for the Commission to have authority to require LWC and HCWD1 to submit the Agreement to it for prior approval under KRS 278.300, there has to be an issuance of a security or some other evidence of indebtedness or HCWD1 has to assume an obligation or a liability in respect to the security or evidence of indebtedness. For the reasons stated herein, LWC submits that HCWD1 has issued no security and has assumed no liability or debt for which the Commission may require approval.

A. No Security is Issued.

1. The Wholesale Water Purchase Agreement is Not a Security. "Security" is described in statute and by its basic legal definition as a note, stock, treasury stock, bond, certificate of interest, or other interest that describes someone's ownership rights in something. *See KRS § 292.310(19); Security, Black's Law Dictionary (9TH Ed. 2009).* Certainly, the Agreement is not a "note," a "stock," a "treasury stock," a "bond," or a "certificate of interest." More importantly, however, neither LWC nor HCWD1 is giving the other an ownership interest in anything through the terms of the Agreement. HCWD1 is not issuing anything representing an ownership interest of some amount that interested buyers may then purchase.

Words and phrases in statutes must be given reasonable, rational meanings in order to carry out the intent of the statute and avoid an absurd result. Workforce Dev. Cabinet v. Gaines, 276 S.W.3d 789,795 (Ky. 2008). To interpret a statute, one has to rely upon the common meaning of the particular words chosen "which meaning is often determined by reference to dictionary definitions." Jefferson County Bd. of Ed. v. Fell, 391 S.W.3d 713, 719 (Ky. 2012). The definition of "security" in Black's Law Dictionary and in KRS 292.310 is similar to the description in the implementing regulation of KRS 278.300(1), that is, "securities, notes, bonds, stocks or other evidences of indebtedness." *See 807 KAR 5:001, Section 17 (1).*

A court will also consider that a statute is intended by the General Assembly to complement other statutes related to it. Fell, at 719. The other related sections in that statute

clearly indicate a traditional meaning of security is intended, as do the other statutes in that chapter, e.g. KRS 278.290. Subsections (3), (4) and (7) of KRS 278.300 all refer to the use or the disposition of the proceeds of the indebtedness, a normal expectation in a traditional borrowing transaction.

The additional phrase "evidence of indebtedness" begs the question of what else this phrase could mean if it is not a common security defined in practice or regulation as a note, bond or stock. Kentucky courts have held under general rules of statutory construction that when a general phrase follows a list of specific things, the general phrase will be interpreted to include only that same type of thing that was listed specifically. Commonwealth v. Plowman, 86 S.W.3d 47, 50 (Ky. 2002). As such, when interpreting KRS 278.300(1), "other evidences of indebtedness" simply means those other instruments that meet the definition of a security. A wholesale water purchase agreement with a monthly service charge does not meet the definition of a security because no ownership interest is granted to anything.

2. Nothing is being issued. The statute specifically prohibits a regulated utility from *issuing* the security or evidence of indebtedness. The common definition of "issue" applicable to securities or evidences of indebtedness is to "put forth or distribute; to send out for sale or circulation." "Issue" Black's Law Dictionary *(9th Ed. 2009).* Clearly, this is the action a utility takes when it issues bonds or what a private company does when it issues stock. The Agreement was not "issued" in any sense of the word. It was agreed upon by the parties, and the terms were bargained for after consideration by both parties of the benefits and risks associated.

Furthermore, the issued stock or bond is sent out for sale to generate funds for the issuer. The very idea of a security means an investor will earn profit through the efforts of others instead of his own efforts. Smith v. Wedding, 303 S.W. 2nd 322, 323 (Ky. 1957). All of the security examples that are described in the applicable statute are similar in that they provide an ownership interest, they can be traded, and profit can be garnered through the work of

other's efforts. Logic and plain meaning demand that there is no security being issued – in fact, nothing at all is being *issued* -- with the Agreement between HCWD1 and LWC.

B. No Debt is Assumed.

1. A Monthly Service Charge is Not a Debt by Law. Since no security is issued, the key provision of the contract in question – namely, the obligation to pay each month a service charge based on the size of the meter at the point of delivery – would have to be interpreted as an assumption of debt. Traditionally a "debt" is created in a transaction when one party receives an immediate benefit and has the opportunity to pay for it over time, oftentimes for more than the value of the original benefit. There is nothing in KRS 278.300(1) indicating the General Assembly intended anything other than the traditional notion of a borrower receiving proceeds immediately in order to pay for something later. KRS 278.300 (3), (4) and (7) require the utility to describe the use of the proceeds. In fact, even the Commission's own regulations regarding approval of indebtedness support this position insofar as they require a utility to describe the use to be made of the proceeds of the securities, notes, bonds, stocks or other evidences of indebtedness. 807 KAR 5:001(17)(c). It is apparent that not only the General Assembly, but also the Commission, intends this to apply only to traditional debt instruments.

Kentucky courts have held that a debt exists only where the creditor has an unconditional right to receive and the debtor has an obligation to pay. Preston v. Clements, 232 S.W.2nd 85, 90 (Ky. 1950). The reason the creditor deserves the *unconditional* right to receive is because the creditor has already given the debtor something, such as the proceeds of a loan or the proceeds of a bond sale. This is not the situation at hand. HCWD1 will not be receiving anything in advance or paying in advance. There are no proceeds it is receiving from the monthly service charge. Certainly, it is an obligation of HCWD1, but it is not a debt of HCWD1. Likewise, LWC (as the putative creditor) has obligations – *conditions* – imposed on it. There is nothing unconditional about LWC's rights under the wholesale water purchase agreement.

Rather, LWC is required to make a certain minimum quantity of water available at a certain quality, pressure and flow. HCWD1 committed to partner with LWC on the attempt to attain the DOD privatization contract for FKWS, and, should the DOD seek a new source of supply for FKWS from HCWD1, to obtain that supply from LWC. If such agreements, or specifically monthly service charges within agreements, are considered evidences of indebtedness for which a regulated utility must get Commission prior approval, the application of this rule might be limitless. It would be very difficult for a utility to determine what types of contractual commitments fell under such a rule, such as long term lease agreements with monthly service charges, long term licensing or agreements for software, or long term pool cellular agreements, to name a few. One thing all of these long term arrangements have in common is that they are operating expenses common to a utility, but they are not "debt" in the traditional sense of a note, bond or a security.

2. A Monthly Service Charge is not a Debt in Practice. Neither LWC nor HCWD1 treats the monthly service charge as a debt of HCWD1 or an asset of LWC in their respective financial statements. In order for HCWD1 to treat this as a debt on its balance sheet, it would have to be offset with proceeds received upon incurring the debt, which proceeds it never received. Rather, this is an operating expense to HCWD1 in the period in which it actually pays the charge, and it is revenue to LWC in the period in which LWC actually receives the payment for the charge. This is consistent with matching the expense and the revenue for both entities in the period for which the benefit is received. HCWD1 would be overstating their liabilities and LWC would be overstating their assets with an accounting entry to treat the event as indebtedness.

II. THE ELECTRIC UTILITIES' SUBMISSION OF SUCH CONTRACTS AS EVIDENCE OF INDEBTEDNESS IS IRRELEVANT.

A. The Commission Never Determined Wholesale Electric Agreements Were Evidences of Indebtedness under KRS 278.300(1). The Commission wrestled with a similar issue in a prior case involving wholesale electric power in the early 1990s. In PSC Administrative Case No. 350 involving long-term wholesale power by electric utilities,[1] the Commission said those contracts "***may*** well require prior approval under KRS 278.300 *if they constitute evidences of indebtedness.*" (emphasis added). The electric contracts involved the minimum purchase requirements also known as "take or pay" provisions in long term wholesale contracts. As stated previously, a monthly service charge does not constitute a security and does not meet the definition of a debt either legally or in practice. This same argument is applicable to the minimum purchase requirements in a wholesale agreement, and the Commission never determined those were subject to approval as evidences of indebtedness. Thus, by the plain and ordinary reading, a monthly service charge is even less of a security or a debt and therefore, does not constitute an evidence of indebtedness. Consequently, this October 25, 1993 Order by the Commission does not constitute a prior holding applicable to the matter at hand.[2]

B. The Commission Cannot Expand Its Statutory Authority. Subsequent to the Order issued in Administrative Case No. 350, many electric utilities began voluntarily submitting minimum purchase requirements to the Commission for approval. Despite such acts, the Commission did not gain greater power than it had before. "The PSC is a creature of statute

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[1] *In the Matter of The Consideration and Determination of the Appropriateness of Implementing a Ratemaking Standard Pertaining to Power by Electric Utilities as Required by Section 712 of the Energy Policy Act of 1992.*

[2] The Commission's July 17, 2013 order in *In the Matter of Petition and Complaint of Grayson Rural Electric Cooperative Corporation for an Order Authorizing Purchase of Electric Power ... and East Kentucky Power Cooperative Inc.*, 2013 Ky. PUC LEXIS 629 (Case No. 2012-00535) is also distinguishable because the take-or-pay Magnum contract in that case directly impacted certain take-or-pay obligations in a Rural Utilities Service ("RUS") loan that falls within the Commission's jurisdiction. The Agreement at issue in this case does not implicate any existing loan obligations of HCWD1. Therefore, the Commission's July 17, 2013 order in Case No. 2012-00535 is inapplicable.

and has only such powers as have been granted to it by the General Assembly." Boone Cty Water and Sewer Dist. V. Pub. Serv. Comm'n, 949 S.W.2d 588, 591 (Ky. 1997). As a result, only the General Assembly may expand the express powers of the Commission. Further, even if a court would determine that the Commission's inclusion of a monthly service charge in the definition of indebtedness is merely an issue of interpretation and not an expansion by the Commission, the Court would still require such interpretation to be reasonable and according to the intent of the statute. Such an interpretation simply is not supported when general rules of statutory construction are applied. [*Supra, Section I].*

III. THE COMMISSION IS ESTOPPED FROM CONSIDERING THE MONTHLY SERVICE CHARGE AS AN EVIDENCE OF INDEBTEDNESS.

LWC, although not regulated by the Commission, deals with water utilities that are regulated by the Commission. LWC has negotiated and entered into many wholesale water purchase agreements over the past several years with regulated utilities. In all cases, LWC has filed for approval of its wholesale water rates and has filed with the Commission the contract representing the agreement between the regulated utility and LWC. There have already been several of these that have included monthly service charges for terms up to and exceeding forty (40) years. Specifically, LWC's wholesale purchase agreements with North Nelson Water District, North Shelby Water Company and West Shelby Water District were filed with the Commission, which has accepted it. Never has the Commission stopped the approval of the rates or questioned the contracts with these utilities because it had determined the monthly service charge requirement was an indebtedness requiring prior approval. As a result, the Commission is estopped from ruling on the same provision under the same statute now.

IV. THE MONTHLY SERVICE CHARGE REQUIREMENT IS A REASONABLE, BARGAINED-FOR TERM IN A BILATERAL AGREEMENT AND IS LAWFUL.

LWC and HCWD1 have negotiated the terms of the Agreement over considerable time, after multiple meetings among key personnel, with updates on progress to both boards of directors, and with the benefit of separate legal counsel representing the interest of each utility. The Agreement they reached and they filed with the Commission is a fair agreement that represents risks and benefits to both parties, but which are balanced with the best interests of each utilities' ratepayers in mind. The reality of the situation is that Louisville has an abundant supply of water and LWC has excess treatment capacity, a reliable source of high quality potable water to the region and the capability of providing these services to HCWD1. Once water is brought to the delivery point, HCWD1 should pay the same rates and fees as LWC's ratepayers pay.

LWC agrees that the cost of monthly service charge should be reasonable and justified. As such, LWC's rates and fees are always based on a Cost of Service model that is standard in the water industry. LWC meets with and communicates its Cost of Service Study to its wholesale customers, who it considers valuable business partners. LWC's Schedule of Rates and Fees are published in advance and considered at a public board meeting. Rates for regulated utilities are contingent upon approval by the Commission. All of these are practices LWC believes promote transparency and foster customer trust, confidence and satisfaction.

CONCLUSION

This is not a difficult issue or one that needs to be addressed. A monthly service charge is applies to all customers of LWC and is standard in the industry. The cost of the monthly service charge to HCWD1 is an operating expense associated with the purchase of a commodity. That explanation is the practical, logical conclusion supported by the regulations implementing KRS 278.300 and common law. Nothing supports the position of fitting this

contractual provision into the unlikely category of indebtedness. Therefore, Louisville Water Company respectfully requests the Commission find that KRS 278.300(1) does not apply to its Agreement with Hardin County Water District 1, and further, that the parties may move forward implementing the Agreement without further delay.

Respectfully Submitted,

Barbara K. Dickens
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CERTIFICATE OF SERVICE

It is hereby certified on this 19th day of August, 2013 a copy of this Brief of Louisville Water Company was served by mail to Hon. David T. Wilson II, Skeeters Bennett, Wilson and Pike, 550 Lincoln Trail Blvd, Suite 5, P. O. Box 610, Radcliffe, KY, 40159-0610 and an original and ten copies served by hand delivery to Mr. Jeff Derouen, Executive Director, Kentucky Public Service Commission, 211 Sower Blvd, Frankfort, KY 40601.

Barbara K. Dickens