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August 19, 2013

Mr. Jeff Derouen
Executive Director
Public Service Commission
PO Box 615
Frankfort, KY 40602

RE: Case No. 2013-00252
Louisville Water Company
Hardin County Water District No. 2

Dear Mr. Derouen:

Enclosed for filing on behalf of the Hardin County Water District No. 2 are the original and ten (10) copies of the Memorandum of Law which is being submitted in response to the Commission's Order dated July 3, 2013.

Yours truly,
DAMON R. TALLEY, P.S.C.

Damon R. Talley

DAMON R. TALLEY, ATTORNEY FOR
HARDIN COUNTY WATER DISTRICT NO. 2

DRT:ms
Enclosures
cc: Hardin County Water District No. 2
Louisville Water Company

13/HCWD2/Derouen Letter – 8-19-13

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

INVESTIGATION INTO THE PROPOSED	)	
WATER PURCHASE AGREEMENT BETWEEN	)	
LOUISVILLE WATER COMPANY AND	)	CASE NO. 2013- 00252
HARDIN COUNTY WATER DISTRICT NO. 2	)	

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MEMORANDUM OF LAW ON BEHALF OF HARDIN COUNTY WATER DISTRICT NO. 2

*** ** *** ** *** ** *** ** *** ** *** ** *** ** ***

INTRODUCTION

Hardin County Water District No. 2 (the "Hardin District No. 2"), by counsel, files this Memorandum of Law pursuant to the Commission's Order dated July 3, 2013.

On March 19, 2013, the Louisville Water Company (the "LWC") and Hardin District No. 2 entered into a Water Purchase Agreement (the "Agreement") whereby LWC will provide, commencing in 2016, a supplemental supply of potable water to Hardin District No. 2. The Agreement was not easily achieved. It

was reached following many years of meetings, joint planning sessions, numerous studies, and lengthy negotiations.

Pursuant to the Commission's Order in Administrative Case No. 351,[1] long standing Commission precedents[2], and Commission practice that has remained unchanged for nearly 20 years, LWC filed the **executed** Agreement with the Commission. Nothing in Administrative Case No. 351 nor Commission precedents suggests or even hints that a proposed water purchase agreement should be filed with the Commission **before** it is executed. Indeed, historically, the Commission has required a water purchase agreement to be executed by all parties before accepting it for filing.

On July 3, 2013, the Commission opened this case to investigate the reasonableness and lawfulness of the proposed Agreement between LWC and Hardin District No. 2. It also ordered each party to file a Memorandum of Law addressing whether KRS 278.300(1) requires Hardin District No. 2 to apply for Commission approval prior to executing the proposed Agreement. This Memorandum of Law is being submitted pursuant to the Commission's Order.

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[1] Administrative Case No. 351, *Submission of Contracts and Rates of Municipal Utilities Providing Wholesale Utility Service to Public Utilities*, (Ky. PSC Aug. 9, 1994). The responsibility for filing with the Commission a contract that requires a municipal utility to provide utility service to a public utility lies with the municipal utility.

[2] See e.g., Case No 2001-230, *The Contract Filing of Kentucky-American Water Company of a Water Purchase Agreement with Winchester Municipal Utilities Commission* (Ky. PSC Oct. 19, 2001).

STATEMENT OF FACTS

Hardin District No. 2 provides retail water service to over 17,000 customers and wholesales approximately 1,100,000 gallons per day to the City of Elizabethtown.[3] It owns and operates a water treatment plant at White Mills in the southern portion of Hardin County (the "White Mills WTP") with a rated capacity of 8.1 million gallons per day ("MGD"). The Nolin River is the source of water for the White Mills WTP.

As a public utility subject to Commission jurisdiction, Hardin District No. 2 is obligated to provide **adequate service** to its customers. What is "adequate service"?

KRS 278.010(14) defines "adequate service" as:

> [H]aving sufficient capacity to meet the **maximum estimated requirements** of the customer to be served during the year following the commencement of permanent service and to meet the **maximum estimated requirements** of other actual customers to be supplied from the same lines or facilities during such year and to assure such customers of reasonable continuity of service. (Emphasis added).

807 KAR 5:066, Section 10(4) further defines a water utility's obligation to procure an adequate source of supply. This regulation provides that "[t]he quantity of water delivered to the utility's distribution system from all source facilities shall

[3] *Annual Report of Hardin County Water District No. 2 to the Kentucky Public Service Commission for the year ending December 31, 2012* ("Annual Report") at 48.

be sufficient to supply adequately, dependably and safely the **total reasonable requirements** of its customers **under maximum consumption**." (Emphasis added).

The Commissioners of Hardin District No. 2 are very cognizant of their responsibility to provide adequate service to customers. During droughts, ice storms, and other emergencies, this mantle of responsibility is quite heavy.

For 14 consecutive days during the summer of 2012, Hardin District No. 2 experienced an average customer demand in excess of 90% of the rated capacity of its White Mills WTP. Hardin District No. 2's daily production **averaged** over 75% of its rated capacity during a 61 day period in the months of June and July of 2012.[4] Its **maximum day** production was 98%[5] of its rated capacity. Because of the low flow of the Nolin River during drought conditions, the Kentucky Division of Water will not increase Hardin District No. 2 water withdrawal permit. Therefore, expanding the White Mills WTP is not an option.

Because of continued customer growth, Hardin District No. 2 has long known that eventually the Nolin River would no longer be an adequate water source. In essence, Hardin District No. 2 would, some day, "outgrow" the Nolin River. That "day" has arrived!

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[4] *Id.* at 53.
[5] *Id.* at 54.

Throughout the years, Hardin District No. 2 has looked north, south, east, and west for additional sources of water. As early as 2001, Hardin District No. 2 identified LWC as the most reliable and cost effective source of supplemental water[6]. LWC has excess treatment capacity and an abundant supply of water from the Ohio River.

LWC and Hardin District No. 2 executed a Letter of Intent on April 3, 2008 whereby LWC expressed its intent to provide a supplemental supply of water to Hardin District No. 2, and Hardin District No. 2 expressed its intent to purchase a supplemental supply of water from LWC. Earlier this year, LWC and Hardin District No. 2 concluded years of planning, studying, and negotiating when they executed the Agreement that is the subject of this case.

The Agreement is a typical bilateral executory contract. Each party is obligated to take certain actions at certain future dates. Under the terms of the Agreement, LWC must make certain infrastructure improvements to enable it to deliver certain specified quantities of water commencing on January 1, 2016. Thereafter, it must continue to make available the specified quantities throughout the 50 year term of the Agreement.

Likewise, Hardin District No. 2 is required to take certain actions in the future. First, it must construct certain infrastructure improvements. Before

[6] *Hardin County Regional Water Feasibility Study*, July 2001.

commencing these improvements, however, it must obtain a Certificate of Public Convenience and Necessity from the Commission.[7] Commencing in 2016, under the terms of the Agreement, Hardin District No. 2 must purchase at least 60,000,000 gallons per year. The minimum purchase quantity "stair steps" each year until 2021 when it reaches the plateau of 1 MGD or 365,000,000 gallons annually.

Based on its most recent demand projections, Hardin District No. 2 reasonably believes that it will need to purchase at least as much water from LWC as the minimum amounts specified in the Agreement. The high customer demand experienced by Hardin District No. 2 for an extended period during the summer of 2012 confirmed Hardin District No. 2's prior demand projections.

ARGUMENT

The Commission's July 3, 2013 Order directs the parties to address whether KRS 278.300(1) requires Hardin District No. 2 to apply for Commission approval prior to executing the proposed Agreement. Apparently, the Commission is concerned that the minimum purchase requirements contained in the Agreement may constitute an "evidence of indebtedness" within the meaning of KRS

[7] KRS 278.020(1).

278.300(1). If so, then prior approval of the Agreement by the Commission must be obtained.

This is an issue of first impression for the Commission. It has never decided the issue of whether minimum purchase provisions in a water purchase agreement "trigger" the provisions of its financing statute, KRS 278.300. Seeking guidance from the affected utilities, the Commission opened this case and two (2) companion cases: Case No. 2013-00250[8]; and Case No. 2013-00251.[9]

I.
THE AGREEMENT IS NOT SUBJECT TO REVIEW UNDER THE COMMISSION'S FINANCING STATUTE.

The minimum purchase (Take/Pay) provisions included in the Agreement do not render the Agreement subject to review under the Commission's financing statute, KRS 278.300. The relevant portion of the statute provides:

> **278.300 Issuance or assumption of securities by utilities.** 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 so to do by order of the commission. KRS 278.300(1). (Emphasis added).

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[8] Case No. 2013-00250, *Investigation into the Proposed Water Supply Agreement Between Frankfort Electric and Water Plant Board and South Anderson Water District.*

[9] Case No. 2013-00251, *Investigation into the Proposed Water Purchase Agreement Between Louisville Water Company and Hardin County Water District No. 1.*

In order for this financing statute to apply, two (2) requirements must be met: (1) Hardin District No. 2 must propose to **"issue"** a security or financing instrument, and (2) the instrument must be an **"evidence of indebtedness."** In short, Hardin District No. 2 must be the issuer of an evidence of indebtedness. Both requirements must be satisfied. In the instant case, neither is present.

A. Hardin District No. 2 Is Not An Issuer.

Nothing is being "issued" by Hardin District No. 2. The terms: "issue"; "to issue"; "issuer"; and the "issuance" have narrow, specific meanings in the context of public financing and utility financing. When used as a verb, "issue" means "to put forth or distribute: to send out for sale of circulation."[10]

Hardin District No. 2 did not "issue" the Agreement. It negotiated the terms of the water purchase agreement with LWC and then "executed" the Agreement.

Hardin District No. 2 has issued revenue bonds on many occasions. In each case it has applied for Commission approval, as required by KRS 278.300(1), prior to issuing the bonds. Its most recent bond issue took place in 2012.[11] The issuance of bonds or other securities is a process. It requires the issuer, in concert with its financial advisor, bond counsel, and other professionals, to take certain actions; to

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[10] *Black's Law Dictionary* (9th Ed. 2009).

[11] Case No. 2012-00388, *Application of the Hardin County Water District No. 2 to Issue Securities in the Approximate Principal Amount of $6,070,000 for the Purpose Of Refunding Certain Outstanding Revenue Bonds of the District Pursuant to the Provisions of KRS 278.300 and 807 KAR 5:001.*

prepare certain offering documents, including an Official Statement; to advertise the proposed sale or to solicit proposals; to receive offers to purchase the bonds; to evaluate the offers; to accept the best offer; to comply with numerous federal and state statutes and regulations; and to deliver the bonds in exchange for **proceeds**.

Hardin District No. 2 did not receive any proceeds when it executed the Agreement with LWC. Since nothing was issued within the meaning of the financing statute, then KRS 278.300 does not apply. **Issuing** a bond, other security, or an evidence of indebtedness is distinctly different than **executing** a water purchase agreement.

B. The Agreement Is Not An Evidence Of Indebtedness.

The Agreement is not an evidence of indebtedness within the meaning of the financing statute, KRS 278.300(1). The term "evidence of indebtedness" is not defined in KRS 278.300 nor in the Commission's implementing regulation, 807 KAR 5:001, Section 17. Thus, one needs to look to the rules of statutory construction to determine the meaning of evidence of indebtedness.

The case of Jefferson County Bd. of Ed. v. Fell, 391 S.W.3d 713 (Ky. 2012) outlines the principles of statutory construction. The cardinal rule is to ascertain and give effect to the legislative intent. To do this, one must:

1. Look at the language employed by the legislature itself;
2. Rely generally on the common meaning of the particular words chosen;
3. View the word, sentence or subsection in context rather than in a vacuum; other relevant parts of the legislative act must be considered in determining the legislative intent;
4. Presume that the General Assembly intended for the statute to be construed as a whole;
5. Harmonize it with related statutes;
6. Presume that the General assembly did not intend an absurd statute; and
7. Use other canons of construction as a last resort. *Id.* at 718-720.

These principles will now be applied to ascertain the meaning of evidence of indebtedness within the context of the financing statute.

1. An Evidence Of Indebtedness Is A Security or Financing Instrument.

The term evidence of indebtedness is not found in Webster's dictionary nor in Black's Law Dictionary. Obviously, evidence of indebtedness means more than "proof of debt." Utilizing the statutory construction principles outlined above, leads one to conclude that the term "evidence of indebtedness" has a specialized meaning in finance and securities law.

An evidence of indebtedness is a financing instrument and is classified as a security. The Commission's financing statute, KRS 278.300, contains the caption or heading, "Issuance or Assumption of Securities by Utilities." This statute is not

about water purchase contracts that contain minimum purchase requirements. It is about utilities raising capital. Almost every subsection of this statute uses the term securities or evidences of indebtedness followed by "or the proceeds thereof." The statute requires the utility to specify the use of the proceeds it will derive from the proposed issue of securities or evidence of indebtedness. A utility does not receive any proceeds when it executes a long-term water purchase agreement. No funds are exchanged.

The Commission's own regulations lend support to the position that an evidence of indebtedness is a security. 807 KAR 5:001, Section 17, which was promulgated by the Commission to implement KRS 278.300, states:

> **Section 17. Application for Authority to Issue Securities, Notes, Bonds, Stocks, or Other Evidences of Indebtedness.** (1) Upon application by the utility for an order authorizing the issuance of securities, notes, bonds, stocks, or **other** evidences of indebtedness payable at periods of more than two (2) years from the date thereof, pursuant to the provisions of KRS 278.300, the application, in addition to complying with the requirements of Section 14 of this administrative regulation, shall contain: ..... (Emphasis added).

Interestingly, the Commission's regulation adds the word "other" to the statutory term "evidences of indebtedness" throughout the regulation. This reinforces the concept that an evidence of indebtedness is another type of security used to raise capital by a utility. The regulation first lists the more common types

of securities: "notes"; "bonds"; and "stocks" used by utilities and then adds the phrase "or other evidences of indebtedness." The Commission could have used the term "or the like" as a "catch-all" description for any other security that does not readily fit within the other types of security. Notably absent from this laundry list of financing instruments is a water purchase agreement that contains a minimum purchase requirement. The Commission could have included water purchase agreements with Take/Pay provisions in this list of financing instruments which require prior approval by the Commission. It has not done so.

The regulation, like the statute, requires the utility to describe, in great detail, the use to be made of the proceeds from the proposed bond issue or issue of other evidences. In addition, the regulation requires the utility to specify the amount of the "notes, bonds, or other evidences of indebtedness" which the utility proposes to issue with the terms, interest rate, and how it is to be secured (e.g. pledge of revenues or mortgage lien).

Hardin District No. 2 did not receive any proceeds when it executed the Agreement. The Agreement does not contain an interest rate. Hardin District No. 2 did not "secure" the Agreement by pledging its future revenues to LWC. Hardin District No. 2 did not grant LWC a mortgage lien on its water distribution system.

Thus, the Agreement, which contains a minimum purchase requirement, is not an evidence of indebtedness.

2. Other Kentucky Statutes Treat Evidences of Indebtedness as a Security.

As previously discussed, courts should look to other statutes and try to harmonize related statutes. Hardin District No. 2's position that an evidence of indebtedness is a security is consistent with the treatment and use of this term in Kentucky's Blue Sky Law, KRS Chapter 292. While KRS Chapter 278 does not define "security," it is defined in KRS 292.310(19), which states:

> "Security" means any note, stock, treasury stock, bond, debenture, **evidence of indebtedness**, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, life settlement investment, voting-trust certificate, certificate of deposit for a security; fractional undivided interest in oil, gas, or other mineral rights; or, in general, any interest or instrument commonly known as a "security," or any certificate of interest in or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. "Security" does not include any insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed number of dollars either in a lump sum or periodically for life or some other specified period; (Emphasis added).

As expected, this definition of security contained in Kentucky's Blue Sky Law is consistent with the definition contained in the federal securities laws, the Security Act of 1933.[12]

Thus, when KRS 278.300 is harmonized with KRS Chapter 292 and federal securities law, it becomes clear that the term evidence of indebtedness refers to obligations of like character with stocks, bonds, and notes. An evidence of indebtedness is a "catch-all" phrase to describe other securities that cannot be "pigeon-holed" or classified as stocks, bonds, notes, etc.

In summary: (1) because Hardin District No. 2 did not "issue" a security or financing instrument when it executed the Agreement; and (2) because the Agreement is not an evidence of indebtedness, the Agreement does not need to be submitted to the Commission for prior approval under KRS 278.300,

3. The Agreement Is a Bilateral Executory Contract and, Consequently, Cannot Be an Evidence of Indebtedness.

As previously stated, the Agreement is a bilateral executory contract. Each party to the Agreement has specific obligations to perform in the future. LWC must deliver certain specified quantities of water in the **future**. Hardin District No. 2 must pay for the water when it receives it in the **future**. Hardin District No. 2 did not receive any consideration from LWC when the Agreement was executed.

[12] 15 U.S.C. § 77b(1)

In contrast, had Hardin District No. 2 issued revenue bonds or other evidence of indebtedness, it would have received the proceeds at the time the security was issued. It would still be obligated to pay in the future (repayment of principal and interest), but it would not receive any consideration in the future.

In other words, a security, including an evidence of indebtedness, is just the opposite of a bilateral executory contract. If the instrument is a security, then the issuer receives payment or consideration **today** and not in the future.

This distinction is supported by numerous federal court decisions which have interpreted the term "evidence of indebtedness." In U.S. v. Austin, 462 F.2d 724 (10th Cir. 1972), the court stated:

> The term "evidence of indebtedness" is not limited to a promissory note or other simple acknowledgment of a debt owing and is held to include all contractual obligations to pay in the future for **consideration presently received**. *Id.* at 736. (Emphasis added).

The Austin court also stated:

> We think the term "evidence of indebtedness" has reference to some individual printed or written instrument for the transfer or payment of money, that contains on its face evidence of an obligation as to which some innocent person would act in relation to the terms thereof ... *Id.*

In LTV Fed. Credit Union v. UMIC Gov't Secur. Inc., 523 F. Supp. 819, 830 (N. D. Tex. 1981), the court stated, "An evidence of indebtedness has been defined as a contractual obligation to pay in the future for consideration presently received." The LTV court also stated:

> In United States v. Jones, 450 F.2d 523, 525 (5th Cir. 1971), the court held that the "term 'evidence of indebtedness' embraces only such documents as promissory notes which on their face establish a primary obligation to pay the holders thereof a sum of money." ... **But Jones points to a logical distinction that is, that the term "evidence of indebtedness" contemplates a payment of a sum of money in the future for consideration presently received, and not an exchange in the future of securities or commodities for a sum of money.** *Id.* at 829. (Emphasis added).

The distinction and importance between present consideration and future consideration was also made in the case of Berman v. Dean Witter & Co., 353 F. Supp. 669 (C. D. Cal. 1973). In ruling that an executory contract was not an evidence of indebtedness, the court stated:

> The fact that the agreement is executory – the seller being obligated to make delivery in the future, the purchaser being obligated to tender payment in the future does not transform it into a securities contract. To accept plaintiffs' view of "evidence of indebtedness" would be tantamount to a declaration that all bilateral executory contracts are securities under the federal securities laws. *Id.* at 671. (Emphasis added).

While not binding on the Commission, these federal cases are persuasive authority that a bilateral executory contract, like the Agreement in question between LWC and Hardin District No. 2, is not an evidence of indebtedness. By definition, according to these cases, if there is **future** consideration (delivery of water) in the exchange for future payment, the instrument is not an evidence of indebtedness.

II.

THE COMMISSION HAS NEVER RULED THAT SUPPLY CONTRACTS CONTAINING TAKE/PAY PROVISIONS CONSTITUTE AN EVIDENCE OF INDEBTEDNESS.

Despite exhaustive research, Hardin District No. 2 has not found any Commission decisions which hold that a supply contract containing minimum payment obligations or Take/Pay provisions is deemed to be an evidence of indebtedness requiring prior approval by the Commission under KRS 278.300(1). In 2012, the Commission issued an Order in Case No. 2011-00419[13] directing the City of Versailles and the Northeast Woodford Water District to submit briefs addressing this same legal issue. That case is still pending before the Commission.

[13] Case No. 2011-00419, *Proposed Revision of Rules Regarding the Provision of Wholesale Water Service by the City of Versailles to Northeast Woodford Water District* (Ky. PSC May 14, 2012).

In 1993, the Commission faced a similar issue in the context of an Administrative Case concerning purchase power contracts in the electric industry.[14] The Commission held:

> The Commission finds that in this era of increasing competition, utilities should be able to purchase power **without prior Commission approval.** However, recognizing the significant risk created by a subsequent rate disallowance, utilities are **encouraged** to file such contracts for prior approval. In addition, these contracts **may** well require prior approval under KRS 278.300 **if** they constitute evidences of indebtedness. In particular, the inclusion in such contracts of minimum payment obligations or take/pay provisions **may** necessitate prior approval. The guidelines proposed by KU appear reasonable and should be seriously considered by all electric utilities in their decision-making processes. *Id.* at 8-9. (Emphasis added).

Rarely has the Commission used such tentative, permissive language. By using such timid words as "may," "if," and "encourage," the Commission stopped short of declaring electric purchase power agreements with Take/Pay provisions to be evidences of indebtedness requiring the Commission's prior approval under KRS 278.300.

To an outside observer, it appears that the Commission walked up to the edge of the deep, dark abyss called "evidence of indebtedness," peered over the

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[14] Administrative Case No. 350, *The Consideration and Determination of the Appropriateness of Implementing a Ratemaking Standard Pertaining to the Purchase of Long-Term Wholesale Power By Electric Utilities as Required in Section 712 of the Energy Policy Act of 1992* (Ky. PSC Oct. 25, 1993)

edge, did not like what it saw (or could not see), and retreated a few steps. It has been nearly 21 years since the Commission decided Administrative Case 350. The Commission has not taken a single step closer to the edge of the abyss in the past two (2) decades. Administrative Case 350 did **not** hold that a purchase power contract with Take/Pay provisions rendered the contract an evidence of indebtedness. Therefore, the Commission can accept the arguments of Hardin District No. 2 in this case without the need to distinguish or overrule Administrative Case No. 350.

As expected, some electric utilities have heeded the advice of the Commission and sought the safe harbor of obtaining prior approval of purchase power contracts from the Commission.[15] Indeed, the prudent course of conduct for an electric utility is to submit the contract for prior approval and avoid the significant risk of having the purchase power expenses disallowed in a subsequent rate case. Thus, the utility avoids being "second guessed," to its financial detriment, by its ratepayers and the Commission.

A careful reading of these Orders, however, reveals that the Commission has **never** ruled that these purchase power contracts with Take/Pay provisions are evidences of indebtedness. The Commission simply reviewed, and ruled upon, the

[15] See e.g., Case No. 2011-00125, *East Kentucky Power Cooperative, Inc.* (Ky. PSC Dec. 1, 2011); Case No. 2009-00545, *Kentucky Power Co.* (Ky. PSC June 28, 2010); Case No. 2004-00395, *Kentucky Utilities Co.* (Ky. PSC Dec. 30, 2004); Case No. 2004-00396, *Louisville Gas & Electric Co.* (Ky. PSC Dec. 30, 2004)

reasonableness of these contracts without having to decide whether the Take/Pay provisions in the contracts rendered them evidences of indebtedness.

In a recent case,[16] the Commission revisited Administrative Case No. 350 and stated:

> The Commission went on to encourage all electric utilities to file long-term purchase power contracts for prior approval **even if the contracts do not constitute evidences of indebtedness** because, absent prior approval, there is a significant risk that the contracts will be subject to subsequent review in rate cases and the contracts' costs could be subject to rate disallowances if the Commission finds the costs to be unreasonable or not prudent. *Id.* at 21. (Emphasis added).

This recent statement by the Commission confirms Hardin District No. 2's position that the Commission has never ruled that a supply contract containing minimum payment obligations constitutes an evidence of indebtedness. There is no reason for the Commission to issue such a ruling now.

[16] Case No. 2012-00503, *Petition and Complaint of Grayson Rural Electric Cooperative Corporation for an Order Authorizing Purchase of Electric Power ... and East Kentucky Power Cooperative Inc.* (Ky. PSC July 17, 2013).

III.

THE COMMISSION'S SMALL UTILITY ASSISTANCE DIVISION ENCOURAGES THE USE OF TAKE/PAY PROVISIONS IN WATER SUPPLY CONTRACTS.

In recent years, the Commission has created a Small Utility Assistance Division with its own website easily accessible from the Commission's website. The Small Utility Assistance Division has provided, and continues to provide, very useful information and helpful hints on a variety of subjects, including wholesale water purchase agreements. On its Small Utility Assistance Division website, at the Legal section under "Wholesale Contract Negotiations," the Commission recognizes the need for minimum purchase (Take/Pay) provisions in water supply contracts.

The following excerpt from the "Wholesale Contract Negotiations" portion of the Small Utility Assistance Division Website is insightful:

> I. **Quantity.**
>
> A. **Minimum Quantity ("Take or Pay Provision")**
>
> 1. Suppliers should consider establishing a minimum amount that the Purchaser must purchase when a portion of the Supplier's facilities must be available to supply the Purchaser's demand and such sales are factored into the Supplier's decisions regarding repayment of debt incurred to finance the construction of water treatment or distribution facilities necessary to supply the Purchaser. Suppliers should

consider minimum quantity provision when additional facilities must be constructed to serve Purchaser's demand.

2. Specifying a minimum quantity obligates a Purchaser to purchase a minimum amount regardless of whether it has actual need for that amount. The Purchaser must pay for minimum volume regardless of whether it actually takes that amount. Such provision also requires the Supplier to maintain sufficient capacity to meet this quantity.

This discussion concerning minimum quantity and Take/Pay provisions is the very **first** topic discussed on the website under the Wholesale Contract Negotiations topic. Hence, its importance. The Commission alerts a supplier that it needs to include a Take/Pay provision in its contract, especially if it will be required to construct improvements to supply the purchaser. Likewise, the Commission educates a purchaser to expect a Take/Pay provision. The undersigned commends this article as a "must read" for all utilities (and their attorneys) before commencing wholesale water supply contract negotiations.

Later in the article, under paragraph **"I. C. Total Requirements,"** the perils of entering into a "total requirements" contract is discussed. The article warns against the use of a "total requirements" provision. Conspicuously absent from the article and the website, however, is a warning that the use of a Take/Pay provision will cause the contract to be closely scrutinized by the Commission. There is no such warning. There is no suggestion that inclusion of a Take/Pay provision could

cause the agreement to be deemed an evidence of indebtedness requiring the Commission's prior approval under KRS 278.300.

Clearly, industry best practices and fundamental fairness require the use of Take/Pay provisions in a water supply agreement in many instances. The Commission recognizes this reality and is to be commended for its efforts to educate small utilities on this important issue. Imposing an additional burden (prior approval by the Commission) on a utility which elects to utilize a Take/Pay provision will discourage utilities from negotiating a Take/Pay provision.

Therefore, Hardin District No. 2 urges the Commission to rule that the inclusion of a minimum purchase (Take/Pay) provision in a water supply agreement does not render the agreement an evidence of indebtedness requiring prior approval by the Commission under KRS 278.300.

[Remainder of page intentionally left blank.]

CONCLUSION

WHEREFORE, for the foregoing reasons, Hardin District No. 2 respectfully requests the Commission to issue an Order:

A. Declaring that the minimum purchase provisions contained in the Water Purchase Agreement dated March 19, 2013 between LWC and Hardin District No. 2 do not render the Agreement an evidence of indebtedness within the meaning of KRS 278.300(1);

B. Declaring that the Commission's prior approval was not required before Hardin District No. 2 executed the Agreement;

C. Accepting the Agreement for filing;

D. Declaring that the Agreement is reasonable and lawful;

E. Permitting Hardin District No. 2 to commence taking all appropriate and necessary actions to implement the Agreement, including the filing, at the appropriate time, of an application for a Certificate of Public Convenience and Necessity; and

F. Granting LWC and Hardin District No. 2 such other relief as the Commission deems appropriate.

This 19th day of August, 2013.

Respectfully submitted,

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13/HCWD2/Memo of Law