



Paul E. Patton
Governor

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Ronald McCloud,
Secretary
Public Protection and
Regulation Cabinet

June 17, 1999

Hon. Sid Stewart
County Judge Executive
Morgan County Government
450 Prestonsburg Street
West Liberty, Kentucky 41472-1140

Dear Judge Stewart:

Commission Staff is in receipt of your letter of April 14, 1999 in which you request Commission Staff's review of the proposed water purchase agreement between Morgan County Water District and the City of West Liberty.

In your letter, you raise concerns regarding the proposed agreement's minimum purchase requirements and its rate adjustment provisions. Under the terms of the proposed agreement, Morgan County Water District agrees to purchase a minimum of 2.25 million gallons monthly. It will make a minimum monthly payment of \$5,175 even when its monthly consumption falls below 2.25 million gallons. This type of provision is common in water purchase agreements when the purchaser has assumed a portion of the debt service for a water treatment plant. The provision is not unreasonable per se. As you do not state the amount of water treatment capacity allocated to the water district or the total debt service requirements associated with water treatment plant, Commission Staff can render no opinion regarding the reasonableness of the amount of the minimum payment.

Commission Staff suggests that the proposed agreement address the following issues:

- Methodology For Determining Cost Of Service. The agreement does not provide for any specific cost of service methodology to establish a rate. If the parties have agreed upon a methodology for determining the cost of service, the agreement should set forth this methodology. Failure to identify this methodology may lead to future disputes. Such a methodology should identify how common costs will be allocated between the purchaser and the seller.



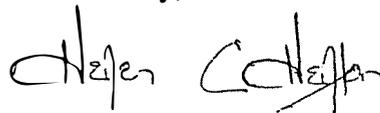
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Hon. Sid Stewart
June 17, 1999
Page 2

- Disclosure Requirements. The agreement is silent on the seller's obligation to disclose information. While both parties to the agreement are subject to the Open Records Act, an agreed procedure for the disclosure of pertinent cost and service information may avoid unnecessary disputes by ensuring both parties have complete and accurate information.
- Cost of Service Study Performed By An Independent Party. Some water purchase supply contracts provide for a cost of service study performed on a periodic basis by an independent third party.
- Litigation Expenses. Parties may wish to impose some limitations on expenses that are incurred in any regulatory proceedings regarding the water purchase agreement or establish formula for the allocation of such expenses. Current Public Service Commission practice has been to allocate all reasonable expenses incurred by a municipal utility to obtain approval of a rate adjustment to the municipal utility's wholesale customers.
- Procedure For Negotiation of Rate Adjustment. The purchase water agreement provides that the parties may negotiate an adjustment of rates at any time, but fails to specify a procedure for negotiations. To avoid disputes, the parties may wish to specify how negotiations are to be initiated, the parties' obligations during those negotiations, and the time period for those negotiations. The parties may also wish to require negotiations before any rate adjustment filing may be made to the Public Service Commission

If you have any questions regarding this letter or wish to discuss this matter further, please contact Gerald Wuetcher, Commission counsel, at (502) 564-3940, Extension 259.

Sincerely,



Helen C. Helton
Executive Director