

**COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION**

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In the Matter of:

**PROPOSED REVISION OF RULES)
REGARDING THE PROVISION OF)
WHOLESALE WATER SERVICES BY THE)
CITY OF VERSAILLES TO NORTHEAST)
WOODFORD WATER DISTRICT)**

PUBLIC SERVICE
COMMISSION

CASE NO. 2011-00419

**NORTHEAST WOODFORD COUNTY WATER DISTRICT'S
BRIEF IN OPPOSITION TO CITY OF VERSAILLES PROPOSED RULE**

The Northeast Woodford County Water District (the Water District) opposes the rule proposed by the City of Versailles (Versailles) which would require the Water District to purchase its first 15,000,000 gallons of water each month from Versailles (the Proposed Rule). The Proposed Rule is not a part of the contractual agreement between the Water District and Versailles and to institute it would effectively re-write the contract of the parties. The Commission does not have the authority to do that. Versailles is concerned that it may be unable to service debt incurred for the expansion of its water treatment plant. If this is the case then the proper avenue is to address its rates as to all of its customers, not place a disproportionate burden on the Water District and its customers.

SUMMARY OF FACTS

The Water District and Versailles entered into a Water Purchase Contract on May 17,

1966.¹ That contract provides, in pertinent part, that Versailles agrees to furnish the Water District water "...in such quantity as may be required by the [Water] District not to exceed Five Million (5,000,000) gallons per month."² By an Amendment to Water Purchase Contract dated August 3, 1994³ the contract was amended "...to provide that the quantity of water furnished to the [Water] District shall not exceed 15,000,000 gallons per month, if available."⁴ (The Water Purchase Contract as amended by the Amendment to Water Purchase Contract is hereafter referred to as the Water Purchase Contract, as amended.)

Both prior to, and after, the Amendment To Water Purchase Contract Versailles expanded the capacity of its water treatment plant with the final expansion in 2004 increasing its capacity from 4 million gallons per day to 10 million gallons per day.⁵ Versailles incurred substantial debt as a result of the expansion.⁶

The Water District currently serves an area in the northeast portion of Woodford County between Versailles and the City of Midway.⁷ The Water District purchased 145,022,100 gallons of water from Versailles in 2011, an average of 12,085,175 gallons per month.⁸

The Water District was encouraged by the Governor's 2020 Plan, the Environmental Protection Agency's Vulnerability Assessment, the Water District's Emergency Response Plan, and the Commission to obtain an alternate supply of water in addition to Versailles in order to assure water service in the event of a failure of the Versailles system.⁹ A supplementary water

¹ Copy attached as Exhibit 1 to Testimony on Behalf of City of Versailles, Testimony of Allison White, City Clerk, City of Versailles.

² See paragraph 1, page 2, of the Water Purchase Contract.

³ Copy attached as Exhibit 2 to Versailles Testimony, White Testimony.

⁴ See paragraph 1, page 2 of the Amendment To Water Purchase Contract.

⁵ See City of Versailles Response to Staff's Request For Information, Response #5.

⁶ See Testimony of Versailles, White Testimony, paragraph 7, page 2.

⁷ See Northeast Woodford County Water District's Response to Staff's Request for Information, Response #15.

⁸ See Testimony On Behalf Of Northeast Woodford County Water District, Testimony of Fred Faust, Biller/Bookkeeper of Northeast Woodford County Water District, paragraph 5, page 2.

⁹ See Testimony on Behalf of Northeast Woodford County Water District, Testimony of John S. Davis, Chairman of Northeast Woodford County Water District Board of Commissioners, paragraph 7, page 3.

supply also enhances the integrity of the Water District's system and is sound water system design management.¹⁰ In order to obtain a supplementary source of water the Water District contacted the Electric and Water Plant Board of the City of Frankfort (the Plant Board) in May, 2001.¹¹ The Water District also began plans to obtain funds for, and construct, an interconnection with the Plant Board's water distribution system.¹² The interconnection project is expected to be completed in the summer of 2012.¹³

The Water District entered into a Water Supply Agreement dated April 19, 2011 with the Plant Board ("the Water Supply Agreement").¹⁴ The Water Supply Agreement provides that the Water District's minimum consumption "...shall be 3,000,000 gallons per month computed on an annual basis...".¹⁵ The Water District has not yet purchased any water from the Plant Board.¹⁶

ARGUMENT

The Water District, in order to obtain an alternate supply of water and improve the integrity of its system, entered into the Water Supply Agreement with the Plant Board which requires the Water District to purchase a minimum of 3,000,000 gallons per month. If the Proposed Rule is approved the Water District would be forced to pay twice for 3,000,000 gallons of water each month. The rate charged by Versailles is \$2.26 per 1,000 gallons.¹⁷ The rate

¹⁰ See Water District Testimony, Testimony of Warren A. Broughman, III, Engineer For Northeast Woodford County Water District, paragraph 4, page 1.

¹¹ See Water District Response, Response #7.

¹² See Water District Testimony, Davis Testimony, paragraphs 8 through 12, pages 4-5.

¹³ See Water District Testimony, Davis Testimony, paragraph 12, page 5.

¹⁴ Copy attached as Exhibit "B" to Water District Testimony, Faust Testimony.

¹⁵ See paragraph 2, page 2 of the Water Supply Agreement.

¹⁶ See Water District Testimony, Davis Testimony, paragraph 3, page 2. The Davis testimony was given on March 3, 2012. Counsel for the Water District states that the Water District interconnection with the Plant Board is not complete as of the date of filing this Brief.

¹⁷ See Commission Staff's Request For Information to the Water District #22 and the Water District's Response.

charged by the Plant Board is currently \$1.91 per 1,000 gallons to be increased to \$2.01 per 1,000 gallons on April 1, 2013.¹⁸ If the Proposed Rule is approved it will cost the Water District \$68,760.00 to \$72,360.00 per year.¹⁹ The Water District cannot be forced to incur this additional cost.

The primary issue raised by the Proposed Rule is one of contract interpretation. Versailles argues that the Water Purchase Contract, as amended, contains a provision requiring the Water District to purchase all of the water it consumes up to 15,000,000 gallons per month from Versailles.²⁰ The Water District maintains that the Water Purchase Contract contains no such requirement.

In addition to the issue of contract interpretation the Commission, by its Order entered May 14, 2012, has instructed each party to address issues regarding jurisdiction of the Commission to hear the primary issue presented, and interpret the Water Purchase Contract, as amended. The Commission's Order further directs each party to address the Commission's authority to approve the imposition of a condition of service upon a public utility's purchase of service from a municipal utility over the public utility's objection; certain matters relating to KRS 278.300; and the weight to be given a determination by the Commission that the Water Purchase Contract does not contain a minimum purchase requirement on its determination of whether the Proposed Rule should be approved. The Water District will first address the jurisdiction of the Commission, then the interpretation of the Water Purchase Contract as amended, and then the remaining issues raised by the Commission.

¹⁸ *Id.*

¹⁹ Based on the Plant Board rates of \$1.91 and \$2.01 per 1,000 gallons.

²⁰ See Versailles Response to Commission Staff's Request For Information, Response #18, 19, and 22.

DOES THE COMMISSION HAVE JURISDICTION TO HEAR A DISPUTE OVER THE TERMS OF A PURCHASED WATER CONTRACT BETWEEN A MUNICIPAL UTILITY AND A PUBLIC UTILITY?

The Commission has jurisdiction to hear a dispute over the terms of a purchased water contract between a municipal utility and a public utility under the “rates and service” exception found in KRS 278.040(2) and KRS 278.200.²¹ Although the Commission’s jurisdiction over a municipal utility is limited, where a municipal utility provides services pursuant to a contract with a utility that is regulated by the Commission the municipal utility is subject to the jurisdiction of the Commission in regard to the matters covered under the contract.²²

The present matter arises from Versailles’ effort to impose a condition on its service to the Water District. Versailles attempts to achieve its goal through an interpretation of the Water Purchase Contract, as amended. This matter relates to the service between a municipal utility and a public utility which Versailles alleges is covered under a contract between the two. This matter is within the jurisdiction of the PSC under KRS 278.040 (2).

DOES THE COMMISSION HAVE JURISDICTION TO INTERPRET THE TERMS OF A CONTRACT BETWEEN A MUNICIPAL UTILITY AND A PUBLIC UTILITY FOR THE SALE OF WATER SERVICE?

The jurisdiction of the Commission to hear this dispute necessarily invokes the jurisdiction of the Commission to interpret the terms of the Water Purchase Contract, as amended. In Simpson County Water District, supra, the Court, at page 464, considered the argument that the Commission did not have jurisdiction to interpret a contract between a municipal utility and a public utility. In light of the Court’s consideration of this argument, its

²¹ Simpson County Water District v. City of Franklin, 872 S.W.2d 460 (Ky. 1994).

²² City of Greenup v. Public Service Commission, 182 S.W.3d 535 (Ky. App 2005).

holding that the case was subject to the Commission's jurisdiction under the rates and services exception necessarily implies that the interpretation of the contract is within the jurisdiction of the Commission as well.

The dispute between Versailles and the Water District is directly related to the service provided by Versailles to the Water District. Versailles is attempting to use its interpretation of the Water Purchase Contract, as amended, to dictate from whom the Water District may purchase water. The jurisdiction of the Commission to hear this matter necessarily invokes its jurisdiction to interpret the terms of the Water Purchase Contract, as amended.

INTERPRETATION OF THE WATER PURCHASE CONTRACT AS AMENDED

Versailles argues that the Water Purchase Contract, as amended, mandates that the Water District must purchase all of its water needs up to 15,000,000 gallons per month from Versailles.²³ The problem with this argument is that nowhere in the Water Purchase Contract, as amended, is it stated that the Water District agrees to purchase all of its water from Versailles. The Water Purchase Contract, as amended, simply states that Versailles agrees to furnish water to the Water District in such quantity as may be required by the Water District not to exceed 15,000,000 gallons per month, if available. Versailles would like the Commission to read into the contract that the Water District agrees to buy all of its water from Versailles up to 15,000,000 gallons per month. The Water Purchase Contract, as amended, could easily have contained such a provision had the parties so intended, but it doesn't.

The fact that the Water Purchase Contract, as amended, doesn't require the Water District to purchase all of its water from Versailles up to 15,000,000 gallons per month was recognized

²³ See Versailles Response, Response #18,19, and 22.

by Versailles when Bruce Southworth, its Public Works Director, wrote to John Davis, Chairman of the Water District, on September 17, 2010 "...requesting an amendment to the contract between the City and the District to require the Northeast Woodford Water District to purchase a minimum of 12 million gallons of water from the City each month."²⁴ Obviously Versailles knew the Water Purchase Contract, as amended, did not require the Water District to purchase all of its water from Versailles. If Versailles believed the Water District was obligated to purchase its first 15,000,000 gallons of water each month from Versailles then why would Versailles expect the Water District to guarantee a minimum purchase of 12,000,000 gallons per month?

Versailles suggests that the Water Purchase Contract, as amended, is a "requirements contract" and, therefore, the Water District is required to purchase all of its water from Versailles up to 15,000,000 gallons per month.²⁵ In a "requirements contract" the buyer agrees to purchase all of its requirements from the seller. Versailles' bootstrap argument overlooks the absence of any contractual provision stating that the Water District agrees to purchase all of its requirements from Versailles. Since the Water District did not agree to purchase all of the water it requires from Versailles the Water Purchase Contract, as amended, is not a "requirements contract".

Neither a court, nor the Commission as the tribunal hearing this dispute, can re-write the contract between the parties. "There is no better established rule of law in this state than that a court cannot make a contract for the parties, but can only construe the contract it finds they have entered into. Nor has the court the authority to read words into a contract."²⁶ The tribunal cannot add a condition to a contract which was not written into it.²⁷ The Water Purchase Contract, as amended, does not require the Water District to purchase all of its water from Versailles up to

²⁴ See Exhibit "B" to Water District Testimony, Testimony of John S. Davis.

²⁵ See Versailles Response #18 and 19.

²⁶ Yates v. Mammoth Cave National Park Ass'n, 55 S.W.2d 348 (Ky. 1933).

²⁷ Consolidated Jewelers, Inc. v. Standard Financial Corporation, 325 F.2d31 (6th Cir. 1963).

15,000,000 gallons per month,²⁸ and cannot be rewritten to include such a provision.

DOES KRS 278.200 CONFER AUTHORITY UPON THE COMMISSION TO APPROVE THE IMPOSITION OF A CONDITION OF SERVICE UPON A PUBLIC UTILITY'S PURCHASE OF UTILITY SERVICE FROM A MUNICIPAL UTILITY OVER THE PUBLIC UTILITY'S OBJECTION?

KRS 278.200 does not confer authority upon the Commission to approve the imposition of a condition of service on a public utility's purchase of utility service from a municipal utility over the public utility's objection. The purpose of KRS 278.200 is to authorize the Commission's oversight of the transactions between a public utility and a private utility. However, that authority does not extend to imposing a contractual obligation on the public utility in its contract with a municipal utility where one does not exist. KRS 278.200 cannot be construed to allow the impairment of the contractual obligations agreed to by Versailles and the Water District as set forth in the Water Purchase Contract, as amended. Section 19 of the Kentucky Constitution provides, "No...law impairing the obligation of contracts, shall be enacted." Neither the legislature, nor the Commission, can impair the contractual obligations between Versailles and the Water District. Imposing the obligation of purchasing from Versailles the first 15,000,000 gallons of water each month on the Water District impairs the obligations set forth in the Water Purchase Contract. It would be a violation of the Kentucky Constitution for the Commission to do so.

²⁸ Gerald E. Wuetcher, the Commission's attorney, agrees, stating in an email on March 23, 2004 to John Davis, the Water District's chairman, that his review of the Water Purchase Contract, as amended, "...did not indicate any provisions that required North East Woodford County Water District to purchase its water requirements exclusively from Versailles."

DOES KRS 278.300 REQUIRE NORTHEAST WOODFORD WATER DISTRICT TO OBTAIN COMMISSION AUTHORIZATION BEFORE EXECUTING AN AGREEMENT WITH FRANKFORT ELECTRIC AND WATER PLANT BOARD FOR THE PURCHASE OF WATER THAT HAS A 30-YEAR TERM AND CONTAINS AN ANNUAL MINIMUM PURCHASE REQUIREMENT?

KRS 278.300 is not applicable to the Water Supply Agreement between the Water District and the Plant Board. That statute provides in subsection (1):

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.

The Water Supply Agreement merely contains a minimum consumption obligation. That does not render the Water Supply Agreement "...securities or evidences of indebtedness...".

The Water District believes that a minimum consumption provision is common in water supply agreements between utilities in Kentucky. The Water District further believes that many such agreements have been filed with the Commission. The Water District has been unable to locate any instance where the parties to such an agreement, or the Commission, have taken the position that KRS 278.300 applies. This is understandable. A water supply agreement is simply an agreement regarding the purchase of a commodity. It's an agreement to exchange value for value over a period of time. The minimum purchase provision is not evidence of one party borrowing money from another. It is not a debt. It is simply a promise to purchase a minimum amount of the commodity each month.

The term "evidence of indebtedness" should not be construed as embracing every agreement where one party promises to pay another party some money. See Baker's Adm'x v. Louisville & N.R. Co., 152 S.W.2d 276 (Ky. 1941) in which the court held that a written contract of settlement was not an "evidence of indebtedness" within the meaning of the former Kentucky Civil Code of Practice which required filing with a pleading a "note, bond, bill or other writing,

as evidence of indebtedness”. See also Hiller v. Olmstead, 54 F.2d5 (6th Cir. 1931) in which the court held that a contract of insurance was not “evidence of indebtedness” under a Michigan statute dealing with bonds, certificates of stock, mortgages, promissory notes, debentures, or other evidences of indebtedness.” The Water Supply Agreement is simply a contract to purchase water wherein the Water District promises to buy a minimum amount each month. That simple promise does not convert the Water Supply Agreement into an evidence of indebtedness under KRS 278.300.

A reading of KRS 278.300 in its entirety reveals that the statute contemplates the borrowing of money by the utility. The statute refers to the “...issue...” of “...securities or evidences of indebtedness...”²⁹. It requires that the Commission investigate “...the purposes and uses of the proposed issue and the proceeds thereof...”³⁰. It refers to reports by the utility that the Commission may require showing “...the disposition made of such securities or evidences of indebtedness and the application of the proceeds thereof.”³¹ It specifically exempts notes³² and certain certificates and debentures.³³ The statute contemplates the borrowing of money, and the issuance of the instruments, or evidence, reflecting the borrower’s obligation to repay. It speaks of “issue” and “proceeds”. Those terms have no application to a water purchase contract between two utilities that contains a minimum water consumption provision. Attempting to place the Water Supply Agreement within the parameters of KRS 278.300 is attempting to fit a square peg in a round whole. It just doesn’t fit.

²⁹ KRS.278.300(1)

³⁰ KRS 278.300(3)

³¹ KRS 278.300(7)

³² KRS 278.300(8)

³³ KRS 278.300(9)

IF KRS 278.300 REQUIRES NORTHEAST WOODFORD WATER DISTRICT TO OBTAIN COMMISSION AUTHORIZATION BEFORE EXECUTING AN AGREEMENT WITH FRANKFORT ELECTRIC AND WATER PLANT BOARD FOR THE PURCHASE OF WATER THAT HAS A 30-YEAR TERM AND CONTAINS AN ANNUAL MINIMUM PURCHASE REQUIREMENT, WHAT IS THE EFFECT ON THE CONTRACT OF NORTHEAST WOODFORD DISTRICT'S FAILURE TO OBTAIN SUCH APPROVAL?

If KRS 278.300 applies to the Water Supply Agreement then the failure to obtain such approval renders the Water Supply Agreement unenforceable. KRS 278.300(6) provides that the validity of securities and evidences of indebtedness issued after an order of the Commission authorizing such issue is unaffected by a failure to comply with the provisions of the statute or rules of the Commission prior to such order if the provisions of the order are fully complied with. By implication then, an evidence of indebtedness issued before an order of authorization is invalid. In this case if the Water Supply Agreement is an "evidence of indebtedness" then its issuance prior to authorization by the Commission would render it invalid. However, since the rights of the Plant Board would be affected by a determination that KRS 278.300 applies to the Water Supply Agreement the Water District believes that the Plant Board should be made a party to this proceeding before such determination is made.

WERE THE REQUIREMENTS OF KRS 278.300 SATISFIED BY FRANKFORT ELECTRIC AND WATER PLANT BOARD'S FILING OF THE PURCHASED WATER CONTRACT WITH THE COMMISSION?

The Water District does not believe that the filing of the Water Supply Agreement with the Commission satisfies KRS 278.300. That statute states that securities or evidences of indebtedness shall not be issued until authorized by the Commission.³⁴ The statute further

³⁴ KRS 278.300(1)

requires an application, made under oath.³⁵ The filing of the Water Supply Agreement, without an application, and without an order of authorization of the Commission, does not satisfy the requirements of KRS 278.300.

IF THE COMMISSION DETERMINED THAT THE PURCHASED WATER CONTRACT BETWEEN THE CITY OF VERSAILLES AND NORTHEAST WOODFORD WATER DISTRICT DID NOT CONTAIN A MINIMUM PURCHASE REQUIREMENT, WHAT WEIGHT, IF ANY, SHOULD THE COMMISSION GIVE TO THE ABSENCE OF SUCH REQUIREMENT IN DETERMINING WHETHER VERSAILLES' PROPOSED RULE SHOULD BE APPROVED?

A determination by the Commission that the Water Purchase Contract, as amended, does not contain a minimum purchase requirement is conclusive that the Proposed Rule should not be approved. The Commission does not have the authority to impose the obligation if it does not exist. Versailles has presented evidence that it has incurred debt in order to expand its water treatment plant. The effect of the Proposed Rule is to place on one customer, the Water District, a disproportionate burden of carrying that debt. In the absence of a contractual provision requiring the Water District to purchase all of its water from Versailles up to 15,000,000 gallons per month it is patently unfair to place that burden on the Water District and its customers, even if the Commission had the authority to do so. If Versailles is unable to service its debt then its avenue is to address an increase in its rates as to all of its customers and not put a disproportionate amount of the burden on just one.

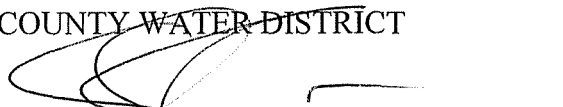
³⁵ KRS 278.300(2)

CONCLUSION

The Water District is not obligated to purchase its first 15,000,000 gallons of water each month from Versailles under the Water Purchase Contract, as amended, and the Commission cannot, and should not, impose such an obligation. Even if the Commission had the authority, approval of the Proposed Rule would place an unfair burden on the Water District and its customers by increasing the Water District's costs by up to \$72,360 each year.

The Water District has taken the salutary step of enhancing the integrity of its system and obtaining a supplementary source of water in the event of a failure of the system of Versailles, its primary supplier. The Water District should not be punished for this appropriate action by imposing an obligation where none exists. If Versailles is unable to meet its debt requirements then the proper recourse is to spread the burden over all of its customers by a general rate increase and not place a disproportionate amount of the burden on the Water District and its customers. The Proposed Rule should be denied.


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CERTIFICATE OF SERVICE

It is hereby certified that true copies of the Northeast Woodford County Water District's Brief In Opposition To City of Versailles Proposed Rule have been served by United States first class mail to: City of Versailles, 196 South Main St., Versailles, KY 40383 and to William K. Moore, City Attorney, 126 South Main Street, Versailles, KY 40383 on this 25th day of June, 2012.



JOSEPH M. HOFFMAN