

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

JUL 06 2012

PUBLIC SERVICE
COMMISSION

In the Matter of:

PROPOSED REVISION OF RULES)
REGARDING THE PROVISION OF)
WHOLESALE WATER SERVICE BY THE) CASE NO. 2011-00419
CITY OF VERSAILLES TO NORTHEAST)
WOODFORD WATER DISTRICT)

BRIEF ON BEHALF OF THE CITY OF VERSAILLES

Now comes the City of Versailles (hereafter "City"), by counsel, and for its brief in the above-styled matter, states as follows:

INTRODUCTION

This matter is before the Commission on the City's proposed rate adjustment to require the Northeast Woodford Water District (hereafter "District") to purchase its requirements for potable water, up to a maximum of 15 million gallons of water each month, from the City before the District purchases any water from the Frankfort Electric and Water Plant Board (hereafter Plant Board), or any other provider.

REASON FOR THE REQUEST

The City has operated for many years upon the belief that District was required to purchase all of its requirements for potable water from the City. In order to meet the demands of the District, and its other customers, the City has incurred substantial debt to increase size of its potable water treatment and transmission facilities. Sales to the District range from 16% to 20% of the City's total production of potable water.

(Testimony of Bart Miller, page 3, paragraph 10).

The District received grants to construct an emergency supply line connecting it to the Plant Board's transmission system. On May 25, 2011, the Plant Board filed with the Commission a copy of a contract to supply potable water to the District. The contract contains the requirement that the District purchase no less than 3 million gallons of water per month from the Plant Board. (*Water Supply Agreement, Exhibit B to Testimony of Fred Faust, page 2*). The contract between the Plant Board and the District contains no maximum limit of water than can be purchased monthly and the supply line connecting the Plant Board to the District is capable of supplying all of the District's requirements. No water had been purchased by the District from the Plant Board at the time these proceedings were filed. (*Testimony of Fred Faust, paragraph 7*).

The City initiated this action to address the adverse effect that the loss of its largest customer would have upon its remaining customers and its bond holders. The District originally proposed to resolve this matter by limiting its purchases from the Plant Board to the minimum amount required by the Plant Board's contract. Subsequent discussions led to an agreement between the City and District to permit the District to purchase 1.5 million gallons per month from the Plant Board. This amount substantially exceeds the volume required to maintain quality standards through the emergency supply line. (*Testimony of Warner A. Broughman, III, paragraph 5*). However, the Plant Board has refused to agree to the proposed reduction of its minimum purchase requirement leaving the parties with no alternative but to proceed with this action.

SUMMARY OF FACTS

The City owns and operates a water treatment plant that produces drinking water for the residents and businesses located in the community of Versailles. The City also supplies water to the two water districts serving residents of Woodford County.

(*Testimony of Bart Miller, paragraph 3*). The City and the District entered into a written contract dated May 17, 1966 by which the City agreed to furnish the District with such quantity of potable water as may be required by the District, not to exceed five million gallons per month. This contract had an original term of 40 years (through 5/16/2006) unless renewed or extended. (Testimony of Allison White, Exhibit 1, Water Purchase Contract, and *Testimony of Bart Miller, paragraph 5*).

On August 3, 1994, the City and the District entered into a written Amendment to their original contract that increased the maximum monthly limit of water available to the District from 5 million gallons to 15 million gallons and extended the term of the contract for a period of thirty years from the original termination (through 5/16/2036).

(Testimony of Allison White, Exhibit 2, Amendment to Water Purchase Agreement).

This amendment had been requested by the District in Order to enable the District to meet certain minimum requirements for grants and was approved by the Versailles City Council after much discussion concerning its potential adverse effect upon the City's other customers. (See City Council minutes produced by the City in response to Staff's Request for Information as Exhibits 1a, 1b, and 1c).

At the time the contract was amended, the City was already supplying the District with substantially more than 5 million gallons of water monthly. The District's purchases of potable water from the City of Versailles for the period 1995 through 1999 were:

<u>Year</u>	<u>Total Gallons</u>	<u>Avg. Monthly</u>
1995	116,381,000	9,698,417
1996	114,408,000	9,534,000
1997	119,231,000	9,935,917
1998	124,234,000	10,352,833
1999	131,946,000	10,995,500

(Testimony of Bart Miller, paragraph 7).

In order to be able to continue to meet the requirements of its customers, the City issued a series of bonds in 2000, 2001, 2004 and 2005 which raised a total of \$ 12,965,554.80 utilized for the purpose of increasing the City's production of potable water from 4 million gallons per day to 10 million gallons per day. *(Testimony of Allison White, paragraph 7).* These bonds are currently in existence or have been refinanced into new debt obligations of the City. *(Testimony of Allison White, paragraph 7; City's Response to Staff's Request for Information, Response # 6).* Moody's Investors Service assigned a rating of A3 to the City's Water and Sewer Revenue Bonds, Series, 2004. Moody's report justifying that rating described a stable customer base, including two water districts with long term contracts that are each responsible for ten percent of the City's revenues. *(Moody's letter and Report, Exhibit 3 of City's Additional Documents Requested by Hearing Officer at 5/3/12 Hearing).*

From 2006 through 2010, the District's purchases of potable water from the City represented from 16% to 20% of the City's total production of potable water:

<u>Year</u>	<u>Total Gallons</u>	<u>Avg. Monthly</u>	<u>% of City's Total Production</u>
2006	171,992,700	14,332,725	19%
2007	182,191,700	15,181,808	19%
2008	151,840,000	12,653,333	16%
2009	159,461,900	13,288,492	20%
2010	166,549,300	13,879,108	19%

(Testimony of Bart Miller, paragraph 10).

Although the written documents between the parties limits the City's obligation to provide water to the District to 15 million gallons per month, the City has never failed to meet the requirements of the District when its requirements exceeded 15 million gallons per month. The City has provided the District with more than 21 million gallons of water in a single month. *(Testimony of Bart Miller, paragraph 11).* The City remains ready and able to supply the potable water requirements of the District. *(Testimony of Bart Miller, paragraph 12).*

The stated purpose of the new supply line connecting the District with the Plant Board was for "standby or emergency use only." *(Letter from John Davis, District Chairman to Jim Smith, Frankfort Electric & Water Plant Board dated October 26, 2010, provided as District's Response to Staff's Request, Response # 8.d).* Construction of the line was funded by grants obtained by the District from the Kentucky Infrastructure Authority. *(District's Response to Staff's Request for Information, Request # 3).* The new line consists of approximately 7,200 linear feet of eight inch pipeline. *(Testimony of Warner Broughman, III, paragraph 5).* The District was required to pay for the costs incurred by the Plant Board relating to the new line. *(Exhibit B to Testimony of Fred Faust, Water Supply Contract, page 2, paragraph 2; District's Response to Staff's Request for Information, Request #9, Video Record of 5/03/12 hearing at 10:24:00 a.m. to 10:24:45 a.m.).*

The minimum volume required to keep water in the pipeline fresh is 1,128,000 gallons per month. *(Testimony of Warner Broughman, III, paragraph 5).* The District

had proposed an agreement with the Plant Board providing for its purchase of at least 1 million gallons per month, but the Plant Board wanted a 3 million gallon minimum.

(District's Response to Staff's Request for Information, Response 2.f, Minutes of District Board meeting held 9/7/2004).

On April 19, 2011 the District and Plant Board entered into a written agreement requiring the District to purchase a minimum of 3 million gallons of water per month from the Plant Board. *(Water Supply Agreement, Exhibit B to Testimony of Fred Faust)*. The Agreement was submitted to the Public Service Commission by the Plant Board on May 25, 2011. No action has been taken by the Commission regarding the Agreement between the District and the Plant Board.

ARGUMENT

Issue 1. 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 City submits that the Commission does have jurisdiction to resolve disputes concerning the terms of a purchased water contract between a municipal utility and a public utility.

KRS 278.040(2) extends jurisdiction to the Commission for all utilities in this state, including specifically the regulation of rates and service of utilities. While KRS 278.010(3)(d) exempts cities from its definition of a "utility;" KRS 278.200 provides an exception to this exemption when a city contracts with a regulated utility.

KRS 278.200 provides:

The commission may, under the provisions of this chapter, originate, establish, change, promulgate and enforce any

rate or service standard of any utility that has been or may be fixed by any contract, franchise or agreement between the utility and any city, and all rights, privileges and obligations arising out of any such contract, franchise or agreement, regulating any such rate or service standard, shall be subject to the jurisdiction and supervision of the commission, but no such rate or service standard shall be changed, nor any contract, franchise or agreement affecting it abrogated or changed, until a hearing has been had before the commission in the manner prescribed in this chapter.

The Commission's jurisdiction over contracts between a municipal utility and a public utility has been confirmed in the cases of *Simpson County Water District v. City of Franklin*, 872 S.W.2d 460 (Ky. 1004) and *City of Greenup v. Public Service Commission*, 182 S.W.3d 535 (Ky.App 2005).

These cases hold that the Commission does not have jurisdiction over utility services furnished by a municipality except to the extent that those services are rendered pursuant to a contract with a utility which is regulated by the Commission. In such cases the municipality, in the matters covered under the contract, is subject to the jurisdiction of the PSC.

This proceeding instituted by a city to enforce its contract with a local water district by requiring the district to purchase its first 15 million gallons of water per month from the city clearly falls within the scope of the Commission's jurisdiction.

Issue 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 City submits that the Commission does have the authority to interpret the terms of a contract for the sale of water service between a municipal utility and a public utility.

In order to change or enforce any rate or service standard that has been fixed by contract between a municipal utility and a public utility, the Commission must first have the authority to interpret the terms of the contract. The power to interpret a contract is inherent in the power to enforce a contract.

Issue 3. Does the contract between the City and the District require the District to purchase its requirements from the City up to a maximum of 15 million gallons per month?

The contract at issue was negotiated and executed before the District began providing any service its residents. It was a necessary prerequisite for the funding that enabled the District to construct the facilities necessary to provide water service. (See Exhibit 1 to Testimony of Allison White, Water Purchase Contract dated May 17, 1966, page 7, paragraph 7).

The operative provisions of the contract at issue are contained in three separate sections of the instrument entitled (A) the City Agrees; (B) the District Agrees and (C) it is Mutually Agreed. Paragraph 1 under the heading "The City Agrees" requires the City to furnish the District with potable treated water "in such quantity *as may be required by the District* not to exceed Five Million (5,000,000) gallons per month." *Emphasis added.* Paragraph 2 under that heading specifies the point of delivery of the water and the pressure under which the water is to be delivered. Paragraph 3 under that heading requires the City to furnish and maintain the metering equipment necessary to measure the water delivered to the District and Paragraph 4 requires the City to submit itemized bills to the District monthly.

Paragraph 1 under the heading "The District Agrees" requires the District to pay for the water delivered by the City. Paragraph 2 requires the District to pay a specified

connection fee and Paragraph 3 requires the District to apply for a specified amendment to its service boundary.

Under the heading of "Mutually Agreed" the duration of the contract is established at 40 years; rationing is established between the District and the City's other customers in the event of shortage of water; provisions are established for future modification or assignment of the agreement; and the parties stipulate that the contract is subject "to such rules, regulations, or laws as may be applicable to similar agreements in the State of Kentucky."

The 1966 contract was amended by written agreement between the parties dated August 3, 1994 to increase the City's obligation to provide water to the District to a maximum of 15 million gallons per month and extend the term of the contract for 30 years from the original date of termination. (Exhibit 2 to Testimony of Allison White, Amendment to Water Purchase dated August 3, 1994).

The City acknowledges that the contract contains no express language requiring the District to purchase its water needs from the City. However, the City respectfully submits that District's obligation to purchase all its requirements from the City is implied in the instrument and by the parties' historical course of dealings.

A contract may be measured by the output of the seller or the requirements of the buyer. *A & A Mechanical Inc. v. Thermal Equipment Sales, Inc.*, 998 SW2d 505 (Ky.App 1999). A requirements contract demands that the buyer order from the seller such actual requirements as may occur in good faith. KRS 355.2-306(1).

Requirements contracts generally arise where a unit price can be determined but the total quantity of units cannot. *A & A Mechanical, Inc.* at 512.

There are strong public policy reasons for allowing a buyer and seller to enter into a contract measuring quantity by the buyer's subsequently determined requirements, since the buyer, perhaps unable to anticipate its precise needs, may nevertheless wish to have assurances of the supply and fixed price, while the seller may find an advantage in having a steady customer. American Jurisprudence, Chapter 3. The Uniform Commercial Code, (2012).

The universal rule in construing contracts is that the court will attempt to arrive at the intention of the parties as expressed in the instrument as a whole and in so doing consider the subject matter of the contract, the situation of the parties and the conditions under which the agreement was written. *Reese v. Greenlee*, 214 S.W.2d 262, 264 (Ky. 1948).

The buyer's obligation to purchase all of its requirements from particular seller need not be stated expressly in a contract, the obligation will be implied where the reciprocal promise to purchase follows from a practical reading of the agreement. *Laclede Gas Co. v. Amoco Oil Co.*, 522 F.2d 33 (8th Cir. 1975). The buyer's implied promise to purchase all of its requirements from the seller was found to exist in *Famous Brands v. David Sherman Corp.*, 814 F.2d 517 (8th Cir. 1987); *Propane Indus. v. General Motors Corp.*, 429 F.2d 214 (W.D. Mo. 1977); and *Cyril Bath Co. v. Winters Industries*, 892 F.2d 465 (6th Cir. 1989).

Other factors that aid in determining whether the parties intended their agreement to be a requirements contract are the parties course of dealings and the principal's understanding of the agreement.

The parties' exclusive course of dealings and course of performance over a long period time indicates that the parties intended their agreement to be a requirements contract. *Zemco Mfg., Inc. v. Navistar Intern. Transp. Corp.*, 186 F.3d 815 (7th Cir. 1999).

In the case at issue, the City has been the District's exclusive provider of water since the District was created in 1966. From the beginning of the parties' relationship, the City was intended to be the District's only supplier. The City has obligated itself to provide the District's requirements for water and the City has steadfastly satisfied the District's requirements - even when those requirements exceeded the cap contained in the written documents. The City has incurred substantial expense to guarantee its ability to provide the District with its needs and that expense is reflected in the rates charged to the District as approved by the Commission.

Where the parties' principals testified they understood the agreement to be an exclusive arrangement, the obligation to purchase all of the buyer's requirements from the seller was implied in *Essco v. Harvard Industries*, 46 F.3d 718 (8th Cir. 1995).

The District's position on its contract with the City was described by its Chairman, John Davis, at the 5-03-12 hearing as follows:

- Q. What to you believe the District's obligation is, if any, to buy water from the City of Versailles?
- A. The obligation of Versailles is to supply water to the District to a maximum amount of 15 million gallons per month.
- Q. Does the District have any obligation to buy water from Versailles?
- A. There is no minimum amount, but based on that contract, we are to buy our water from the City of Versailles.

(Testimony of John Davis, 5/03/12 hearing, 10:48:40 a.m to 10:49:25 a.m.)

The City respectfully submits that it is only natural and logical to imply a reciprocal obligation for the District to purchase all of its water from the City under the circumstances presented herein.

Issue 4. 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?

The City submits that the Commission does have authority to impose a condition of service upon a public utility's purchase from a municipal utility over the public utility's objection

KRS 278.200 specifically confers upon the Commission the power to change any rate or service standard of any utility that may be fixed by any contract or agreement with any city and further provides that all rights, privileges and obligations arising out of any such contract regulating such rate or standard is subject to the jurisdiction and supervision of the Commission. The only limitation upon the Commission's authority in this regard contained in KRS 278.200 is that the Commission cannot take such action without a prior public hearing.

Issue 5. Does KRS 278.300 require the 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?

The City submits that, under the circumstances presented in this matter, the Water Supply Contract between the District and the Plant Board is an assumption of

indebtedness by the District that requires approval of the Commission under KRS 278.300.

KRS 278.300(1) provides:

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.

In the case at issue, the District presently has a contract with the City of Versailles that requires the District to purchase its requirements from the City up to a maximum of 15 million gallons per month. The 15 million gallon threshold was not exceeded in all of 2011. The District's new contract with the Plant Board requires the District to purchase at least 3 million gallons of water from the Plant Board monthly, whether the District has any use for the water or not. In other words, the District is required to pay a substantial minimum monthly fee to the Plant Board whether it receives any water from the Plant Board or not.

The terms "indebtedness" or "evidences of indebtedness" are not defined in KRS 278.100. The term indebtedness is defined in Black's Law Dictionary (6th Ed. 1990) as being:

The state of being in debt, without regard to the ability or inability of the party to pay the same. The owning of a sum of money upon a certain and express agreement. ... And in the broad sense and in common understanding the work may mean anything that is due and owing. See *also* Debt.

This definition is echoed in Webster's New World College Dictionary, (4th Ed 1999) as "the state of being indebted."

The term “debt” is defined in Black’s Law Dictionary (6th Ed. 1990) as “a sum of money due by certain and express agreement;” and in Webster’s New World College Dictionary, (4th Ed 1999) as “something owed by one person to another or others.”

The District’s obligation to pay the Plant Board a sum of money each month based upon the written agreement between the parties without regard to whether any water service is provided by the Plant Board is clearly an indebtedness of the District for purposes of KRS Chapter 278.

Issue 6. If KRS 278.300 requires the 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 terms and contains an annual minimum purchase requirement, what is the effect on that contract of the Northeast Woodford Water District’s failure to obtain such approval?

The City submits that the agreement between the District and the Plant Board has no legal effect until it has been approved by the Commission.

KRS 278.300(1) prohibits the assumption of indebtedness unless authorized by order of the Commission. The utility desiring to incur indebtedness must make application to the Commission on the form prescribed by the Commission. KRS 278.300(2). The Commission then undertakes an investigation of whether the purpose of the debt is necessary or appropriate for the proper performance of the utility and whether it will impair the utility’s ability to provide its service. KRS 278.300(3). The Commission is authorized to grant, in whole or in party, or deny the utility’s application. KRS 278.300(4).

Upon proper application, the Commission may determine to deny part or all of the District’s proposed purchase of water from the Plant Board under KRS 278.300(4).

Issue 7. 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 City submits that the requirements of KRS 278.300 have not been satisfied.

As noted above, KRS 278.300 requires the Commission conduct an investigation as to whether the purpose of the debt is necessary or appropriate for the proper performance of the utility and whether it will impair the utility's ability to provide its service. KRS 278.300(3). After such investigation, the Commission is authorized to grant, deny or grant only a portion of the utility's application. KRS 278.300(4).

In the event the filing of the water purchase contract is considered the filing of an application to assume indebtedness, the Commission has yet to investigate or approve the agreement.

Issue 8. 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?

The City submits that the determination of whether it has a requirements contract with the District is only one factor affecting the Commission's decision upon its Proposed Rule.

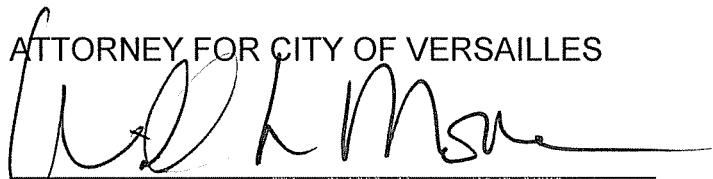
The Commission is clearly authorized by KRS 278.200 to create, change or enforce any service standard of any utility that has been fixed by a contract between the utility and a city. The term service, as defined in KRS 278.010(13), specifically includes quantity of water to be purchased by the District.

The issue before the Commission absent a requirements contract would be whether the City's Proposed Rule was a reasonable standard governing the conduct of its business and the conditions under which it is required to render service to the District under KRS 278.030(2).

The City respectfully submits that its Proposed Rule is reasonable in that the City incurred the cost of expanding its water treatment facilities to ten million gallons per day in part upon its obligation to supply the District's needs and that it would be manifestly unfair to the City, its bond holders, and remaining customers to permit the District to purchase its water requirements from another source before the cost of those facilities has been paid.

CONCLUSION

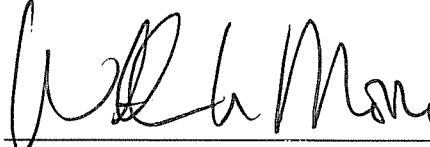
The City respectfully submits that its Proposed Rule is reasonable and supported by the evidence presented in this matter. The City requests that its Proposed Rule be approved by the Commission.

ATTORNEY FOR CITY OF VERSAILLES


WILLIAM K. MOORE
MOORE LAW OFFICE, PLLC
126 South Main Street
Versailles, KY 40383
Tel. (859) 873-6207
Fax. (859) 873-6189
Email: wkmoorelaw@gmail.com

CERTIFICATE OF SERVICE

It is hereby certified that true copies of the foregoing Brief on behalf of the City of Versailles have been served by mailing, postage prepaid, to: Northeast Woodford Water District, 225 South Main Street, Suite A, Versailles, KY 40383 and Hon. Joseph Hoffman, attorney for said District, United Bank Building, Versailles, KY 40383 on this 6th day of July, 2012.



WILLIAM K. MOORE