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PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In The Matter of:

INVESIGATION INTO THE PROPOSED WATER SUPPLY AGREEMENT BETWEEN FRANKFORT ELECRIC AND WATER PLANT BOARD AND SOUTH ANDERSON WATER DISTRICT	))))	**CASE NO. 2013-00250**

MEMORANDUM OF SOUTH ANDERSON WATER DISTRICT

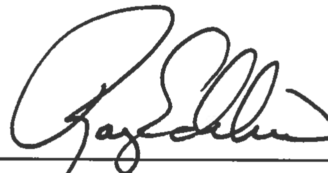
Comes, South Anderson Water District (hereinafter "SAWD"), by and through counsel and pursuant to the Commission's Order dated July 3, 2013 hereby responds to said Order, as follows:

1. SAWD hereby adopts the memorandum filed by the Electric and Water Plant Board of the City of Frankfort, Kentucky (hereinafter "FPB"), as its own.

2. A copy of said memorandum is attached hereto and labeled Exhibit "A" for identification.

3. For the various reasons set forth in the attached memorandum, SAWD requests the Commission permit SAWD and FPB to implement the terms of this joint agreement and further find that no prior approval of such minimum purchase water contracts are required.

This the 9th day of August, 2013.



Honorable Ray Edelman
Attorney at Law
148 South Main Street
Lawrenceburg, Kentucky 40342
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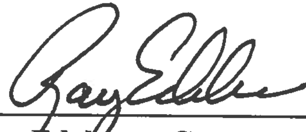
CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing memorandum has been served upon Executive Director, Jeff Deroven, Public Service Commission, Commonwealth of Kentucky 211 Sower Blvd., Post Office Box 615, Frankfort, Kentucky 40602-0615 and Frankfort Electric and Water Plant Board, Honorable Hance Price, Staff Attorney by mailing or hand delivery of same on this the 9th day of August, 2013.



Ray Edelman, Counsel for South Anderson Water District

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

INVESTIGATION INTO THE PROPOSED WATER SUPPLY AGREEMENT BETWEEN FRANKFORT ELECTRIC AND WATER PLANT BOARD AND SOUTH ANDERSON WATER DISTRICT	)	**CASE NO. 2013-00250**

BRIEF OF FRANKFORT ELECTRIC AND WATER PLANT BOARD

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I. INTRODUCTION

For thirteen (13) years, since June of 2000, the Electric and Water Plant Board of the City of Frankfort, KY ("FPB") has sold water on a wholesale basis to South Anderson Water District ("SAWD"). These sales are made pursuant to a mutually agreeable long term contract. This relationship has been, and is, beneficial to the ratepayers of both organizations.

On October 23, 2012, FPB and SAWD entered into their most recent contract to extend these purchases. Like many contracts currently on file with the Kentucky Public Service Commission ("Commission"), the contract contains a requirement that SAWD purchase a minimum amount of water each month. FPB filed this contract on October 25, 2012 and the parties have already taken steps to implement its provisions.

However, on July 3rd, 2013, the Commission opened the instant case to determine whether minimum purchase requirements in a water supply agreement are evidences of indebtedness requiring prior Commission approval pursuant to KRS 278.300(1). Case No. 2013-00250, In the Matter of: Investigation into the Proposed Water Supply Agreement Between Frankfort Electric and Water Plant Board and South Anderson Water District (Ky. PSC July 3, 2013) at 1. The Commission has never promulgated a rule or held that such provisions are an evidence of indebtedness and the parties relied on this when they executed the agreement. FPB maintains such minimum purchase provisions do not require prior approval and cannot be defined as an evidence of indebtedness. KRS 278.300 cannot be reasonably interpreted to include a minimum purchase requirement as an evidence of indebtedness. Finally, other authorities that have considered this question have concluded that a mere obligation to pay in the

future is not an evidence of indebtedness because such a rule would require prior approval of nearly all routine contracts.

II. THE COMMISSION SHOULD BE ESTOPPED FROM HOLDING THAT THE MINIMUM PURCHASE REQUIREMENT IS AN EVIDENCE OF INDEBTEDNESS REQUIRING PRIOR APPROVAL.

A. The FPB-SAWD water purchase agreement executed June 3, 2000 has been examined by the Commission in three (3) prior cases.

FPB's June 3, 2000 contract with SAWD has been examined in at least three (3) cases before the Commission. In all of these cases, the Commission required FPB to produce its wholesale water supply agreements. And in all three (3) cases, the Commission asked specifically whether there are minimum purchase requirements in these agreements.

In Case No. 2006-00444, FPB noted in its Response to Item Fourteen (14) of the Commission's Order dated October 20, 2006 that its contract with SAWD contains a minimum purchase requirement of 50,000 gallons per day. Likewise, in Case No. 2008-00250, FPB noted in its Response to Item Thirteen (13) of the Commission's Order dated July 2, 2008 that its contract with SAWD contains a minimum purchase requirement of 50,000 gallons per day. Finally, FPB provided the same data to the Commission in its Response to Item Fourteen (14) of the Commission's Order dated December 17, 2010 in Case No. 2010-00485.

The minimum purchase requirement contained in the SAWD contract was never questioned by the Commission in any of these three (3) cases. Consequently, the Commission should be estopped from claiming that prior approval is now required. In Electric & Water Plant Board v. Suburban Acres Development, Inc., 513 S.W.2d 489 (Ky. 1974), the Frankfort Plant Board told a developer that service was available at a particular parcel. Id. at 490. Thereafter, the Plant Board "at a regular meeting voted to delay water service." Id. at 490. However, the

developer had relied on the Plant Board's representations to arrange financing. Id. at 491. The court noted that "[w]e are of the opinion that this situation presents a state of facts which constitute estoppel." Id. at 491.

In the instant case, the Commission was aware of the minimum purchase requirement in the SAWD agreement and never questioned it. In a similar circumstance, the Arizona Corporation Commission found that it was reasonable for Arizona-American Water to rely on past Commission practice when the company did not seek prior approval of an infrastructure agreement. Docket No. W-01303A-09-0343, In the Matter of: The Application of Arizona-American Water Company, an Arizona Corporation, for a Determination of the Current Fair Value of its Utility Plant and Property and for Increases in its Rates and Charges Based Thereon for Utility Service by its Anthem Water District and its Sun City Water District, and Possible Rate Consolidation for all of Arizona-American Water Company's Districts; In the Matter of: The Application of Arizona-American Water Company, an Arizona Corporation, for a Determination of the Current Fair Value of its Utility Plant and Property and for Increases in its Rates and Charges Based Thereon for Utility Service by its Anthem/Agua Fria Wastewater District, its Sun City Wastewater District and its Sun City West Wastewater District, and Possible Rate Consolidation for all of Arizona-American Water Company's Districts, 2011 Ariz. PUC LEXIS 11 (Ariz. Corp. Comm'n Jan. 6, 2011) at *64. Here, FPB has relied on longstanding Commission practice holding that such minimum purchase requirements are acceptable when it negotiated and executed the October 23, 2012 SAWD agreement. The Commission should not retroactively now seek to abrogate the minimum purchase term of the contract.

B. The Commission has never announced a rule that a minimum purchase requirement in a wholesale water purchase agreement is an evidence of indebtedness requiring prior approval.

FPB has been unable to locate any case decided by this Commission holding that KRS 278.300(1) applies to minimum purchase provisions in a wholesale water purchase agreement. Likewise, FPB is unaware of any rule announced by this Commission requiring prior approval of such provisions. Consequently, the Commission should not require prior approval when the parties have relied on the most current authority when crafting their agreement.

The Commission has not defined an evidence of indebtedness. In Administrative Case No. 350, the Commission discussed KRS 278.300(1) in the context of wholesale electric power supply contracts. The Commission wrote "these contracts **may** well require prior approval under 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." Administrative Case No. 350, In the Matter of: 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 October 25, 1993) at 8-9 (emphasis added). Even with respect to electric power purchase agreements, the Commission never held that such agreements **shall** require approval. In fact, the Commission wrote that "utilities should be able to purchase power without prior Commission approval." Id. at 8.

Nearly twenty (20) years have passed since this case was decided by the Commission. During that time, and before, cities and water districts relied on Commission practice, negotiated

mutually agreeable contracts and filed them with the Commission. This system has served the industry well and there is no need to modify it.

III. AN EVIDENCE OF INDEBTEDNESS CANNOT BE INTERPRETED TO INCLUDE A MINIMUM PURCHASE REQUIREMENT CONTAINED IN A WHOLESALE WATER PURCHASE AGREEMENT.

KRS 278.300(1) cannot be reasonably interpreted to mean that a minimum purchase provision in a wholesale water purchase agreement is an evidence of indebtedness. The Kentucky Supreme Court in Jefferson County Bd. of Ed. v. Fell, 391 S.W.3d 713 (Ky. 2012) outlined the principles of statutory interpretation used in order to "carry out the intent of the legislature." Id. at 718 (citation omitted). First, consider "the language employed by the legislature itself, relying generally on the common meaning of the particular words chosen, which meaning is often determined by reference to dictionary definitions." Id. at 719. Next, "[t]he particular word, sentence or subsection . . . must also be viewed in context rather than in a vacuum; other relevant parts of the legislative act must be considered in determining the legislative intent." Id. at 719. A court will also "presume that the General Assembly intended for the statute to . . . harmonize with related statutes . . . [and] that [it] did not intend an absurd statute." Id. at 718-19 (citation omitted). Finally, a court may use "canons of statutory construction" in its analysis. Id. at 720 (citation omitted).

A. The plain language contained in KRS 278.300(1) does not suggest that it applies to water purchase agreements.

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.

Nothing in the plain language of this section suggests that it applies to agreements other than those involved in the issuance of securities used to raise funds for the utility. KRS 278.300(1) refers to an "issue." The Attorney General of Washington, interpreting similar language, wrote that "issue" means "'[t]o put into circulation, to emit.'" 1950 Wash. AG LEXIS 279 at *5 (citation omitted). The Opinion also noted that "'[t]he execution and delivery of an instrument or obligation not intended for further circulation by delivery is rarely spoken of as an issue of such instrument.'" Id. at *5-6 (citation omitted). Here, wholesale water agreements are not circulated. They are not sold or traded on any securities market.

Moreover, as to the meaning of evidence of indebtedness, the Washington Attorney General opined that "'other evidence of indebtedness means such as has been issued and distinct from such indebtedness as may have been merely incurred or created.'" Id. at *6 (citation omitted). That is, an evidence of indebtedness is a security. Id. at *6. In Smith v. Wedding, 303 S.W.2d 322 (Ky. 1957) the court held that "the term 'security' carries with it the idea that the investor will earn his profit through the efforts of others than his own." Id. at 323 (citation omitted). Wholesale water agreements are not issued or delivered to investors who trade them to earn a profit. Consequently, such agreements are not properly considered securities or evidences of indebtedness.

B. Other sections of KRS 278.300 suggest that it does not apply to water purchase agreements.

In addition to the section in question, the language contained in the entire statute must be considered when discerning its meaning. KRS 278.300(4) and KRS 278.300(7) both suggest that the statute was not intended to apply to minimum purchase requirements in wholesale water purchase agreements. KRS 278.300(4) notes that the Commission's order "shall specify that the

securities or evidences of indebtedness, or the proceeds thereof, shall be used only for the lawful purposes specified in the application." KRS 278.300(7) requires the utility "issuing any security or evidence of indebtedness" to provide reports to the Commission showing "the disposition made of such securities or evidences of indebtedness, and the application of the proceeds thereof." Unlike securities, wholesale water contracts are not sold by a utility to raise funds. There are no proceeds from the disposition of a wholesale water contract. The statute simply has no application to this circumstance.

KRS 278.300(8) and KRS 278.300(9) also suggest that the statute does not apply to wholesale water agreements with minimum purchase requirements. KRS 278.300(8) discusses the "renewal" or "refunding" of "notes issued by a utility" with payment terms of less than two (2) years. Wholesale water agreements are not refunded. KRS 278.300(9) indicates that the state does not guarantee securities or evidences of indebtedness and notes the section places no limit on a court's jurisdiction "to authorize or cause receiver's certificates or debentures to be issued." The state would have no need to guarantee water purchase contracts and they would not be issued in a receivership proceeding. The statute's terms could not have been meant to apply to wholesale water purchase agreements.

C. Statutory construction principles require a narrow reading of the term evidence of indebtedness that cannot include water purchase agreements.

In addition to inspecting the statute's language, Kentucky courts also apply rules of statutory construction. One such principle, ejusdem generis, "'is used . . . when a general word or phrase follows a list of specific persons or things. The general word or phrase will be interpreted to include only persons or things of the same type of those listed.'" Workforce Dev. Cabinet v. Gaines, 276 S.W.3d 789, 795 (Ky. 2008) (citation omitted). That is, general words contained in a

list are not considered broadly. Id. at 795. Rather, they are interpreted narrowly in light of other words contained in the list or statute. Id. at 795.

Here, the term evidence of indebtedness follows security. A security "carries with it the idea that the investor will earn his profit through the efforts of others than this own." Lewis v. Creasey Corp., 248 S.W. 1046, 1048 (Ky. 1923). No such idea is associated with a wholesale water purchase agreement containing a minimum purchase requirement.

The Hawaii Public Utilities Commission applied this principle when it found that a lease for office space was not an evidence of indebtedness requiring Commission approval. Docket No. 05-0084, In the Matter of: the Petition of Hawaiian Electric Co., Inc.; For a Declaratory Ruling on the Applicability of Hawaii Revised Statutes Section 269-17, for a Capital Lease Arrangement, 2005 Haw. PUC LEXIS 248 (Haw. PUC May 12, 2005). The Hawaii PUC wrote that "'other evidences of indebtedness' is limited to things of like character to stocks, stock certificates, bonds, and notes, usually issued a means of raising funds . . . [to] become part of the utility's capital structure.'" Id. at *16-17. The Hawaii PUC noted "that the lease agreement was not a loan and was never intended to be issued or sold to others, and thus, was not a method of generating capital." Id. at *8. Likewise, wholesale water purchase agreements are not sold or used to raise capital.

D. An interpretation that KRS 278.300(1) does not apply to minimum purchase requirements promotes consistency with other sections of the Kentucky Revised Statutes and leads to a reasonable result.

Finally, when interpreting a statute courts should harmonize its meaning "with other parts of the [KRS] beyond [the chapter in which it is contained.]" Jefferson County Bd. of Ed. v. Fell, 391 S.W.3d 713, 725 (Ky. 2012). "[H]armony and consistency are both factors frequently noted

in statutory construction cases as further evidence of the appropriateness of a particular interpretation of a statute." Id. at 725. Although KRS Chapter 278 does not define the term "security", KRS Chapter 292 does. KRS 292.310(19) defines security. It 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.

Minimum purchase requirements are not an evidence of indebtedness in the same sense that an evidence of indebtedness is a security. Water contracts are not of the same character as stocks, bonds, notes or other securities issued by a utility to raise funds. They are not bought, sold or otherwise traded for a profit or loss. There are no proceeds when the contract is executed by the parties. To find that a minimum purchase requirement is an evidence of indebtedness, a type of security, would not harmonize KRS Chapter 278 with Chapter 292.

The Kentucky Supreme Court also wrote that it is "presume[d] that the General Assembly did not intend an absurd statute." Jefferson County Bd. of Ed. v. Fell, 391 S.W.3d 713, 718-19 (Ky. 2012). To find that a water contract, or any contract containing any obligation to pay, is an evidence of indebtedness requiring prior Commission approval would lead to at least an unintended, if not absurd, result. Such an interpretation would require the Commission to review even the most mundane agreements such as those for: cleaning services, copier services, computer services, cell phones or vending machines. The Commission would likely have difficulty reviewing the overwhelming number of such commonplace agreements that would be

submitted for approval within the sixty (60) day limitation contained in KRS 278.300(2). The Legislature could not have intended such a result.

IV. <u>AN EVIDENCE OF INDEBTEDNESS DOES NOT INCLUDE AN ORDINARY COMMERCIAL CONTRACT CONTAINING MUTUAL OBLIGATIONS.</u>

A. The essential element of an evidence of indebtedness under Kentucky law is an expectation of profit based on another's efforts.

Courts have distinguished between an evidence of indebtedness that is an obligation to pay a certain amount from an evidence of indebtedness that is a type of security. The fact that an agreement may provide an obligation to pay, or an evidence of indebtedness, does not transform it into a security. In <u>Lewis v. Creasey Corp.</u>, 248 S.W. 1046 (Ky. 1923) the court discussed the application of the Kentucky Blue Sky laws to a service contract. <u>Id.</u> at 1047. There, the Creasey Corporation sold grocery supply contracts. <u>Id.</u> at 1047.

The court began by noting that "words [in a statute] will not be given their literal meaning when to do so would evidently carry the operation of the statute far beyond the purposes which the legislature had in view, and which would make its provisions apply to transactions never contemplated by the legislative body." <u>Id.</u> at 1048. The court reasoned that all contracts could be securities since any contract "'guarantees to the parties thereto something of value.'" <u>Id.</u> at 1049 (citation omitted). However, the court distinguished between securities and "any ordinary commercial contract." <u>Id.</u> at 1048.

A security is an investment whereby the purchaser earns a "profit through the efforts of others than his own." <u>Id.</u> at 1048. In contrast, an ordinary commercial contract involves a mutual obligation requiring the parties to earn profits by their own efforts. <u>Id.</u> at 1048-49. Here, a

wholesale water purchase contract involves a mutual obligation. There is no expectation of profits based on the efforts of another that is characteristic of a security.

B. Wholesale water purchase agreements containing minimum purchase requirements are bilateral agreements and as such are not evidences of indebtedness.

Other courts have adopted this distinction between contracts where there is an expectation of profit based on the efforts of another and bilateral contracts finding that the latter are not securities. In Berman v. Dean Witter & Co., 353 F. Supp. 669 (C.D. Cal. 1973) the court considered whether yen futures contracts were securities. Id. at 670. The court wrote that "[t]he 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." Id. at 671. To adopt such a rule "would be tantamount to a declaration that all bilateral executory contracts are securities." Id. at 671.

The Texas Court of Criminal Appeals also reviewed the term evidences of indebtedness in the context of a securities fraud case. Thomas v. State, 65 S.W.3d 38, 46 (Tex. Crim. App. 2001). The court noted that "a literal application [of the term evidences of indebtedness] turn[s] all bilateral contracts into securities despite having a commercial instead of an investment character." Id. at 46.

In addition, the California Public Utilities Commission utilized the distinction between bilateral and unilateral contracts when deciding whether an agreement qualifies as a security requiring prior Commission approval. Pacific Gas & Electric Co. ("PG&E") asked that the California PUC "adopt an additional guideline for buyouts of [qualifying facility contracts] under which utilities pay the [qualifying facility, i.e. another power generator] over a period of more than one year (multiyear QF buyouts) by determining that such buyouts are not 'evidences of

indebtedness' under PU Code § 818, and therefore do not require prior Commission authorization." Decision No. 97-08-016, Order Instituting Rulemaking on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation; Order Instituting Investigation on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation, 1997 Cal. PUC LEXIS 667 (Cal. PUC August 1, 1997) at *4. PG&E argued that evidences of indebtedness are akin to notes or bonds and the qualifying facility contracts were not because the QF buyout was "not a unilateral promise to pay." Id. at *5. Moreover, PG&E maintained that Section 818, the California counterpart to KRS 278.300, addressed "indebtedness in the sense of borrowing, the proceeds of which would be used for utility purposes." Id. at *5.

The California PSC found that the multiyear buyouts did not require approval because they were bilateral agreements and the term evidences of indebtedness should be narrowly construed. Id. at *14-16. Here, the QF buyout was "not a unilateral promise to pay" and did not raise funds for the utility. Id. at *15. Rather, "each party . . . [had] certain duties and obligations, and [had] certain liabilities." Id. at *14. The California PUC also noted that the term "'evidences of indebtedness' has a narrower, as opposed to a broader reading, so that it would encompass only things 'of the same general nature as notes or bonds.'" Id. at *14-15. The buyouts, like the minimum purchase contracts, shared none of the characteristics of a note or bond issued to raise funds for the utility and contained mutual obligations.

The Arizona Corporation Commission also employed this paradigm. In 2011, the Arizona Commission discussed whether Arizona-American Water Company's Infrastructure Agreement with Pulte Homes was an evidence of indebtedness requiring prior approval. Docket No. W-

01303A-09-0343, In the Matter of: The Application of Arizona-American Water Company, an Arizona Corporation, for a Determination of the Current Fair Value of its Utility Plant and Property and for Increases in its Rates and Charges Based Thereon for Utility Service by its Anthem Water District and its Sun City Water District, and Possible Rate Consolidation for all of Arizona-American Water Company's Districts; In the Matter of: The Application of Arizona-American Water Company, an Arizona Corporation, for a Determination of the Current Fair Value of its Utility Plant and Property and for Increases in its Rates and Charges Based Thereon for Utility Service by its Anthem/Agua Fria Wastewater District, its Sun City Wastewater District and its Sun City West Wastewater District, and Possible Rate Consolidation for all of Arizona-American Water Company's Districts, 2011 Ariz. PUC LEXIS 11 (Ariz. Corp. Comm'n Jan. 6, 2011) at *39, 51. The Arizona Commission agreed with its Staff's findings and held that "the Infrastructure Agreement is not a stock or bond, but an agreement that provides terms and conditions of service, as well as refund obligations, and that its approval . . . was not necessary." Id. at *63. The Arizona Commission also noted that the Infrastructure Agreement was not used to "build[] up the utility's general and permanent capital structure like an issuance of stock." Id. at *63.

The Arizona Commission rejected an interpretation that "any contract that a utility enters into that requires the payment of money over a term [should] require prior Commission approval." Id. at *62. The Commission's Staff noted that were such an interpretation accepted "then nearly every existing . . . extension agreement in the State of Arizona would become invalid, and the Commission would be inundated with agreements that could potentially qualify as 'other evidences of indebtedness.'" Id. at *62.

V. CONCLUSION

The Commission has never required prior approval of wholesale water purchase agreements containing minimum purchase requirements and there is no need to implement such a rule. A finding that KRS 278.300(1) requires prior approval of a mere obligation to pay at some future time would require the Commission to review a myriad of commonplace contracts executed by utilities in the normal course of their business. That could not have been the statute's intent. An obligation to pay contained in a bilateral agreement is not an evidence of indebtedness. Rather, that term can only apply to securities issued and circulated to raise capital for the utility.

WHEREFORE, for the foregoing reasons, FPB respectfully requests that the Commission allow the parties to implement the terms of their agreement, find that no prior approval of such minimum purchases is required and grant such other relief as the Commission finds appropriate.

Respectfully Submitted,

Hance Price

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CERTIFICATE OF SERVICE

I, Hance Price, certify that on the 2nd day of August, 2013 a copy of this Brief of Frankfort Electric and Water Plant Board was served by mail to Honorable Ray Edelman, Attorney at Law, 148 South Main Street, Lawrenceburg, KY 40342 and an original and ten copies by hand delivery to Jeff Durouen, Executive Director, Kentucky Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky, 40601.

Hance Price