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November 21, 2007

David B. Vickery, Esq.
101 North Main Street
Leitchfield, Kentucky 42754

Re: Leitchfield-Grayson County Water District

Dear Mr. Vickery:

Commission Staff acknowledges receipt of your letter of February 21, 2007 in which the City of Leitchfield ("Leitchfield") requests reconsideration of Commission Staff's letter of February 16, 2007. I apologize for the delay in responding.

On February 16, 2007, Commission Staff advised Grayson County Water District ("Grayson District") by letter regarding the procedures that Leitchfield should follow to adjust its wholesale water service rate to Grayson District. More specifically, it opined that Leitchfield must at a minimum file a revised rate schedule with the Commission at least 30 days prior to the effective date of any proposed rate adjustment. At the time of this advisement, Leitchfield had revised its wholesale rate and was assessing the revised rate, but had not filed such schedule with the Commission. As a result of its failure to file a revised rate schedule, Commission Staff opined, Leitchfield could not properly charge the revised rate.

In your letter and in your telephone conversations with Commission Staff, you request that Commission Staff reconsider its position. You assert that the wholesale water purchase agreements between Leitchfield and Grayson District set forth an exact formula for establishing the wholesale rate, that this formula is the "wholesale rate," and that, while the product of formula has changed, the formula has not changed. As the formula has not changed, you further assert, KRS 278.180 does not require the filing of a new rate schedule or advance notice to the Commission of the recalculation of the formula.

Commission Staff understands the facts as follows:

Leitchfield is a city of the fourth class. It provides wholesale water service to Grayson County Water District, a water district created pursuant to KRS Chapter 74. Grayson

District provides water service to the unincorporated areas of Grayson County.

On August 21, 1972, Leitchfield and Grayson District entered into a contract for the sale and purchase of water. This contract specified a wholesale water rate of \$0.35 per 1,000 gallons. It further provided that this rate was subject to modification at the end of every three-year period and that change in the rate must be based on a demonstrable change in the costs of performance. Costs related to the increased capitalization of Leitchfield's system were not to be considered in establishing the wholesale rate.

On April 11, 1978, Leitchfield and Grayson District amended their earlier contract to clarify the methodology used to establish the wholesale service rate. The new agreement provided that the wholesale rate was based upon the proportionate percentage of water sold to Grayson District as compared to the total pumped at Leitchfield's plant and the cost of water withdrawn from the raw source, processed, pumped, stored and delivered to Grayson District (including Operation and Maintenance, Administrative Costs, and Debt Service). The new agreement stated a wholesale rate of \$0.53 per 1,000 gallons.

To resolve a contract dispute that resulted in a legal action before Grayson Circuit Court, Leitchfield and Grayson District agreed in 1983 to amendments to their earlier agreements. While agreeing to a revised rate of \$0.95 per 1,000 gallons, they further agreed that engineers representing both parties would use the results of the audit of Leitchfield's water operations for the 1983-84 fiscal year and prepare a joint report on a new wholesale water rate. Once a new rate was established, it would remain in effect for a two-year period until a new rate was established using the audit report from the previous fiscal year.

On August 4, 1988, Leitchfield and Grayson District executed a Supplemental Agreement that, inter alia, specified that future wholesale rates would be calculated in accordance with the 1983 Agreement and "the methods, assumptions, formulae, and procedures" in the Joint Report that the utilities prepared in March 1988. The Supplemental Agreement further established a formula for the allocation of cost of certain capacity improvements.

On June 9, 1994, Leitchfield and Grayson District entered a Second Supplemental Agreement. This agreement affirmed the procedures in the 1983 Agreement, 1988 Joint Report and Supplemental Agreement, but specified cost allocation procedures for various cost components. The Second Supplemental Agreement also provided that a rate study would be completed within 30 days of the delivery of "all required information" to Leitchfield and that the recalculation would become effective 45 days after completion of the rate study.

Leitchfield has filed all of the agreements mentioned above with the Public Service Commission.

Commission records indicate that Leitchfield has recalculated its wholesale rate in accordance with procedures and methodologies set forth in these agreements on at least three occasions since 1994. Commission records further reflect that Leitchfield has not filed with the Commission a rate schedule reflecting the recalculation of its rate in accordance with the contract formulae since 1997.

On January 12, 2007, consultants for Grayson District and Leitchfield recalculated the wholesale water service rate based upon the procedures set forth in the agreements mentioned above. On January 22, 2007, Grayson District's Board of Commissioners accepted these calculations. Three days later Grayson District notified Leitchfield of its Board of Commissioners' action and requested that it be notified upon Leitchfield's filing of notice of the proposed rate adjustment with the Public Service Commission. On January 31, 2007, Leitchfield's legal counsel advised Grayson District that the Public Service Commission would be notified of the recalculated rate by letter for "courtesy purposes." Leitchfield's City Clerk subsequently advised Grayson District that Leitchfield would bill at the recalculated rate for service provided on and after January 12, 2007.

In its letter of February 16, 2007, Commission Staff opined that the recalculated rate could not become effective until Leitchfield complied with KRS 278.180(1) by providing the Commission with 30 days' notice of the recalculated rate. Commission Staff noted that Leitchfield had yet to file any tariff sheet with the Commission that indicated a revised rate for wholesale water service.

Based upon its review of the agreements between Leitchfield and Grayson District, which were not mentioned in the first letter requesting guidance and, therefore, not considered in the development of the earlier opinion, Commission Staff finds that its

David B. Vickery, Esq.
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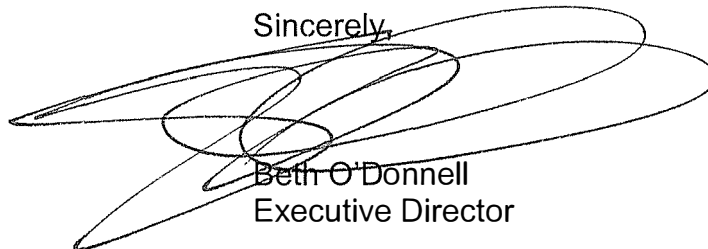
earlier opinion requires revision. The formula set forth in the agreements is the rate for wholesale water service. In this respect, the wholesale service rate is similar to an electric utility's fuel adjustment rate. See, e.g., State ex. rel Utils. Comm'n v. Edmisten, 230 S.E.2d 651, 659 (N.C. 1976) ("[T]he word 'rate' used in the Public Utility Act refers not only to the monetary amount which each customer must ultimately pay but also to the published method or schedule by which that amount is figured."). As this formula has remained unchanged since the execution of the Second Supplemental Agreement, KRS 278.180(1) did not require 30 days' notice to the Commission of the recalculated cost components.

Commission Staff is further of the opinion that, based upon the terms of the parties' agreements, Leitchfield could not assess the recalculated rate until February 27, 2007 and should refund any amounts collected in excess of the then-existing rate of the rate of \$1.439 per 1,000 gallons prior to that date. The Second Supplement Agreement provided that the recalculated rate became effective 45 days after completion of the rate study. Under the terms of the 1983 Agreement, the recalculated rate must be determined and agreed upon by the parties' engineers. Accordingly, the rate study was not completed until January 12, 2007 when Grayson District's engineers concurred in the study's results.

Finally, while KRS 278.180(1) did not require notice to the Commission of rate recalculations based upon the agreements' formula, Commission Staff respectfully recommends that the better practice is for Leitchfield to file revised tariff sheets with the Commission prior to placing the results of the recalculation into effect.

This letter represents Commission Staff's interpretation of the law as applied to the facts presented. This opinion is advisory in nature and not binding on the Commission should the issues herein be formally presented for Commission resolution. Questions concerning this opinion should be directed to Gerald Wuetcher, Assistant General Counsel, at (502) 564-3940, Extension 259.

Sincerely,

A large, stylized handwritten signature in black ink, consisting of several overlapping loops and curves, positioned above the printed name and title.

Beth O'Donnell
Executive Director

gew/

cc: Kevin Shaw