

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE CONTRACT FILING OF HARRISON COUNTY)
WATER ASSOCIATION, INC. OF A WATER) CASE NO. 2001-173
PURCHASE AGREEMENT WITH KENTUCKY-)
AMERICAN WATER COMPANY)

O R D E R

Kentucky-American Water Company (“KAWC”) and Harrison County Water Association, Inc. (“HCWA”) have submitted a proposed water purchase agreement. At issue is whether the limitations upon HCWA’s ability to extend service and to transfer its assets that are set forth in the purchase agreement are reasonable conditions of service. Finding that these conditions are unreasonable, we strike those conditions and approve the remaining provisions of the proposed water purchase agreement.

PROCEDURE

On May 21, 2001, HCWA submitted to the Commission a proposed purchased water agreement with KAWC.¹ Finding further proceedings were necessary to determine the reasonableness of the proposed agreement, we initiated this proceeding on June 13, 2001. We subsequently permitted the Attorney General, through his Office of Rate Intervention (“AG”), to intervene in this proceeding. Following limited discovery conducted by Commission Staff and the parties’ submission of comments on certain

¹ The Commission notes that KAWC had the statutory and regulatory responsibility for submitting the proposed agreement. See KRS 278.160; 807 KAR 5:006, Section 5; 807 KAR 5:011, Section 13. We expect that KAWC will in the future fulfill its responsibilities rather than shift them to others.

facets of the proposed agreement, the matter stood submitted for decision on September 10, 2001.²

BACKGROUND

HCWA, a non-profit corporation organized pursuant to KRS Chapter 273, owns and operates facilities that are used to distribute water to 4,414 customers in Bourbon, Harrison, Nicholas, and Scott counties, Kentucky.³ It does not own or operate a water treatment facility, but purchases water from the city of Cynthiana, Kentucky for resale to its customers.

KAWC is a Kentucky corporation that owns and operates facilities that treat and distribute water to 96,457 customers in Bourbon, Clark, Fayette, Harrison, Scott and Woodford counties, Kentucky.⁴ It also supplies wholesale water service to the cities of Midway, North Middleton, Versailles, and Georgetown, Kentucky and to Spears Water Company and Lexington-South Elkhorn Water District.⁵ KAWC currently has a maximum daily production capacity of 65 million gallons.

On September 20, 2000, KAWC and HCWA executed a water purchase agreement for KAWC to provide water service to HCWA. This agreement states that KAWC will provide HCWA an amount of water not to exceed 150,000 gallons in any 24-

² Pursuant to our Order of August 22, 2001, we authorized KAWC to provide water service to HCWA pending the completion of these proceedings.

³ Annual Report of Harrison County Water Association, Inc. to the Public Service Commission for the Year Ended December 31, 2000 at 5 and 29.

⁴ Annual Report of Kentucky-American Water Company to the Public Service Commission for the Year Ended December 31, 2000 at 5 and 31.

⁵ Id. at 33.

hour period and at a rate not to exceed 150 gallons per minute.⁶ It further requires KAWC to construct the facilities necessary to provide service to HCWA. Under the terms of the agreement, HCWA must purchase water from KAWC in sufficient quantity within the first 3 years of the contract to equal KAWC's actual investment in the new facilities. HCWA agreed to compensate KAWC if it fails to purchase this quantity during the 3-year period.⁷ KAWC will provide service at its filed rates for wholesale service.⁸ The agreement prohibits HCWA from reselling water outside its service territory as of September 20, 2000⁹ and grants to KAWC the right of first refusal to purchase all of HCWA's assets that are devoted to providing water service.¹⁰

While the two water utilities had facilities in close proximity, the construction of additional facilities was necessary to serve HCWA. These facilities included

⁶ Agreement at ¶ 1.

⁷ Under the terms of the agreement, HCWA's total water purchases are compared to KAWC's investment semi-annually for the first 3 years during which KAWC provides water. If HCWA's total water purchases from KAWC for the 6 months under review are less than one-sixth of KAWC's investment, then HCWA must pay to KAWC an amount equal to the difference. See Agreement at ¶ 3. Based upon HCWA's present customer demand, it appears that HCWA will be required to make additional payments to KAWC. HCWA's average daily customer demand for 2000 was 178.5 gallons (269,961,000 gallons ÷ 365 days ÷ 4,414 customers). Assuming that 262 HCWA customers will be served through the KAWC connection, HCWA will purchase approximately 46,767 gallons daily (178.5 gallons x 262 customers). KAWC reports that HCWA must purchase an average of 78,757 gallons per day to equal KAWC's actual investment. See KAWC's Response to Commission Staff's First Set of Interrogatories and Requests for Production of Documents, Item 8.

⁸ Agreement at ¶ 3.

⁹ Id. at ¶ 5. For a description of HCWA's service territory, see KAWC's Response to Commission Staff's First Set of Interrogatories and Requests for Production of Documents, Item 7.

¹⁰ Agreement at ¶ 10.

approximately 2,500 feet of 12-inch water main and a 4-inch turbine meter. KAWC began construction on May 9, 2000 and completed it on August 3, 2000. Total cost of the facilities was \$186,000.¹¹ After completion of the facilities, KAWC can deliver water to HCWA at a point approximately 2,500 feet east of Leesburg Lane on the north side of U.S. Highway 62 in Harrison County, Kentucky.

Although HCWA apparently has an adequate quantity of water from the city of Cynthiana, it considers KAWC as a more efficient supplier for those portions of its service area that are located in southern Harrison County and northern Bourbon County.¹² Prior to the connection with KAWC, HCWA had to pump water through 3 water storage tanks and 2 pumping stations to serve these areas. With the connection, HCWA no longer supplies water service to these areas using its storage tanks or pumping stations. Accordingly, it expects the purchase of KAWC water to reduce pumping and maintenance expenses and to permit the stabilization of water levels in 3 of its water storage tanks.¹³

DISCUSSION

The controversy in this proceeding concerns the proposed water purchase agreement's provisions that limit HCWA's service area and provide KAWC with the right of first refusal to purchase HCWA's assets. The AG contends that the restrictions on HCWA's service area are unnecessary and are contrary to the intent of KRS Chapters

¹¹ KAWC's Response to Commission Staff's First Set of Interrogatories and Requests for Production of Documents, Item 1b(2).

¹² This area contains approximately 262 HCWA customers.

¹³ KAWC's Response to Commission Staff's First Set of Interrogatories and Requests for Production of Documents, Item 9.

151 and 278. He further contends that the right-of-first-refusal provision is unnecessary and unreasonable and will reduce HCWA's flexibility in its operations. The AG requests that the Commission strike these provisions from the proposed agreement.

Dismissing such arguments, KAWC asserts that the proposed restriction does not conflict with any statute and is consistent with KRS Chapter 151's objective to encourage the coordination of utility efforts to expand water service. It argues that the AG has failed to articulate any reason for striking the provisions related to the right of first refusal and that such provision does not interfere or restrict the Commission's authority to review transfers of utility assets.

A utility has the right to impose reasonable conditions upon applicants for the provision of service. See KRS 278.030(2) ("Every utility shall furnish adequate, efficient and reasonable service, and may establish reasonable rules governing the conduct of its business and the conditions under which it shall be required to render service.") When proposing such conditions, it bears the burden of demonstrating that such conditions are reasonable and proper. See, e.g., Energy Regulatory Commission v. Kentucky Power Co., Ky.App., 605 S.W.2d 46 (1980). To the extent that such conditions are unlawful, unjust, improper, or unreasonable, they may be stricken or modified. KRS 278.280(1).

We fail to discern any reasonable basis for the proposed agreement's restriction on HCWA's service territory. While KAWC asserts that the provision is necessary to ensure that HCWA does not push "the limits of the intent of the contract,"¹⁴ such purpose can be achieved without restricting HCWA's service territory. The proposed

¹⁴ Id. at Item 7(b).

contract already limits the quantity of water that HCWA may purchase. KAWC, moreover, may propose to impose a penalty on any excessive water withdrawals as a means of discouraging such conduct.¹⁵

As the restriction is not limited to the portions of HCWA's service territory that will be served with KAWC water but applies to HCWA's entire service territory, it is overly broad. Nothing in the record indicates that HCWC intends to purchase water from KAWC to supply any portion of its service area other than southern Harrison County and northern Bourbon County. The record fails to show that HCWA's purchases from KAWC for such purposes would be practical or economical in light of HCWA's longstanding relationship with the city of Cynthiana. For that matter, the record also fails to reflect that Cynthiana is unable or unwilling to meet HCWA's additional water requirements if the quantity levels set forth in the proposed agreement are reached.

The Commission finds no merit to KAWC's contention that the restriction is necessary to ensure that KAWC is aware of significant changes in service in the future that may impact its current service territory.¹⁶ Such need could easily be satisfied by requiring HCWA to make routine reports to KAWC or participating in KAWC's planning processes. Even without such a requirement, HCWA's plans and most aspects of its operations are already a matter of public record and readily accessible to KAWC. HCWA files a report of its financial operations with the Commission annually. It must make periodic filings with Rural Development, its principal creditor, which are subject to

¹⁵ The record contains no evidence to suggest that KAWC proposed such penalties or that HCWA rejected such a proposal.

¹⁶ KAWC's Response to Commission Staff's First Set of Interrogatories and Requests for Production of Documents, Item 7.

public review. Moreover, HCWA participates in the Bluegrass Water Management Planning Council.

We next turn to the provision related to the right of first refusal. KAWC requested this provision during its negotiations with HCWA.¹⁷ It states the provision is necessary to “protect its current investment for the length of the contract should the situation unexpectedly change.”¹⁸

The Commission finds that adequate protections already exist in the agreement without the addition of the right of first refusal. The proposed agreement has a term of 40 years.¹⁹ In the event that another party purchases HCWA’s assets, the terms of the proposed agreement are binding upon the purchaser.²⁰ The proposed agreement, furthermore, requires HCWA to make payments to KAWC for KAWC’s initial investment during the first 3 years of the proposed agreement if certain purchase levels are not met. KAWC has failed to explain how, even with such protections, its interests are further protected by the right of first refusal.

SUMMARY

Having reviewed the evidence of record, the Commission finds that, except for Paragraphs 5 and 10, the provisions of the proposed water purchase agreement are reasonable and should be approved. We further find that Paragraphs 5 and 10 are

¹⁷ Id. at Item 11(a).

¹⁸ Id. at Item 11(c).

¹⁹ Agreement at ¶ 13.

²⁰ Id. at ¶ 11.

unreasonable and unnecessary and should be rejected and that the parties should file a revised agreement that excludes those provisions.

IT IS HEREBY ORDERED that:

1. The proposed water purchase agreement, with the exception of Paragraphs 5 and 10, is approved as of the date of this Order.
2. Paragraphs 5 and 10 are rejected.
3. Within 30 days of the date of this Order, KAWC and HCWA shall file a revised water purchase agreement that excludes those provisions found unreasonable herein.

Done at Frankfort, Kentucky, this 28th day of September, 2001.

By the Commission

ATTEST:


Executive Director