

has not proposed to revise or modify the Master Agreement, but simply seeks to follow it.

Marion District, on the other hand, requests that the Commission ignore the single, uniform rate embodied in the Master Agreement and substitute a dual rate (i.e., one rate for city customers and another rate for Marion District). In essence, Marion District seeks to rewrite the Master Agreement. Marion District's action is nothing less than a challenge to a central and critical provision of the Master Agreement and a request for modification of the Master Agreement. To the extent that it is challenging a provision of a filed contract, Commission precedent clearly assigns the burden of proof on Marion District to demonstrate that the process set forth in the Master Agreement and the results of that process are unreasonable and require Commission action.

STATEMENT OF THE CASE

A. Background

The Company, a non-profit corporation created by an act of the Kentucky General Assembly in 1884, owns and operates facilities that treat and distribute water to the residents of the City of Lebanon, Kentucky (the "City"). It provides water service to approximately 2,640 customers located in and near Lebanon, Kentucky. The City is the Company's sole shareholder and appoints the members of the Company's board of directors. The Board of Directors, however, functions

independently and exercises its own discretion in the management and operation of the Company's facilities. The Lebanon City Council retains the authority to fix and regulate the rates charged to the Company's customers.²

Marion District, a water district organized pursuant to KRS Chapter 74, owns and operates facilities that distribute water for compensation to unincorporated portions of Marion and Nelson Counties, Kentucky. Marion District does not produce its own water but purchases almost all of its water requirements from the Company.³

The Company has provided water to Marion District under the terms of a series of contracts beginning in 1968. In February 1968, Marion District entered its initial agreement with the Company to purchase water. Between 1968 and 1988, the Company and Marion District agreed on several occasions to modify the rate and service provisions of their initial agreement.

In 1988 the Company and Marion District executed the Master Agreement, which they intended to supersede and replace all prior contracts and to govern their relationship for the next 41 years.⁴ The Master Agreement incorporated the existing schedule of rates set forth in Ordinance 87-12. It also established a

² KRS 96.190(2).

³ Marion District purchases a small amount of water from Campbellsville to serve a limited number of customers.

⁴ Testimony of Daren Thompson ("Thompson Testimony"), Exhibit 1 at 15. The Company and Marion District have executed subsequent amendments to the Master Agreement to extend its term until March 31, 2050.

detailed and elaborate process for adjusting the contract rate for water service to ensure it accurately reflects the Company's current cost of service.

Under the Master Agreement, the Lebanon City Council acts as the neutral finder of fact that reviews the need and reasonableness of any rate adjustment. The Master Agreement requires the Company to submit any proposed rate adjustment to the Lebanon City Council for review and approval through the enactment of an ordinance.⁵ It further requires the Company to demonstrate that any adjustment to the rate schedule was based upon demonstrable changes in the cost of the Company's operations.⁶ The Master Agreement requires the Company to make all documents related to any proposed adjustment available to the City Council and to Marion District. It affords Marion District the right to request copies of or inspect documents and specifies that the production of documents or the opportunity to conduct document inspection be sufficiently in advance of any public hearing "to permit . . . [Marion District's] reasonable assimilation and review of the same prior to any such hearing."⁷

To underscore the distinct and independent role of the Lebanon City Council as a neutral finder of fact, the City joined as a party to the Master Agreement for "purposes of acknowledging the obligations imposed upon it with respect to the

⁵ *Id.* at 6.

⁶ *Id.*

⁷ *Id.* at 7.

procedures that will be followed when the Company makes applications for rate modifications.”⁸

The Master Agreement also provides an additional protection for Marion District by requiring the use of the same single, uniform rate to Marion District and Lebanon city residents.⁹ The single, uniform rate is also reflected in the City Ordinances. Ordinance 1987-12 provided one set of rates that applied to “all persons who use the waterworks facilities of the City of Lebanon, Kentucky.”¹⁰

Ordinance 1991-08 more specifically set out the single, uniform rate:

All users who [*sic*] service is provided through a meter located outside the municipal limits of the City of Lebanon shall pay 110% of the applicable charge provided for under the uniform minimum water rate schedule set out above. **Provided, however, this shall not apply to the Marion County Water District, which shall pay those charges set forth in the uniform minimum water rate schedule.**¹¹

In each of the four (4) subsequent ordinances it has adopted modifying the rates in the Master Agreement, the Lebanon City Council has expressly provided that Marion District will be subject to the single, uniform rate applicable to customers

⁸ *Id.* at 13.

⁹ *Id.* at 6 (“With respect to any future application for modification of its rates, the COMPANY shall present only to the City Council of Lebanon, Kentucky, the basis upon which such rate modification is sought. Whereupon, the City Council, having heard and considered such application for rate modification, and any protest or objection thereto, may enact by proper Ordinance **a rate schedule fixing those rates to be charged by the Company to its customers, including the District.**”) (emphasis added). In their 1995 Addendum to Water Purchase Agreement, the Company and Marion District expressly acknowledged that “by written agreement with an effective date of December 23, 1988, entered into an understanding pursuant to which the Company contracts and is obligated to furnish to the District certain quantities of treated water for which the District is obligated to pay **in accordance with the Company’s prevailing rate schedule . . .**” Thompson Testimony, Exhibit 5 at 1.

¹⁰ Thompson Testimony, Exhibit 9 at 1.

¹¹ Thompson Testimony, Exhibit 10 at 2 (emphasis added).

within the City limits.¹² Because of the single, uniform rate, any unreasonable or discriminatory determination imposed upon Marion District would also be imposed upon the residents of Lebanon – the same persons to whom each member of the Lebanon City Council is directly accountable through the electoral process. The Lebanon City Council has recognized and complied with this agreement when approving modifications to the rate schedule set forth in the Master Agreement.

Prior to 2017, the Company and Marion District followed the process established in the Master Agreement to adjust rates for water service four (4) times without incident. The amount of the four (4) rate adjustments and the current proposed rate increase are shown below:

Date	Percent (%) Increase
1991	97%
1997	21%
2007	38%
2013	17%
2017	34%

In each instance, the Lebanon City Council reviewed and approved the Company’s proposed rate with no objections from Marion District.

The Master Agreement has been amended numerous times since 1988 by addendums. Most of the addendums simply increase the maximum daily volume of water that Marion District may purchase from the Company or extend the term

¹² See Thompson Testimony, Exhibits 11 – 14

of the contractual relationship to enable Marion District to obtain long-term financing from Rural Development. Each of these addendums were filed with, reviewed by, and accepted for filing by the Commission. None of the addendums modified the single, uniform rate principle embodied in the Master Agreement. Instead, this single, uniform rate principle has been the hallmark of the contractual and historic relationship of the parties for nearly 50 years.

In the addendum dated June 30, 1997 to the Master Agreement, (“1997 Addendum”), the parties codified the single, uniform rate principle that had been previously set forth in city ordinances and observed by the parties. The provision states:

Consistent with the terms of Ordinance No. 96-16 of the City of Lebanon, Kentucky, the District intends, subject to approval of the Public Service Commission of the Commonwealth of Kentucky, to be bound by the terms of the uniform minimum water rate schedule set forth in the aforesaid Ordinance¹³

Thus, the single, uniform rate principle whereby Marion District paid the same rate as “in-city” customers is embodied in both the contractual agreements and in city ordinances. The Company, the City Council, and Marion District have continued to observe the single, uniform rate principle for each rate adjustment.

In 2017, the Company and the City Council followed the process set forth in the Master Agreement and observed the single, uniform rate principle in adjusting

¹³ Thompson Testimony, Exhibit 5.

the rate. Marion District, however, has chosen to ignore the plain language of the contractual agreements and nearly 50 years of precedent and is insisting upon having a separate, more favorable rate. In essence, it is seeking to have the Commission rewrite the Master Agreement and the 1997 Addendum so that a dual rate structure can be implemented.

B. Proposed Single Uniform Rate Adjustment

In 2016, the Company launched a review of its expenses to determine if its current rates reflected the full cost of providing service. In December 2016, Daren Thompson, the Company's Operations and Management Superintendent, notified Marion District's Manager of this review. By early July 2017, the Company had determined that its present rates were insufficient to meet its current operation and maintenance expenses and finance system improvements necessary to maintain safe and reliable service. The Company's calculations indicated that the single, uniform rate, which applies to all customers within Lebanon's city limits and includes Marion District, should be increased to produce sufficient revenues to cover the increased cost of service. This increase includes an 8.9 percent increase to the meter charge and a 34 percent increase to the volumetric component of the single, uniform rate.

On July 10, 2017, the Lebanon City Council conducted the first reading of Ordinance 2017-06 which would implement the proposed adjustment to the

Company's single, uniform rate. Prior to this first reading, Company officials met with Marion District officials to explain the Company's proposal. Despite receiving notice of the first reading, Marion District officials failed to attend the Lebanon City Council meeting or submit any formal protest or challenge to the proposed rates.

Between July 10, 2017 and September 11, 2017, Company officials met with Marion District officials to provide additional information regarding the proposed rate adjustment. At Marion District's request, the Company asked the Lebanon City Council to delay a second reading of Ordinance 2017-06 an additional 30 days to permit additional discussions with Marion District regarding the rate adjustment. Company officials also provided informational briefings to various public officials in city and county government and to various community organizations.

On September 11, 2017, the Lebanon City Council conducted its second reading of Ordinance 2017-06. Marion District officials did not attend these proceedings, did not present any evidence to the Lebanon City Council regarding the proposed rate adjustment, nor make any formal protest of the proposed rate adjustment to the Lebanon City Council.

The Company immediately implemented the rates contained in Ordinance 2017-06 to its retail customers. The implementation of these rates for Marion

District, however, was delayed 60 days pursuant to the terms of the Master Agreement.

C. Commission Proceedings

On September 13, 2017, the Company filed with the Commission notice of the proposed rate that the Lebanon City Council had reviewed and approved in accordance with the procedures set forth in the Master Agreement.¹⁴ This action followed the guidance that the Commission had previously provided to utilities that had detailed contract procedures for the review and adjustment of rates pursuant to water purchase agreements.¹⁵

On September 25, 2017, Marion District filed with the Commission a written protest and requested that a formal proceeding be initiated to investigate the reasonableness of the proposed rate. In its protest, Marion District stated that it was unable “to ascertain whether the proposed adjustment is consistent with the methodology set forth in the water purchase contract that Lebanon and MCWD have executed.”¹⁶ It questioned whether the proposed rate “reflects Lebanon’s

¹⁴ In its notice, the Company indicated that the proposed rate would be implemented for service provided on and after November 15, 2017. This implementation date is consistent with the Master Agreement’s requirement that the final determination of the Lebanon City Council would not take effect until 60 days after the final reading and passage of an Ordinance approving the single, uniform rate to permit Marion District adequate time to obtain an adjustment of its rates for service pursuant to KRS 278.015. Thompson Testimony, Exhibit 1 at 7.

¹⁵ See, e.g., *Purchased Water Adjustment of Bath County Water District*, Case No. 2007-00299 (Ky. PSC Sept. 26, 2007).

¹⁶ Letter from Kaelin G. Reed, counsel for Marion County Water District, to John S. Lyons, Acting Executive Director, Kentucky Public Service Commission (Sept. 19, 2017) (“Reed Letter”) at 1.

actual cost of providing service” to Marion District and cited nine (9) specific concerns regarding the rate adjustment.¹⁷

On November 13, 2017, the Commission established this proceeding to review “the reasonableness of the proposed rates.” In its Order, the Commission observed that the Company had “proposed adjustments to its existing rates for wholesale water service” to Marion District and invoked KRS 278.180 and KRS 278.190 as the statutory basis for its action.

ARGUMENT

1. Marion District is seeking to modify the single, uniform rate to provide a more favorable dual rate.

For nearly a half century, the Company has provided wholesale water to Marion District under the principle of a single, uniform rate. Marion District has paid no more or no less for water than the City’s in-city customers. Marion District is now seeking to modify the single, uniform rate and is requesting the Commission to replace it with a dual rate that would be more favorable to Marion District. By requesting the rewrite of the Master Agreement, Marion District ignores the contractual remedies that are available to it and requests an extraordinary remedy from the Commission.

¹⁷ *Id.* at 1-2.

In the Master Agreement, Marion District and the Company mutually established an elaborate and detailed method, with significant procedural safeguards to protect Marion District, to ensure the Company's single, uniform rate would reflect the cost of service. This process requires the Company to do the following: (a) submit any proposed rate adjustment to the Lebanon City Council for review and approval through the enactment of an ordinance; (b) demonstrate to the Lebanon City Council that the proposed rate is based upon demonstrable changes in the cost of service; and (c) make available to Marion District all documents necessary to assess the proposed rate. It allows Marion District to challenge the rate adjustment process before the Lebanon City Council.

When adjusting the single, uniform rate, the process set forth in the Master Agreement has been strictly followed. The Company provided Marion District with advance notice of its proposed adjustment and offered information regarding the current and future cost of service to support its proposed adjustment. The proposed adjustment was presented to and reviewed by the Lebanon City Council. Marion District had numerous opportunities to request information and inspect documents supporting the rate adjustment. It also had the opportunity to present its concerns and questions to the Lebanon City Council. By requesting the Commission investigate the single, uniform rate, Marion District has circumvented

the process in the Master Agreement and has sought a remedy not available to it in the Master Agreement.

The Master Agreement also requires that the Company charge the same single, uniform rate to Marion District as it charges to in-city customers. This requirement that the Company charge a single, uniform rate provides additional protections to Marion District and ensures that the Lebanon City Council rigorously investigates any proposed rate to determine that the proposed rate accurately reflects the cost of service.¹⁸ The restriction that the single, uniform rate be charged to in-city customers and Marion District is a fundamental part of the Master Agreement. Marion District may not simply reap the benefits of this restriction when it is favorable to it and then seek to establish a dual rate when it believes it is entitled to a lower rate.

To establish the dual rate Marion District is requesting, Marion District had two options: (1) negotiate with the Company for mutually agreed revisions to the Master Agreement to permit a dual rate or (2) request the Commission grant it extraordinary relief by rewriting the Master Agreement. Marion District has done neither.

¹⁸ See *Louisville Water Co. v. Public Service Commission*, 318 S.W.2d 537, 539 (Ky. 1958) (“Residents of a city have some means of protection against excessive rates or inadequate service of a utility through their voting power.”). The Kentucky Supreme Court has noted the lack of protection to customers of a municipal utility who are located outside of the city. *Grayson Rural Electric Corporation v. City of Vanceburg*, 4 S.W.3d 526, 529 (Ky. 1999) (“[O]ur predecessor Court recognized that voting power gave residents of a city some means of protection against excessive rates or inadequate service of a utility owned by the city. However, customers outside the city have no such protection. Moreover, rural consumers serviced by the EPB [municipal utility] lack any recourse regarding rates charged or services extended or denied.”).

2. Marion District bears the burden of proof in this matter as it seeks to rewrite the Master Agreement.

As the party seeking to modify the Master Agreement and establish a dual rate, Marion District bears the burden of proof to prove that the change is reasonable. The Commission clearly possesses the authority to modify the terms of a contract between a municipal utility and a public utility.¹⁹ Before such revision can be made, however, it must be demonstrated that the change is reasonable.²⁰ The party seeking the change bears the burden to make such a demonstration.

In Case No. 2005-00322, in which a water district challenged a municipal utility's existing rate for wholesale service, the Commission, noting that a filed rate is presumed to be reasonable, found that the water district bore the burden of proof.²¹ Similarly, in Case No. 2011-00419, the Commission declined to modify a wholesale water service contract because the party seeking the modification failed to demonstrate that its proposed modification was reasonable.²²

¹⁹ *Proposed Revision of Rules Regarding the Provision of Wholesale Water Service By the City of Versailles To Northeast Woodford Water District*, Case No. 2011-00419 (Ky. PSC Aug. 12, 2014) (“KRS 278.200 authorizes the Commission to modify contracts involving utility rates and services as a valid use of the state's police power to regulate utility rates and service. The Commission may revise any rate or service standard in a contract between a municipal utility and public utility despite objections by either party if the Commission finds that the proposed revision is reasonable under the circumstances.”)

²⁰ *See City of Franklin v. Simpson County Water District*, Case No. 92-084 (Ky. PSC Jan. 18, 1996) at (“KRS 278.200, by requiring the Commission to hold a hearing on any proposed change in contract rate, implies that such changes are not presumptively valid and reasonable, but that their reasonableness must be adequately demonstrated.”).

²¹ *East Clark County Water District v. City of Winchester, Acting By and Through Winchester Municipal Utilities Commission*, Case No. 2005-00322 (Ky. PSC Apr. 3, 2006). *See also, Southwestern Electric Power Co. v. Grant*, 73 S.W.3d 211 (Tx. 2002) (“The ‘filed-rate doctrine’ . . . holds that a tariff filed with and approved by an administrative agency under a statutory scheme is presumed reasonable unless a litigant proves otherwise.”)

²² *Proposed Revision of Rules Regarding the Provision of Wholesale Water Service By the City of Versailles To Northeast Woodford Water District*, Case No. 2011-00419 (Ky. PSC Aug. 12, 2014).

In requesting review of the single, uniform rate, Marion District essentially requests the modification of the Master Agreement and should therefore be required to bear the burden of proof in this proceeding. In its letter of September 19, 2017, it implies that the evidence of the Company's current costs is insufficient to support the proposed rates and that the Lebanon City Council failed to consider certain factors. Marion District requests that the Commission conduct its own review of the cost of service, substitute its own methods of analysis and procedures for those set forth in the Master Agreement, and then impose its findings upon the parties to the Master Agreement. Although Marion District has requested the investigation of the single, uniform rate under the guise of a rate investigation, Marion District's challenge is tantamount to a Complaint. Because Marion District is the party requesting the change in the long standing Master Agreement, it must bear the burden of proof.

Assigning the burden of proof to Marion District is also consistent with sound public policy in light of Marion District's failure to participate in the process set forth in the Master Agreement. Marion District previously agreed to the elaborate and detailed process set forth in the Master Agreement for adjusting the wholesale rate to reflect the current cost of wholesale service and **to accept the results of that process**. As a party to the Master Agreement, it had an obligation to participate fully in the rate adjustment process and exhaust its remedies under

the Master Agreement. In declining to participate and then challenging the process results, Marion District failed to act in good faith.

For example, Marion District states that a Commission investigation is necessary in part because “it [Marion District] is unable to ascertain whether the proposed adjustment is consistent with the methodology set forth in the water purchase contract that Lebanon and MCWD have executed.”²³ The Company, however, briefed Marion District on its costs and provided it supporting information during the 63 days between the First and Second Readings of the Ordinance by the City Council. The means and tools available to discern the accuracy of the proposed rates were readily available to Marion District, but Marion District failed to submit any formal objection to the City Council.

Marion District further suggests that the Lebanon City Council failed to conduct a thorough review of the proposed rate. It details nine (9) concerns regarding the single, uniform rate and implies that these concerns were not adequately considered in the City Council’s review. Marion District, however, had the opportunity to raise these concerns and present evidence on them to the City Council, but elected not to appear at the City Council’s proceedings on the rate.

The instant case is very similar to Case No. 2011-00419 where the City of Versailles (“Versailles”) sought to change a material provision in its long-term

²³ Reed Letter at 1.

water supply contract with its wholesale customer, Northeast Woodford Water District (“Northeast Woodford District”). The contract between Versailles and Northeast Woodford District did **not** contain a minimum purchase requirement. Versailles requested the Commission to rewrite the contract and impose a minimum purchase requirement upon Northeast Woodford District. The Commission declined to modify the contract because Versailles failed to meet its burden of proof. Instead, the Commission ruled that the relief sought by Versailles was unreasonable.

Here, Marion District is requesting the Commission to rewrite the Master Agreement by abolishing a material provision (i.e., the single, uniform rate) and by inserting a new dual rate provision so Marion District will obtain a more favorable rate. Therefore, Marion District must bear the burden of proof just as Versailles was required to bear the burden of proof.

Assigning the burden of proof to Marion District would encourage the water district to first avail itself of the procedures in the Master Agreement prior to seeking Commission review. It would encourage both parties to use the less costly and less adversarial discovery provisions of the rate adjustment process. It would ensure that the Commission review is used only as a last resort when the contract process has failed to function adequately. It would avoid unnecessary use of limited Commission resources.

In summary, Marion District should be assigned the burden to demonstrate that the results of the rate adjustment process set forth in the Master Agreement are unreasonable. In seeking review of the results, it is requesting to rewrite the Master Agreement and appropriately bears the burden of proof. Moreover, assignment of the burden to Marion District will achieve several policy objectives, including ensuring the full use of the contract process and avoid frequent resorts to Commission review before exhausting all remedies provided in the Contract.

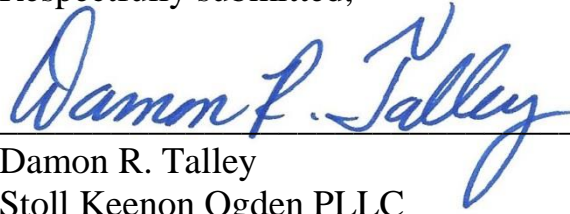
CONCLUSION

This proceeding does not involve the review of a proposed rate adjustment, but a request for the Commission to ignore the plain reading of the contract and, in essence, rewrite the contract. As Marion District is challenging the longstanding process used to establish the single, uniform rate, it has the burden of proof of demonstrating that the single, uniform rate is unreasonable. Accordingly, the Commission should enter an order that assigns the burden of proof to Marion District and establishes a procedural schedule in this matter consistent with the assignment of that burden.

[Remainder of page intentionally left blank]

Dated: January 31, 2018

Respectfully submitted,



Damon R. Talley
Stoll Keenon Ogden PLLC
P.O. Box 150
Hodgenville, KY 42748-0150
Telephone: (270) 358-3187
Fax: (270)358-9560
damon.talley@skofmn.com

Gerald E. Wuetcher
Mary Ellen Wimberly
Stoll Keenon Ogden PLLC
300 West Vine Street, Suite 2100
Lexington, Kentucky 40507-1801
Telephone: (859) 231-3000
Fax: (859) 259-3517
gerald.wuetcher@skofirm.com
maryellen.wimberly@skofirm.com

*Counsel for Lebanon Water Works
Company*

CERTIFICATE OF SERVICE

In accordance with 807 KAR 5:001, Section 8, I certify that Lebanon Water Works Company's January 31, 2018 electronic filing of this Supporting Memorandum is a true and accurate copy of the same document being filed in paper medium; that the electronic filing has been transmitted to the Commission on January 31, 2018; that there are currently no parties that the Commission has excused from participation by electronic means in this proceeding; and that an original and one copy in paper medium of this Memorandum will be delivered to the Commission on or before February 2, 2018.



Damon R. Talley