COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC PROPOSED ADJUSTMENT OF THE WHOLESALE WATER SERVICE RATES OF LEBANON WATER WORKS	**)** **)** **)** **)**	**CASE NO. 2017-00417**

REPLY TO RESPONSE TO MOTION FOR AN ORDER ESTABLISHING A PROCEDURAL SCHEDULE AND ASSIGNING BURDEN OF PROOF

Pursuant to 807 KAR 5:001, Section 5(3), Lebanon Water Works Company (the "Company"), by counsel, submits this Reply to the *Response to Motion for an Order Establishing a Procedural Schedule and Assigning Burden of Proof* ("Response") of Marion County Water District ("Marion District"). In support of its Reply, the Company states as follows:

In its Response, Marion District mischaracterizes the Company's filing as a proposed rate adjustment that triggers the requirement for a hearing[1] and imposes the burden of proof on the Company as the party seeking the adjustment.[2] The Company, however, has not proposed to adjust any rate, but has merely applied the mutually agreed process set forth in the Water Purchase Agreement of December

[1] KRS 278.200.
[2] KRS 278.190(2).

23, 1988 ("Master Agreement") to recalculate its charges for water service to Marion District and has provided notice to the Commission of this recalculation.

The Master Agreement specifies not only a rate that the Company may charge for water service, but **a process for modifying and recalculating that rate** to reflect the changes in the cost of providing service. This process is part of the rate. *See, e.g.*, *State ex. rel Utilities Commission v. Edmisten*, 230 S.E.2d 651, 659 (N.C. 1976) ("the 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").[3] In performing that process, the Company is not adjusting the rate, but merely applying the contract process to recalculate the rate.

Marion District's reliance upon the Commission Staff Opinion of February 16, 2007 to support its contention that the Company's filing of September 13, 2017 "could never become effective as applied to Marion District without first being reviewed and scrutinized by the Commission"[4] is equally in error. In a later opinion involving the same two utilities, Commission Staff repudiated the earlier opinion and expressly found as follows: (1) that a water supplier's recalculation of a wholesale water service charge in accordance with the process and procedures set

[3] *See also* KRS 278.010(12) ("'Rate' means any individual or joint fare, toll, charge, rental, or other compensation for service rendered or to be rendered by any utility, and **any rule, regulation, practice, act, requirement, or privilege in any way relating to such fare, toll, charge, rental, or other compensation**, and any schedule or tariff or part of a schedule or tariff thereof.").
[4] Response at 6, n.15.

forth in a water purchase agreement did not constitute a rate adjustment; (2) that KRS 278.180 did not require the supplier to file notice of the recalculated charge with the Commission; and (3) that the recalculated charge became effective without any Commission action.[5] The Commission Staff concluded: "[W]hile KRS 278.180(1) did not require notice to the Commission of rate recalculations based on 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."[6] A copy of the later opinion is attached as **Exhibit 1** to this Reply.

The Commission has reached the same conclusion. In Case No. 2007-00299, it determined that, because the rate formula set forth in a contract between a municipal utility and a water district had not been changed – only applied to the municipal utility's current costs, no rate adjustment had occurred and no notice of the recalculated rate to the Commission was required by KRS 278.280(1).[7] This Commission noted that while KRS 278.180(1) did not require notice, it would be the "better practice" for the municipal utility to "file revised tariff sheets with the Commission prior to placing the results of the recalculation into effect."[8] By submitting its tariff showing the recalculated rate on September 13, 2017, the

[5] Commission Staff Opinion dated November 21, 2017. A copy of the Staff Opinion is attached hereto and incorporated by reference as Exhibit 1.
[6] *Id.* at 4.
[7] *Purchased Water Adjustment of Bath County Water District*, Case No. 2007-00299, Order (Ky. PSC Sept. 26, 2007).
[8] *Id.* at 2, n.3.

Company simply followed longstanding Commission guidance that wholesale suppliers should provide the Commission with timely notice of recalculated rates.[9]

The Response argues that the procedure in the Master Agreement between the Company and Marion District has been nullified by *Simpson County Water District v. City of Franklin*.[10] However, unlike in *Simpson County*, the Company has not proposed any rate change, but has instead applied the mutually agreed process to recalculate its charges for water service to Marion District set forth in the Master Agreement. In *Simpson County*, the water supplier ignored the provisions in the contract that specified a specific volumetric rate and enacted two rate increases, which doubled the wholesale rate, in less than one year. In one instance, the wholesale rate was substantially increased while the supplier's in-city retail rates were not changed. Here, in contrast, the Lebanon City Council followed the process in the Master Agreement to recalculate the single, uniform rate to be paid by the Company's in-city customers and Marion District.

Marion District argues that two Commission cases relied upon by the Company are "readily distinguishable."[11] But the *East Clark District* and *City of Versailles* cases still stand for the propositions cited by the Company: (1) that the Commission possesses the authority to modify the terms of a contract between a municipal utility and a public utility, but that the reasonableness of the change

[9] *Id.*
[10] 872 S.W.2d 460 (Ky. 1994).
[11] Response at 6.

must be adequately demonstrated[12]; and (2) that the party seeking to change a filed rate bears the burden of proof to demonstrate that the change is reasonable.[13]

A few additional points merit a response. Marion District states that "the Company does not even suggest that the rate it is proposing could be too low – the motion concedes that any deviation from the proposed rate will be downward."[14] In its Memorandum supporting its Motion, the Company states that Marion District is *requesting* the Commission replace the proposed rate with a rate more favorable to Marion District.[15] The Company has never conceded that any Commission modification to the proposed rate would be a reduction to its proposed rate.

In addition to not conceding that any deviation in the proposed rate would be downward, the Company has no means of predicting a Commission determination. The Company has never participated in a Commission proceeding involving its rates. The agreed methodology used to establish the single, uniform rate set forth in the Master Agreement is not the same as that which the Commission uses to establish rates for public utilities. The Company has no means of determining the final results from the use of the Commission's methodology. It appears, however, that Marion District has attempted to make this calculation, has determined that jettisoning the agreed methodology may inure to its favor, and for this reason, has

[12] *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, Order at 12 (Ky. PSC Aug. 12, 2014).
[13] *East Clark County Water District v. City of Winchester, Acting By and Through Winchester Municipal Utilities Commission*, Case No. 2005-00322, Order at 2 (Ky. PSC Apr. 3, 2006).
[14] Response at 3.
[15] Memorandum at 11, 13, 17.

sought Commission intervention to modify and alter the parties' decades-long Master Agreement.

Next, courts have long recognized that the ballot box provides protection against unreasonable rates. Indeed, Marion District recognizes this protection, citing a Kentucky Supreme Court decision, which states: "[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."[16] Here, although Marion District is located outside of the city, it is afforded the same protections as in-city customers because Marion District pays the same single, uniform rate as in-city customers.

Marion District also alleges that its concerns were "virtually ignored,"[17] but the Company provided significant notice to Marion District, requested meetings with Marion District to discuss the proposed increase, and delayed the Second Reading of the Ordinance to permit additional discussions with Marion District. Despite these actions by the Company, Marion District failed to attend either Reading of the Ordinance or use the means and tools available to it in the Master Agreement to discern the accuracy of the proposed rates.

[16] Response at 5, n.10. *Grayson Rural Electric Corp. v. City of Vanceburg*, 4 S.W.3d 526, 528 (Ky. 1999) (citing *Louisville Water Co. v. Public Service Comm'n*, 318 S.W.2d 537, 539 (Ky. 1958).
[17] Response at 9.

CONCLUSION

As the Company stated in its January 31, 2018 Motion and Memorandum, Marion District is challenging the longstanding process used to establish the single, uniform rate set forth in the Master Agreement. 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.

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Dated: February 12, 2018

Respectfully submitted,

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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 February 12, 2018 electronic filing of this Reply 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 February 12, 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 Reply will be delivered to the Commission on or before February 14, 2018.

Damon R. Talley

EXHIBIT 1

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Governor

Teresa J. Hill, Secretary
Environmental and Public
Protection Cabinet

Timothy J. LeDonne
Commissioner
Department of Public Protection

Commonwealth of Kentucky
Public Service Commission
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Frankfort, Kentucky 40602-0615
Telephone: (502) 564-3940
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Mark David Goss
Chairman

John W. Clay
Vice Chairman

Caroline Pitt Clark
Commissioner

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

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,

Beth O'Donnell
Executive Director

gew/

cc: Kevin Shaw