



**COMMONWEALTH OF KENTUCKY**

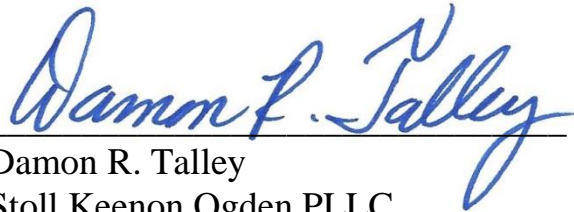
**BEFORE THE PUBLIC SERVICE COMMISSION**

**In the Matter of:**

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

**RESPONSE OF LEBANON WATER WORKS COMPANY TO  
COMMISSION STAFF'S REQUEST FOR INFORMATION**

Comes the Lebanon Water Works Company, for its Response to the Commission Staff's Request for Information, and states as shown on the following pages.



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@skofirm.com

*Counsel for Lebanon Water Works  
Company*

**COMMONWEALTH OF KENTUCKY**

**BEFORE THE PUBLIC SERVICE COMMISSION**

**In the Matter of:**

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

**CERTIFICATION OF RESPONSE TO  
COMMISSION STAFF'S REQUEST FOR INFORMATION**

This is to certify that I have supervised the preparation of Lebanon Water Works Company's Response to the Commission Staff's Information Request. The response submitted on behalf of Lebanon Water Works Company is true and accurate to the best of my knowledge, information, and belief formed after a reasonable inquiry.

Date: 3/7/18



Daren Thompson, Operations &  
Management Superintendent  
Lebanon Water Works Company

**LEBANON WATER WORKS COMPANY**

**CASE NO. 2017-00417**

**Response to Commission Staff's Request for Information**

**Question No. 1**

**Responding Witness: Daren Thompson**

Q-1. Refer to Lebanon Water's "Memorandum in Support of Motion for an Order Establishing a Procedural Schedule and Assigning Burden of Proof," (filed Jan. 31, 2018). In Exhibits 1-14, Lebanon Water has referenced a formula from the Master Agreement.

A. Provide that formula.

B. Provide the calculations used to determine the proposed rates, including all documents supporting the inputs applied to the referenced formula.

A-1.

A. The references in "Memorandum in Support of Motion for An Order Establishing a Procedural Schedule and Assigning Burden of Proof" to a formula do not refer to a mathematical formula, but to a procedural process to which the parties to the Master Agreement had agreed. Courts have previously recognized that a process set forth in a rate schedule or special contract constitute a formula for ratemaking, which, when applied, does not result in a rate adjustment. *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”). The Master Agreement sets forth a process or procedure in which Lebanon Water Works Company (“the Company”) proposes revisions to its single uniform rate and submits this rate to the Lebanon City Council for the City Council’s examination and review. This process requires the Company to provide notice to Marion County Water District (“Marion District”) of the proposed revision and to address all requests for information. It establishes and expressly recognizes Marion District’s right to present evidence and argument to the City Council regarding the proposed revisions. Finally, it requires the City Council to evaluate and consider all evidence regarding a proposed revision and to enter a decision on the proposed revision based upon its evaluation of the evidence. In this regard, the procedures are similar to those the Commission Staff recognized as a formula in its formal opinion regarding the City of Leitchfield-Grayson County Water District Water Purchase Agreement. In that opinion, the Commission Staff opined that the application of those procedures did not constitute a rate revision. *See* Letter from Beth O’Donnell, Executive Director, Kentucky Public Service Commission, to David Vickery, Legal

Counsel, City of Leitchfield (Nov. 21, 2007). This Letter is attached to this question response as pages 4-7 of 9. Therefore, there is no mathematical formula to file with the Commission.



Ernie Fletcher  
Governor

Teresa J. Hill, Secretary  
Environmental and Public  
Protection Cabinet

Timothy J. LeDonne  
Commissioner  
Department of Public Protection

Commonwealth of Kentucky  
**Public Service Commission**  
211 Sower Blvd.  
P.O. Box 615  
Frankfort, Kentucky 40602-0615  
Telephone: (502) 564-3940  
Fax: (502) 564-3460  
psc.ky.gov

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

David B. Vickery, Esq.  
November 21, 2007  
Page 4

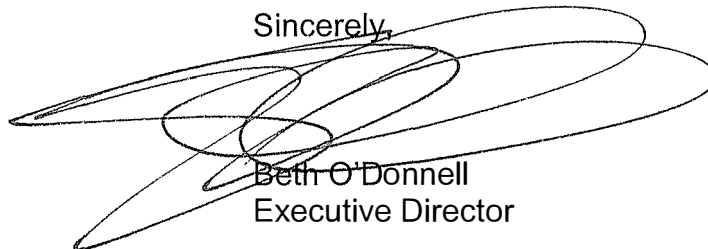
earlier opinion requires revision. The formula set forth in the agreements is the rate for wholesale water service. In this respect, the wholesale service rate is similar to an electric utility's fuel adjustment rate. See, e.g., State ex. rel Utils. Comm'n v. Edmisten, 230 S.E.2d 651, 659 (N.C. 1976) ("[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 lines, positioned above the typed name and title.

Beth O'Donnell  
Executive Director

gew/

cc: Kevin Shaw

B. As noted above, the formula referred to in the “Memorandum in Support of Motion for an Order Establishing a Procedural Schedule and Assigning Burden of Proof” is not a mathematical formula. Thus, the process for determining the proposed rates is more complicated than simply inserting inputs into a mathematical formula. The Company determined the proposed rates by using the same ratemaking methodology that the Public Service Commission has historically used.

Attached are two (2) separate spreadsheets that were used to calculate the Company’s Revenue Requirements and proposed rates. Both spreadsheets contain several different alternatives or “Runs” used in the computations. The Runs refer to the daily gallons of water to be purchased by the Company from the City of Campbellsville. Run #2 assumes that the Company will purchase 400,000 gallons of water per day (“GPD”) from the City of Campbellsville. This is the assumption that was ultimately decided upon and used in determining the proposed rates.

Spreadsheet No. 1 contains several columns that correspond to Run #1 through Run #8. The first column in Spreadsheet No. 1 is for Run #1 (300,000 GPD). The second column in Spreadsheet No. 1 is


for Run #2 (400,000 GPD). The second column is the applicable column to use because the Company has decided to purchase 400,000 GPD from the City of Campbellsville.

Spreadsheet No. 2 contains several different alternatives or “Runs” used in the computations. The Runs refer to the daily gallons of water to be purchased by the Company from the City of Campbellsville. Run #2 assumes that the Company will purchase 400,000 GPD from the City of Campbellsville. Spreadsheet No. 2 demonstrates that the proposed rates will generate the required revenue.

Both of these Spreadsheets were provided to Marion District prior to the Lebanon City Council’s Second Reading and final passage of the Rate Ordinance. The Company plans to provide written testimony to more fully explain the information contained in these Spreadsheets.

# Spreadsheet No. 1

Column #2



Schedule of adjusted operations

	Pro Forma							
<b>Operating Revenues</b>								
Sales of Water								
Unmetered water sales	0							
Metered water sales	2640000	2640000	2640000	2640000	2640000	2640000	2640000	2640000
Bulk loading stations	0							
Fire protection revenue	0							
Sales for resale	0							
<b>Total sales of water</b>	2640000	2640000	2640000	2640000	2640000	2640000	2640000	2640000
<b>Total Operating Revenues</b>	2640000	2640000	2640000	2640000	2640000	2640000	2640000	2640000
<b>Operating Expenses</b>								
Purchased Water-Cville Water & Sewer	433,620	490,560	545,675	602,250	656,635	712,480	768,690	824,900
Savings at WTP	-29,950	-39,733	-49,517	-59,300	-69,183	-78,967	-88,750	-98,533
Salaries	615,200	615,200	615,200	615,200	615,200	615,200	615,200	615,200
Fringe Benefits - Employee ins	188,400	188,400	188,400	188,400	188,400	188,400	188,400	188,400
KRS/CERS - Employer share	118,000	118,000	118,000	118,000	118,000	118,000	118,000	118,000
Payroll taxes	47,100	47,100	47,100	47,100	47,100	47,100	47,100	47,100
Office - Utilities	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000
Office - Repairs/Maintenance	33,200	33,200	33,200	33,200	33,200	33,200	33,200	33,200
Office - Supplies	6,100	6,100	6,100	6,100	6,100	6,100	6,100	6,100
Office - Miscellaneous	15,900	15,900	15,900	15,900	15,900	15,900	15,900	15,900
Professional Fees - Legal/Accting/Surveying	65,400	65,400	65,400	65,400	65,400	65,400	65,400	65,400
Postage	10,700	10,700	10,700	10,700	10,700	10,700	10,700	10,700
Director fees	12,600	12,600	12,600	12,600	12,600	12,600	12,600	12,600
Advertisements	900	900	900	900	900	900	900	900
Uniforms/Safety Equipment	10,100	10,100	10,100	10,100	10,100	10,100	10,100	10,100
Continuing Education Expense	6,800	6,800	6,800	6,800	6,800	6,800	6,800	6,800
Membership Dues/Fees	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000
Insurance	49,100	49,100	49,100	49,100	49,100	49,100	49,100	49,100
Bad Debts	0	0	0	0	0	0	0	0

Pro Forma



Interest on Customer Deposits	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200
Donations	400	400	400	400	400	400	400	400
Rental House - Calvary	800	800	800	800	800	800	800	800
Miscellaneous	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000
Equipment - Repairs/Maintenance	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Shop - Supplies/Expense	13,100	13,100	13,100	13,100	13,100	13,100	13,100	13,100
Meters - Repairs	60,900	60,900	60,900	60,900	60,900	60,900	60,900	60,900
Mains - Repairs	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000
Hydrants - Repairs	16,400	16,400	16,400	16,400	16,400	16,400	16,400	16,400
Tanks - Repairs	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000
Tanks - Utilities	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000
Lab Equipment/Supplies	2,200	2,200	2,200	2,200	2,200	2,200	2,200	2,200
Lab Testing	18,600	18,600	18,600	18,600	18,600	18,600	18,600	18,600
Vehicle - Fuel	13,800	13,800	13,800	13,800	13,800	13,800	13,800	13,800
Vehicle - Repairs/Maintenance	16,700	16,700	16,700	16,700	16,700	16,700	16,700	16,700
Warehouse Rd- BPS - Repairs/Maintenance	0	0	0	0	0	0	0	0
Power	230,000	230,000	230,000	230,000	230,000	230,000	230,000	230,000
Chemicals	170,000	170,000	170,000	170,000	170,000	170,000	170,000	170,000
Utilities	10,500	10,500	10,500	10,500	10,500	10,500	10,500	10,500
Repairs/Maintenance	38,000	38,000	38,000	38,000	38,000	38,000	38,000	38,000
Supplies	8,900	8,900	8,900	8,900	8,900	8,900	8,900	8,900
Lab Equipment	11,000	11,000	11,000	11,000	11,000	11,000	11,000	11,000
Pump Equipment	0	0	0	0	0	0	0	0
Lake - Repairs/Maintenance	1,800	1,800	1,800	1,800	1,800	1,800	1,800	1,800
Buena Vista - Utilities	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Buena Vista - Supplies	0	0	0	0	0	0	0	0
Buena Vista - Repairs/Maintenance	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500
Total Operation and Maintenance Expenses	<u>2,257,970</u>	<u>2,305,127</u>	<u>2,350,458</u>	<u>2,397,250</u>	<u>2,441,752</u>	<u>2,487,813</u>	<u>2,534,240</u>	<u>2,580,667</u>
Depreciation Expense	600000	600000	600000	600000	600000	600000	600000	600000
Total Operating Expenses	2857970	2905127	2950458	2997250	3041752	3087813	3134240	3180667
Utility Operating Income	-217970	-265127	-310458	-357250	-401752	-447813	-494240	-540667

Pro Forma

	KIA B08-09	KIA F15-057	KIA F14-036	CNB 97A	CNB 97B, 02	
2017	33222.91	40190.97	95893	60099.52	304735.1	
2018	33166.11	40123.35	95695	60099.52	304735.1	
2019	33108.71	40055.21	95496	54757.08	304735.1	
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	
	99497.73	120369.5	287084	174956.1	914205.2	1596113 532037.5

New Debt

2000000 @ 2.0%/40 years

532037.5

Minimum Usage	300000	400000	500000	600000	700000	800000	900000	1000000
Purchase Cost	433620	490560	545675	602250	656635	712480	768690	824900
Total Savings at WTP	29950	39733	49517	59300	69183	78967	88750	98533



Revenue Requirement Calculation - Debt Coverage Method

Pro Forma Operating Expenses	2857970	2905127	2950458	2997250	3041752	3087813	3134240	3180667
Plus: Average Annual Debt P&I Payments	532037.5	532037.5	532037.5	532037.5	532037.5	532037.5	532037.5	532037.5
Debt Coverage Requirement	63844.5	63844.5	63844.5	63844.5	63844.5	63844.5	63844.5	63844.5
Total Revenue Requirement	3453852	3501009	3546340	3593132	3637634	3683695	3730122	3776549
Less: Other Operating Revenue	-53400	-53400	-53400	-53400	-53400	-53400	-53400	-53400
Non-operating Revenue								
Interest Income	-9400	-9400	-9400	-9400	-9400	-9400	-9400	-9400
Revenue Required from Rates	3391052	3438209	3483540	3530332	3574834	3620895	3667322	3713749
Less: Revenue from Sales at Present Rates	2640000	2640000	2640000	2640000	2640000	2640000	2640000	2640000
Required Revenue Increase	751052	798209	843540	890332	934834	980895	1027322	1073749
Required Revenue Increase stated as a percentage of revenue at Present Rates	28.45%	30.24%	31.95%	33.72%	35.41%	37.16%	38.91%	40.67%

**Basis for Calculations:**

Proposed June 30, 2018 Budget plus:  
 Water Purchases from C-ville at varying levels  
 Savings at WTP at varying levels  
 Debt -  
 KIA Fund B  
 KIA Fund F14-036  
 KIA Fund F15-057  
 2 CNB Loans  
 Depreciation at 100% of 6/30/18 budget number

*Proposed rates at:*

	<u>Meter Chg</u>	<u>Volume Chg</u>
300,000 gallon purchase		
In Town/MCWD	\$ 7.30	\$ 3.30
Out of Town	\$ 8.03	\$ 3.630

400,000 gallon purchase		
In Town/MCWD	\$ 7.35	\$ 3.35
Out of Town	\$ 8.085	\$ 3.69

500,000 gallon purchase		
In Town/MCWD	\$ 7.40	\$ 3.40
Out of Town	\$ 8.14	\$ 3.740

600,000 gallon purchase		
In Town/MCWD	\$ 7.45	\$ 3.45
Out of Town	\$ 8.195	\$ 3.80

700,000 gallon purchase		
In Town/MCWD	\$ 7.45	\$ 3.50
Out of Town	\$ 8.20	\$ 3.850

800,000 gallon purchase		
In Town/MCWD	\$ 7.45	\$ 3.55
Out of Town	\$ 8.20	\$ 3.91

*Effect on Average Usage: 534 Cubic Feet*

<u>Existing</u>	<u>Proposed</u>	<u>Percent Change</u>
\$ 20.10	\$ 24.92	24%
\$ 22.11	\$ 27.41	24%

<u>Existing</u>	<u>Proposed</u>	<u>Percent Change</u>
\$ 20.10	\$ 25.24	26%
\$ 22.11	\$ 27.76	26%

<u>Existing</u>	<u>Proposed</u>	<u>Percent Change</u>
\$ 20.10	\$ 25.56	27%
\$ 22.11	\$ 28.11	27%

<u>Existing</u>	<u>Proposed</u>	<u>Percent Change</u>
\$ 20.10	\$ 25.87	29%
\$ 22.11	\$ 28.46	29%

<u>Existing</u>	<u>Proposed</u>	<u>Percent Change</u>
\$ 20.10	\$ 26.14	30%
\$ 22.11	\$ 28.75	30%

<u>Existing</u>	<u>Proposed</u>	<u>Percent Change</u>
\$ 20.10	\$ 26.41	31%
\$ 22.11	\$ 29.05	31%

900,000 gallon purchase				<u>Existing</u>	<u>Proposed</u>	<u>Percent Change</u>	
In Town/MCWD	\$	7.55	\$	3.55	\$ 20.10	\$ 26.51	32%
Out of Town	\$	8.31	\$	3.905	\$ 22.11	\$ 29.16	32%

1,000,000 gallon purchase				<u>Existing</u>	<u>Proposed</u>	<u>Percent Change</u>	
In Town/MCWD	\$	7.60	\$	3.60	\$ 20.10	\$ 26.82	33%
Out of Town	\$	8.360	\$	3.960	\$ 22.11	\$ 29.51	33%



# Spreadsheet No. 2

Lebanon Water Works  
 Run #1 - 300,000 gallons purchased/Campbellsville

Customer Category	No. Customers	2016 Usage	Rates				Revenue		534 Cubic Ft		
			Meter Chg	Volume Chg	Pro Forma Meter Chg	Pro Forma Volume Chg	2016	Pro Forma	Existing	Proposed	Percent +
Residential in town	2231	13,305,957	6.75	2.5	7.3	3.3	513,359.93	634,532.18	\$ 20.10	\$ 24.92	24%
industrial in town	36	14,029,258	6.75	2.5	7.3	3.3	353,647.45	466,119.11			
commercial in town	34	6,094,556	6.75	2.5	7.3	3.3	155,117.90	204,098.75			
irrigation in town	8	436,600	6.75	2.5	7.3	3.3	11,563.00	15,108.60			
residential county	268	1,851,016	7.425	2.75	8.03	3.63	74,781.74	93,016.36	\$ 22.11	\$ 27.41	24%
industrial county	5	824,080	7.425	2.75	8.03	3.63	23,107.70	30,395.90			
commercial county	1	42,520	7.425	2.75	8.03	3.63	1,258.40	1,639.84			
irrigation county	1	14	7.425	2.75	8.03	3.63	89.49	96.87			
MCWD	11	59,825,110	6.75	2.5	7.3	3.3	1,496,518.75	1,975,192.23			
	2595	96,409,111					2,629,444.35	3,420,199.84			
							2016 Revenue - Audit	2,672,904	3,391,052	Revenue Required	
							Percent Difference	1.63%	29,147.80		

Revenue Requirement  
 Pro Forma 3,391,052

Lebanon Water Works  
 Run #2 - 400,000 gallons purchased/Campbellsville

Customer Category	No. Customers	2016 Usage	Rates				Revenue		534 Cubic Ft		
			Meter Chg	Volume Chg	Pro Forma Meter Chg	Pro Forma Volume Chg	2016	Pro Forma	Existing	Proposed	Percent +
Residential in town	2231	13,305,957	6.75	2.5	7.35	3.35	513,359.93	642,523.76	\$ 20.10	\$ 25.24	26%
industrial in town	36	14,029,258	6.75	2.5	7.35	3.35	353,647.45	473,155.34			
commercial in town	34	6,094,556	6.75	2.5	7.35	3.35	155,117.90	207,166.43			
irrigation in town	8	436,600	6.75	2.5	7.35	3.35	11,563.00	15,331.70			
residential county	268	1,851,016	7.425	2.75	8.085	3.685	74,781.74	94,211.30	\$ 22.11	\$ 27.76	26%
industrial county	5	824,080	7.425	2.75	8.085	3.685	23,107.70	30,852.45			
commercial county	1	42,520	7.425	2.75	8.085	3.685	1,258.40	1,663.88			
irrigation county	1	14	7.425	2.75	8.085	3.685	89.49	97.54			
MCWD	11	59,825,110	6.75	2.5	7.35	3.35	1,496,518.75	2,005,111.39			
	2595	96,409,111					2,629,444.35	3,470,113.78			
								3,438,209	Revenue Required		
								31,904.73			



Revenue Requirement  
Pro Forma 3,438,209

Lebanon Water Works  
Run #3 - 500,000 gallons purchased/Campbellsville

Customer Category	No. Customers	2016 Usage	Rates				2016	Revenue		Existing	Proposed	Percent +
			Meter Chg	Volume Chg	Pro	Pro		Pro Forma	Pro Forma			
					Forma	Forma						
					Chg	Chg						
Residential in town	2231	13,305,957	6.75	2.5	7.4	3.4	513,359.93	650,515.34	\$ 20.10	\$ 25.56	27%	
industrial in town	36	14,029,258	6.75	2.5	7.4	3.4	353,647.45	480,191.57				
commercial in town	34	6,094,556	6.75	2.5	7.4	3.4	155,117.90	210,234.10				
irrigation in town	8	436,600	6.75	2.5	7.4	3.4	11,563.00	15,554.80				
residential county	268	1,851,016	7.425	2.75	8.14	3.74	74,781.74	95,406.24	\$ 22.11	\$ 28.11	27%	
industrial county	5	824,080	7.425	2.75	8.14	3.74	23,107.70	31,308.99				
commercial county	1	42,520	7.425	2.75	8.14	3.74	1,258.40	1,687.93				
irrigation county	1	14	7.425	2.75	8.14	3.74	89.49	98.20				
MCWD	11	59,825,110	6.75	2.5	7.4	3.4	1,496,518.75	2,035,030.54				
	2595	96,409,111					2,629,444.35	3,520,027.72				
								3,483,540	Revenue Required			
								36,487.67				

Revenue Requirement  
Pro Forma 3,483,540

Lebanon Water Works  
Run #4 - 600,000 gallons purchased/Campbellsville

Customer Category	No. Customers	2016 Usage	Rates				2016	Revenue		Existing	Proposed	Percent +
			Meter Chg	Volume Chg	Pro	Pro		Pro Forma	Pro Forma			
					Forma	Forma						
					Chg	Chg						
Residential in town	2231	13,305,957	6.75	2.5	7.45	3.45	513,359.93	658,506.92	\$ 20.10	\$ 25.87	29%	
industrial in town	36	14,029,258	6.75	2.5	7.45	3.45	353,647.45	487,227.80				
commercial in town	34	6,094,556	6.75	2.5	7.45	3.45	155,117.90	213,301.78				
irrigation in town	8	436,600	6.75	2.5	7.45	3.45	11,563.00	15,777.90				
residential county	268	1,851,016	7.425	2.75	8.195	3.795	74,781.74	96,601.18	\$ 22.11	\$ 28.46	29%	
industrial county	5	824,080	7.425	2.75	8.195	3.795	23,107.70	31,765.54				
commercial county	1	42,520	7.425	2.75	8.195	3.795	1,258.40	1,711.97				
irrigation county	1	14	7.425	2.75	8.195	3.795	89.49	98.87				
MCWD	11	59,825,110	6.75	2.5	7.45	3.45	1,496,518.75	2,064,949.70				
	2595	96,409,111					2,629,444.35	3,569,941.65				
								3,530,332	Revenue Required			
								39,609.61				



Revenue Requirement  
Pro Forma 3,530,332

Lebanon Water Works  
Run #5 - 700,000 gallons purchased/Campbellsville

Customer Category	No. Customers	2016 Usage	Rates				2016	Revenue		Existing	Proposed	Percent +
			Meter Chg	Volume Chg	Pro Forma Meter Chg	Pro Forma Volume Chg		Pro Forma	534 Cubic Ft			
Residential in town	2231	13,305,957	6.75	2.5	7.45	3.5	513,359.93	665,159.90	\$ 20.10	\$ 26.14	30%	
industrial in town	36	14,029,258	6.75	2.5	7.45	3.5	353,647.45	494,242.43				
commercial in town	34	6,094,556	6.75	2.5	7.45	3.5	155,117.90	216,349.06				
irrigation in town	8	436,600	6.75	2.5	7.45	3.5	11,563.00	15,996.20				
residential county	268	1,851,016	7.425	2.75	8.195	3.85	74,781.74	97,619.24	\$ 22.11	\$ 28.75	30%	
industrial county	5	824,080	7.425	2.75	8.195	3.85	23,107.70	32,218.78				
commercial county	1	42,520	7.425	2.75	8.195	3.85	1,258.40	1,735.36				
irrigation county	1	14	7.425	2.75	8.195	3.85	89.49	98.88				
MCWD	11	59,825,110	6.75	2.5	7.45	3.5	1,496,518.75	2,094,862.25				
	2595	96,409,111					2,629,444.35	3,618,282.09				
								3,574,834	Revenue Required			
								43,448.05				

Revenue Requirement  
Pro Forma 3,574,834

Lebanon Water Works  
Run #6 - 800,000 gallons purchased/Campbellsville

Customer Category	No. Customers	2016 Usage	Rates				2016	Revenue		Existing	Proposed	Percent +
			Meter Chg	Volume Chg	Pro Forma Meter Chg	Pro Forma Volume Chg		Pro Forma	534 Cubic Ft			
Residential in town	2231	13,305,957	6.75	2.5	7.45	3.55	513,359.93	671,812.87	\$ 20.10	\$ 26.41	31%	
industrial in town	36	14,029,258	6.75	2.5	7.45	3.55	353,647.45	501,257.06				
commercial in town	34	6,094,556	6.75	2.5	7.45	3.55	155,117.90	219,396.34				
irrigation in town	8	436,600	6.75	2.5	7.45	3.55	11,563.00	16,214.50				
residential county	268	1,851,016	7.425	2.75	8.195	3.905	74,781.74	98,637.29	\$ 22.11	\$ 29.05	31%	
industrial county	5	824,080	7.425	2.75	8.195	3.905	23,107.70	32,672.02				
commercial county	1	42,520	7.425	2.75	8.195	3.905	1,258.40	1,758.75				
irrigation county	1	14	7.425	2.75	8.195	3.905	89.49	98.89				
MCWD	11	59,825,110	6.75	2.5	7.45	3.55	1,496,518.75	2,124,774.81				
	2595	96,409,111					2,629,444.35	3,666,622.53				
								3,620,895	Revenue Required			
								45,727.48				

Revenue Requirement



Pro Forma 3,620,895

Lebanon Water Works  
Run #7 - 900,000 gallons purchased/Campbellsville

Customer Category	No. Customers	2016 Usage	Rates				2016	Revenue		Existing	Proposed	Percent +
			Meter Chg	Volume Chg	Pro Forma Meter Chg	Pro Forma Volume Chg		Pro Forma	534 Cubic Ft			
Residential in town	2231	13,305,957	6.75	2.5	7.55	3.55	513,359.93	674,490.07	\$ 20.10	\$ 26.51	32%	
industrial in town	36	14,029,258	6.75	2.5	7.55	3.55	353,647.45	501,300.26				
commercial in town	34	6,094,556	6.75	2.5	7.55	3.55	155,117.90	219,437.14				
irrigation in town	8	436,600	6.75	2.5	7.55	3.55	11,563.00	16,224.10				
residential county	268	1,851,016	7.425	2.75	8.305	3.905	74,781.74	98,991.05	\$ 22.11	\$ 29.16	32%	
industrial county	5	824,080	7.425	2.75	8.305	3.905	23,107.70	32,678.62				
commercial county	1	42,520	7.425	2.75	8.305	3.905	1,258.40	1,760.07				
irrigation county	1	14	7.425	2.75	8.305	3.905	89.49	100.21				
MCWD	11	59,825,110	6.75	2.5	7.55	3.55	1,496,518.75	2,124,788.01				
	2595	96,409,111					2,629,444.35	3,669,769.53				
								3,667,322	Revenue Required			
								2,447.48				

Revenue Requirement  
Pro Forma 3,667,322

Lebanon Water Works  
Run #8 - 1,000,000 gallons purchased/Campbellsville

Customer Category	No. Customers	2016 Usage	Rates				2016	Revenue		Existing	Proposed	Percent +
			Meter Chg	Volume Chg	Pro Forma Meter Chg	Pro Forma Volume Chg		Pro Forma	534 Cubic Ft			
Residential in town	2231	13,305,957	6.75	2.5	7.6	3.6	513,359.93	682,481.65	\$ 20.10	\$ 26.82	33%	
industrial in town	36	14,029,258	6.75	2.5	7.6	3.6	353,647.45	508,336.49				
commercial in town	34	6,094,556	6.75	2.5	7.6	3.6	155,117.90	222,504.82				
irrigation in town	8	436,600	6.75	2.5	7.6	3.6	11,563.00	16,447.20				
residential county	268	1,851,016	7.425	2.75	8.36	3.96	74,781.74	100,185.99	\$ 22.11	\$ 29.51	33%	
industrial county	5	824,080	7.425	2.75	8.36	3.96	23,107.70	33,135.17				
commercial county	1	42,520	7.425	2.75	8.36	3.96	1,258.40	1,784.11				
irrigation county	1	14	7.425	2.75	8.36	3.96	89.49	100.87				
MCWD	11	59,825,110	6.75	2.5	7.6	3.6	1,496,518.75	2,154,707.16				
	2595	96,409,111					2,629,444.35	3,719,683.46				
								3,713,749	Revenue Required			
								5,934.42				

Revenue Requirement  
Pro Forma 3,713,749

**LEBANON WATER WORKS COMPANY**

**CASE NO. 2017-00417**

**Response to Commission Staff's Request for Information**

**Question No. 2**

**Responding Witness: Daren Thompson**

Q-2. Refer to Marion County Water District's Protest Letter (filed Sept. 25, 2017).

- A. Respond to the concerns contained on page two of that letter.
- B. Provide all documents that support Lebanon Water's responses.

A-2.

A. The Company lists and responds to the following concerns contained in Marion County Water District's Protest Letter:

(1) Use of aggressive depreciation schedules for transmission lines and other capital improvements which are inconsistent with the allowable depreciation referenced in MCWD's recent rate case, 2016-00163

- o **Response:** The Company depreciates its assets in accordance with its Capitalization Policy, which was adopted on January 15, 2007. The Capitalization Policy, which is attached in response to Question No. 2B, assigns a useful life of 40 years to transmission and distribution mains.

(2) Decision to voluntarily purchase water from Campbellsville, over and above contracted quantities, with no demonstrable need

- o **Response:** On December 29, 2015, the City of Campbellsville (the "Campbellsville") and the Company entered into a Water Purchase Contract (the "Campbellsville Contract") whereby the Company would



purchase a supplemental supply of potable water from Campbellsville. **(A copy of the Campbellsville Contract is attached as part of the Response to Question 2B).**

The Campbellsville Contract requires the Company to purchase a minimum of 300,000 gallons of water per day (“GPD”). The maximum purchase amount is 1,000,000 GPD. The rate per 1,000 gallons declines as the amount purchased increases (e.g. if 300,000 GPD is purchased, the rate is \$3.96 per 1,000 gallons; if 400,000 GPD is purchased, the rate is \$3.36 per 1,000 gallons). Pursuant to paragraphs 1 and 8 of the Campbellsville Contract, annually the Company must decide the amount of its minimum daily purchases and notify Campbellsville of this decision. Paragraph 8 of the Campbellsville Contract contains a schedule of rates based upon the minimum daily purchase amount. The wholesale rate is then “fixed” for the ensuing fiscal year based upon the stated minimum daily purchase amount. The wholesale rate is not reduced if the Company purchases more than the stated amount. In other words, if the Company agreed to purchase 300,000 GPD, the rate is \$3.96. If it actually purchases 400,000 GPD, the Company will still pay \$3.96 and not \$3.36 per 1,000 gallons for all water purchased. Thus, it behooves

the Company to accurately estimate the volume of water that it will need to purchase so it can obtain the benefit of the lower wholesale rate.

The Company considered various minimum purchase alternatives, but primarily focused on purchasing either 300,000 GPD (the minimum amount allowed under the Campbellsville Contract) or 400,000 GPD. The annual cost to the Company is **\$490,560** if 400,000 GPD is purchased ( $400,000 \times 365 \times \$3.36$ ) and **\$433,620** if 300,000 GPD is purchased ( $300,000 \times 365 \times \$3.96$ ). This is an annual difference of **\$56,940** less the associated savings from producing less water at the Company's water treatment plant.

The Company's Board of Directors ultimately made a business decision to purchase 400,000 GPD for the first year so the Company will have increased flexibility to shut down all or a portion of its water treatment plant to perform maintenance that is long overdue. Until now, it has not had this "luxury." The Company could not take its water treatment plant out-of-service for extended periods of time to make major repairs or to rehabilitate it because it lacked a supplemental source of supply. Now, it can schedule periodic maintenance projects at its water treatment plant without fear of water shortages.

The Company plans to revisit the minimum daily purchase amount annually, as required by the Campbellsville Contract, and will endeavor to optimize its minimum daily purchase amount depending upon the circumstances existing at that time.

- (3) Use of budgeted expense in its calculations, as opposed to audited figures from the current test year
- **Response:** The Company's Revenue Requirements used to determine the proposed rates do **not** include the higher salaries of long-time employees who have retired and have been replaced by workers who are paid a lower hourly wage.

Technically speaking, the Company used FYE 6-30-16 as the Test Year because the financial statement for FYE 6-30-16 was the most recent audited financial statement available when the Company and its Rate Consultant, Holly Nicholas, were determining the Company's Revenue Requirements. The Company and Ms. Nicholas realized that during the Test Year and a substantial portion of the FYE 6-30-17, the Company was in a transitional period. Several long-time employees were nearing retirement and their replacements were already on the payroll during a portion of this transition period.

To avoid including the wages and fringe benefits of duplicate employees and the higher wages of long-time employees who were in the

process of retiring, the Company “normalized” the wages and benefits of its workforce and then made adjustments to reflect the known and measurable personnel costs. To accomplish this, the Company used the actual wages and benefits of its “going-forward” workforce, annualized these amounts, and then included only these amounts in calculating its Revenue Requirements.

The Company also normalized other Test Year expenses and made adjustments for known and measurable changes. This work was performed during the same time frame that the Company was developing its FY 2018 budget. Naturally, the Company’s budgeted expenses closely correspond to the Revenue Requirements.

- (4) Use of significant projected increase in salaries, despite the recent retirement of long-time employees who were replaced by entry level personnel
- **Response:** The Company’s Revenue Requirements used to determine the proposed rates do **not** include the higher salaries of long-time employees who have retired and have been replaced by workers who are paid a lower hourly wage.

Technically speaking, the Company used FYE 6-30-16 as the Test Year because the financial statement for FYE 6-30-16 was the most recent audited financial statement available when the Company and its Rate Consultant, Holly Nicholas, were determining the Company’s

Revenue Requirements. The Company and Ms. Nicholas realized that during the Test Year and a substantial portion of the FYE 6-30-17, the Company was in a transitional period. Several long-time employees were nearing retirement and their replacements were already on the payroll during a portion of this transition period. For example, the Company employed both Daren Thompson as its new General Manager (Operations & Management Superintendent) and its retiring General Manager, John L. Thomas, during this transition period.

To avoid including the wages and fringe benefits of duplicate employees and the higher wages of long-time employees who were in the process of retiring, the Company “normalized” the wages and benefits of its workforce and then made adjustments to reflect the known and measurable personnel costs. To accomplish this, the Company used the actual wages and benefits of its “going-forward” workforce, annualized these amounts, and then included only these amounts in calculating its Revenue Requirements. Thus, there is no “fat” in its Revenue Requirements – no “duplicate” employees were included and the higher wages of long-term workers that are now retired were not included in this calculation.

(5) Use of a test period in which it employed two General Managers during a transition (non-recurring expense)

- **Response:** The Company's Revenue Requirements used to determine the proposed rates do **not** include the salaries and fringe benefits of two (2) General Managers. Only the current salary and fringe benefits of the Company's current General Manager (Operations & Management Superintendent), Daren Thompson, is included in the Company's Revenue Requirements.

As stated in the Company's Response to Question 2A(4), adjustments were made to the Test Year expenses to remove "duplicate" salaries from the Company's Revenue Requirements. Any other non-recurring expenses were also excluded from the Revenue Requirements. See the Response to Question 2A(4) for a more detailed explanation.

(6) Inclusion of costs for extraordinary maintenance expenses, attorney's fees, lab-testing equipment (non-recurring expenses)

- **Response:** In calculating its proposed rates, the Company sought to remove all extraordinary or non-recurring expenses. To the best of its knowledge and understanding, the proposed rates do not include such expenses. The Company cannot respond further unless and until Marion

- District identifies specific expenses that it considers extraordinary or non-recurring.
- (7) Discrepancy between the percentage of water purchased by MCWD and the percentage of the proposed increase borne by MCWD
- **Response:** The Company affirmatively states that the proposed increase is an across-the-board percentage increase to **all customers, regardless of their classification or location**, based on the percentage increase in revenue required from rates. The meter charge for a customer will increase 8.9 percent from the customer's existing meter charge and a customer's volumetric or "O&M" charge will be increased 34 percent. Currently, both the Company's "In City" customers and Marion District pay the same uniform rate pursuant to the provisions of the Master Agreement. The amount of the proposed increase is the same for both "In City" customers and Marion District. Therefore, it is mathematically impossible for the proposed increase to have a greater impact upon Marion District than upon the Company's "In City" customers.

There are two (2) reasons that the Company did not prepare a cost-of-service study when developing the proposed rates. First, the Master Agreement requires a single, uniform rate to be charged to both the Company's "In City" customers and Marion District. Second, the Company wanted to avoid this unnecessary expense. The Public Service

Commission has previously found that an across-the board percentage increase is an appropriate and equitable method to increase rates in the absence of a cost-of-service study.<sup>1</sup>

(8) Inclusion of 100% of the costs of health benefits payable to Lebanon's employees

- **Response:** In calculating the single, uniform rate, the Company has sought recovery of all costs associated with employee health insurance benefits. Public utilities are entitled to recover the costs of reasonable salaries and benefits necessary to provide water service. Moreover, any determination of the reasonableness of employee compensation should be based upon the total employee compensation package and not on any individual component of that package.<sup>2</sup> Marion District has not suggested that the Company's total employee compensation level is excessive or unreasonable.

The Company has initiated aggressive cost-containment measures to contain and reduce employee insurance expenses. It has restructured its insurance coverages and benefits to reduce its cost for employee health insurance. It has also initiated a required employee contribution for health insurance for employees participating in family coverage. As a

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<sup>1</sup> See, e.g., *Application For Rate Adjustment of Nebo Water District*, Case No. 2016-00435 (Ky. PSC June 5, 2017); *Application of Mountain Water District for an Adjustment of Water and Sewer Rates*, Case No. 2014-00342 (Ky. PSC Oct. 9, 2015).

<sup>2</sup> *Electronic Application of Monroe County Water District For Rate Adjustment Pursuant to 807 KAR 5:076*, Case No. 2017-00070 (Ky. PSC), Staff Report at 15 (filed June 30, 2017).



result of the Company's actions, expenses for employee fringe benefits for the year ending June 30, 2017 were \$356,421, approximately \$54,719 or 13.3 percent less than those incurred in the prior year.

- (9) Lebanon's public acknowledgement that the primary reason for the rate increase is to fund \$2,270,000 of prospective system improvements over the next five (5) years, despite Lebanon's recent 15% rate increase that was meant, presumably, to address some of these same issues (*See* TFS2013-00315)
- **Response:** In meetings with Marion District and in presentations made by Daren Thompson at various community forums, the Company stressed three (3) **primary** "drivers" for the proposed rate increase: (1) need to replace aging infrastructure components (both at the water treatment plant and in the transmission and distribution system); (2) need to increase the supply of water by completing the construction of the new Campbellsville Water Transmission Main and purchasing substantial quantities of water from Campbellsville; and (3) need to perform various repair and maintenance projects, which have been deferred in past years, throughout the Company's existing infrastructure.

In addition, the proposed rate increase will enable the Company to fully fund depreciation expense and meet its Debt Service Coverage requirements as required by its Bond Ordinances.

The Company's Revenue Requirements were calculated using generally accepted ratemaking principles. Accordingly, the Company's Revenue Requirements do **not** include any funds for prospective system improvements. Depreciation expenses and debt service payments for capital projects that have already been placed into service are the **only** capital projects that will be funded by the proposed rate increase. The proposed rates will enhance the Company's cash flow and will enable it to commence performing the overdue deferred maintenance projects. Indeed, the Company has already completed some of these deferred maintenance projects because of its increased cash flow from implementation of the rate increase to its retail customers.

- B. The documents supporting Lebanon Water's responses are attached.

## Capitalization Policy

The policy of the Lebanon Water Works Company, Inc. is to capitalize assets when the useful life is greater than one year and the acquisition cost is at least \$2,000.

Purchased or constructed capital assets and infrastructure are reported at acquisition or construction cost when placed in service.

Contributed assets, such as Developer Contributions or other system components contributed by a developer, are to be recorded at the fair market value at the date when placed in service.

Capital assets are capitalized and depreciated on the straight-line basis over their estimated useful lives as indicated below.

<b>Asset</b>	<b>Useful Life (expressed in years)</b>
Land	No depr
Land - Improvements (fencing, blacktop, sidewalks)	20
Buildings	40
Buildings - Improvements	20
Distribution - mains	40
Distribution - hydrants, tanks	40
Distribution - meters	15
WTP Equipment (lab, other)	7
Grounds Equipment (mowers, tractors, attachments)	7
Vehicles	5
Heavy Construction Equipment	7
Furniture, Office Equipment	10
Computer Hardware/Software	5
Communications Equipment (radio/telephone)	7

## WATER PURCHASE CONTRACT

This contract for the sale and purchase of water is entered into as of the 29<sup>th</sup> day of December, 2015, between the City of Campbellsville, Kentucky, a municipality for and on behalf of the Campbellsville Water and Sewer System, whose address is 110 S. Columbia Avenue, Suite A, Campbellsville, Kentucky 42718 (hereinafter referred to as the "Seller") and Lebanon Water Works Company, a Kentucky Corporation, whose address is 120 Proctor Knott Avenue, Lebanon, Kentucky 40033 (hereinafter referred to as the "Purchaser") and the City of Lebanon, Kentucky, a municipality, whose address is 118 S. Proctor Knott Avenue, Lebanon, Kentucky (hereinafter referred to as the "Guarantor").

### WITNESSETH:

Whereas, the Purchaser is organized and established as a general business corporation created by special act of the Kentucky General Assembly, for the purpose of constructing and operating a water supply distribution system serving water users within the area described in plans now on file in the office of the Purchaser and to accomplish this purpose, the Purchaser will require a supply of treated water, and

Whereas, the Seller owns and operates a water supply distribution system with a capacity currently capable of serving the present customers of the Seller's system and the estimated number of water users to be served by the said Purchaser as shown in the plans of the system now on file in the office of the Purchaser, and

Whereas, by Resolution No. 15-11 enacted on the 7<sup>th</sup> day of December, 2015, by the Seller, the sale of water to the Purchaser in accordance with the provisions of said Resolution was approved, and the execution of this contract carrying out the said Resolution by the Mayor, and attested by the City Clerk, was duly authorized, and

Whereas, by action of the Board of Directors of the Purchaser, taken on the 14<sup>th</sup> day of December, 2015, the purchase of water from the Seller in accordance with the terms of this contract was approved, and the execution of this contract by the President, and attested by the Secretary was duly authorized; and

Whereas, by action taken on the 21<sup>st</sup> day of December, 2015, by the Guarantor, approving the guaranteeing of funds to purchase water by the Purchaser and authorizing the execution of this

contract by the Mayor, and attested by the City Clerk.

Now, therefore, in consideration of the foregoing and mutual agreements hereinafter set forth, the parties do hereby agree as follows:

1. Quantity. The Seller agrees to furnish the Purchaser at the point of delivery hereinafter specified, during the term of this Contract or any renewal or extension thereof, potable treated water in such quantity as may be required by the Purchaser with a daily minimum of 300,000 gallons and not to exceed a daily maximum of 1,000,000 gallons ("Acceptable Quantity Range"). The Purchaser shall provide written notice to the Seller at least thirty (30) days prior to the commencement of any fiscal year of this Contract and identify to the Seller the minimum number of gallons which the Purchaser shall purchase from the Seller on a daily basis (averaged monthly) for that particular year of the Contract and the rate for that minimum quantity shall be utilized for purposes of determining the rate consistent with numerical paragraph 8 of this Contract. The Purchaser shall be obligated to purchase and pay the Seller for at least the daily minimum contained in its notification to the Seller. Provided, however, the Purchaser shall be entitled to modify, on a monthly basis, the daily minimum quantity within the Acceptable Quantity Range during any year of the Contract by providing written notice to the Seller on or before the twenty fifth (25th) day of the month preceding that for which Purchaser elects to modify its daily minimum. Upon Purchaser's election for such modification, it shall be billed at the rate applicable to its modified quantity, and consistent with numerical paragraph 8 of this Contract, unless and until purchaser further modifies its minimum daily requirements by monthly or annual notification to Seller as hereinabove provided.

2. Point of Delivery and Pressure. The Seller shall furnish water pursuant to this Contract at a pressure created by the Seller maintaining a hydraulic grade of elevation 1175 msl (mean sea level) from a newly constructed twelve inch main supply at a point located at the Taylor County-Marion County line in the Kentucky Highway 68 right of way and at a location more precisely depicted on the plans attached hereto as Exhibit A. If a greater pressure than that normally available at the point of delivery is required by the Purchaser, the cost of providing such greater pressure shall be borne by the Purchaser.

3. Emergencies. Emergency failures of pressure or supply due to main supply breaks, power failure, flood, fire and use of water to fight fire, earthquake or other catastrophe shall excuse the Seller from performance pursuant to this contract for such reasonable period of time as may be necessary to restore service. Similarly, emergency failures in the Purchaser's system which prevent it from receiving the required daily minimum from the Seller shall excuse the Purchaser from

purchasing the required daily minimum from the Seller for a period not to exceed fourteen (14) days; provided, however, that in the event of such an emergency situation, the Purchaser shall, within a period of one (1) year, purchase from the Seller quantities in excess of the required daily minimum sufficient to cause the annual purchases divided by three hundred and sixty five (365) to be at least equal the required daily minimum.

4. Metering Equipment. The Seller shall furnish, install, operate and maintain at its own expense at point of delivery or some other appropriate location, the necessary metering equipment, including a meter house or pit, and required devices of standard type for properly measuring the quantity of water delivered to the Purchaser and to calibrate such metering equipment whenever requested by the Purchaser but not more frequently than once every twelve (12) months. A meter registering not more than two percent (2%) above or below the test result shall be deemed to be accurate. The previous readings of any meter disclosed by test to be inaccurate shall be corrected for the two (2) months previous to such test in accordance with the percentage of inaccuracy found by such tests. If any meter fails to register for any period, the amount of water furnished during such period shall be deemed to be the amount of water delivered in the corresponding period immediately prior to the failure, unless Seller and Purchaser shall agree upon a different amount. The metering equipment shall be read on the 25<sup>th</sup> of the month. An appropriate official of the Purchaser at all reasonable times shall have access to the meter for the purpose of verifying its readings.

5. Water Quality. The Seller shall furnish water pursuant to this Contract meeting applicable purity standards of the Commonwealth of Kentucky and the United States of America as defined in KAR 401.5 and 40 CFR (water quality standards guaranteed to point of master meter delivery). The Purchaser shall be entitled to install equipment on the property of the Seller near the point of delivery which will permit the Purchaser to monitor the quality of the water. In the event that issues arise relating to the quality of the water provided by the Seller to the Purchaser pursuant to this Contract, the parties agree to work together in good faith to equitably resolve the quality issues.

6. Monitoring and Equipment. The Seller shall share with the Purchaser telemetry information as Seller monitors water flow and chlorine residual. The Seller and Purchaser currently use the same telemetry provider and each party agrees to reasonably cooperate to share information at all times during the initial or any renewal term of this Contract. The Purchaser shall have the right to install monitoring equipment at the tank site and the Seller shall make reasonable accommodations for Purchaser if it desires to install such equipment. The parties shall cooperate to insure that all equipment of each party is protected, preserved and kept in a safe condition.

7. Billing Procedure. The Seller shall furnish the Purchaser at the above address on or about the first day of each month, an itemized statement of the amount of water furnished to the Purchaser during the preceding month.

8. Rates and Payment Date. The Seller has calculated its costs associated with providing water to the Purchaser pursuant to this Contract in the Feasibility Evaluation which is dated "Revised February 2015" and attached hereto as Exhibit B. The parties recognize that the actual cost of producing the water pursuant to this Contract will change over time and the parties agree to set the rates for the water being purchased pursuant to this Contract utilizing the methodology contained in the Feasibility Evaluation. On or before April 30 of each year, the Seller shall create a rate table similar to the rate table below using data from the audit performed for Seller for the preceding calendar year and that rate table shall constitute the rates to be utilized for that particular year for this Contract. The Purchaser shall, on or before May 31 of each year, provide written notice to the Seller of the required daily minimum gallons which it desires to purchase for the upcoming fiscal year as that daily minimum may be modified as often as monthly pursuant to numerical paragraph 1 of this Contract. For purposes of this Contract, the fiscal year shall begin on July 1 and end on June 30. The Seller shall provide the Purchaser with a copy of the annual audit so that the Purchaser is able to verify the rates set forth in the rate table. If written notice is not provided by the Purchaser to the Seller as contemplated herein, the rates from the prior year shall remain in effect for the upcoming calendar year.

The Purchaser agrees to pay the Seller, not later than the tenth (10<sup>th</sup>) day of each month, for water delivered in accordance with the following schedule of rates:

Minimum Usage Per Day (Gallons)	Water Treatment	Debt Service	Pumping Costs	Service Fee	Wholesale Rate Per 1,000 Gallons
300,000.00	\$1.18	\$2.08	\$0.34	\$0.36	\$3.96
400,000.00	\$1.18	\$1.56	\$0.31	\$0.31	\$3.36
500,000.00	\$1.18	\$1.25	\$0.29	\$0.27	\$2.99
600,000.00	\$1.18	\$1.04	\$0.28	\$0.25	\$2.75
700,000.00	\$1.18	\$0.89	\$0.27	\$0.23	\$2.57
800,000.00	\$1.18	\$0.78	\$0.26	\$0.22	\$2.44

900,000.00	\$1.18	\$0.69	\$0.26	\$0.21	\$2.34
1,000,000.00	\$1.18	\$0.62	\$0.25	\$0.21	\$2.26

In the event that the Seller intends to make repairs and/or improvements to its infrastructure which may cause a substantial increase in rates, the Seller shall provide as much notice as possible to the Buyer so that the Buyer can evaluate whether this may necessitate a rate increase to its customers and take appropriate action to implement such a rate increase.

9. Construction of Infrastructure. The Seller and the Purchaser shall each be independently responsible for the cost of construction of the infrastructure necessary to allow each to comply with the terms of this Contract. The Seller and the Purchaser agree to jointly apply for funding with the Kentucky Infrastructure Authority and/or the United States of America, acting through the Farmers Home Administration of the United States Department of Agriculture. The Seller and Purchaser agree to diligently complete the construction of the necessary infrastructure so as to allow each of them to be ready to go forward with the purchase and sale of water pursuant to this contract on or about the same date. The parties shall communicate with each other regarding the anticipated time frame in which the construction of the infrastructure is to be completed on an ongoing basis.

10. Term. This Contract shall be for a term of twenty (20) years from the date of the initial delivery of any water as shown by the first bill submitted by the Seller to the Purchaser and, thereafter may be renewed or extended for such term, or terms, as may be agreed upon by the Seller and Purchaser. This Contract shall automatically renew for one (1) year terms unless either party provides notice to the other at least sixty (60) days prior to the end of the initial or any renewal term.

11. Failure to Deliver. The Seller will, at all times, operate and maintain its system in an efficient manner and will take such action as may be necessary to furnish the Purchaser with quantities of water required by the Purchaser. Temporary or partial failures to deliver water shall be remedied with all possible dispatch. In the event of an extended shortage of water, or the supply of water available to the seller is otherwise diminished over an extended period of time, the supply of water to Purchaser shall be reduced or diminished in the same ratio or proportion as the supply to Seller's consumers is reduced or diminished.

12. Regulatory Agencies. This Contract is subject to such rules, regulations, or laws as may be applicable to similar agreements in this State and the Seller and Purchaser will collaborate in



obtaining such permits, certificates, or the like, as may be required to comply therewith.

13. Contingency. The construction of the water supply distribution system and other infrastructure necessary for the Seller and Purchaser is being financed through a loan and/or grant by multiple entities, including, but not limited to, the Kentucky Infrastructure Authority, the United States of America, acting through the Farmers Home Administration of the United States Department of Agriculture, and the provisions hereof pertaining to the undertakings of the parties are conditioned upon the approval, in writing, of the State Director of the Farmers Home Administration and the authorized agent of the Kentucky Infrastructure Authority.

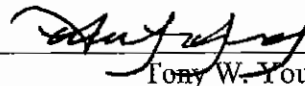
14. Successor to the Purchaser. In the event of any occurrence rendering the Purchaser incapable of performing under this contract, any successor of the Purchaser, whether the result of legal process, assignment, or otherwise, shall succeed to the rights of the Purchaser hereunder.

15. Guarantee of Obligations. The Guarantor does hereby guarantee the Purchaser's obligations under this contract and the Guarantor joins in this contract for this purpose. Furthermore, the Guarantor shall take all steps necessary to meet the Purchaser's obligations under this contract, including raising water rates or taking any other revenue generating measure within its power.

In Witness Whereof, the parties hereto, acting under authority of their respective governing bodies, have caused this contract to be duly executed in multiple counterparts, each of which shall constitute an original.

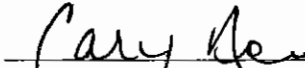
**Seller:**

**City of Campbellsville, Kentucky d/b/a  
Campbellsville Water and Sewer System**



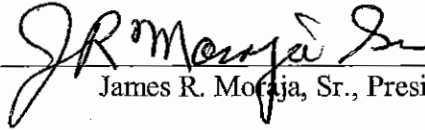
\_\_\_\_\_  
Tony W. Young, Mayor

Attest:

  
\_\_\_\_\_  
Cary Noe, City Clerk

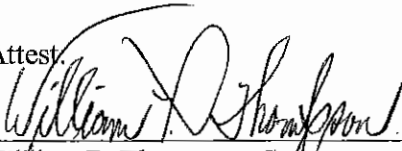
**Purchaser:**

**Lebanon Water Works Company**



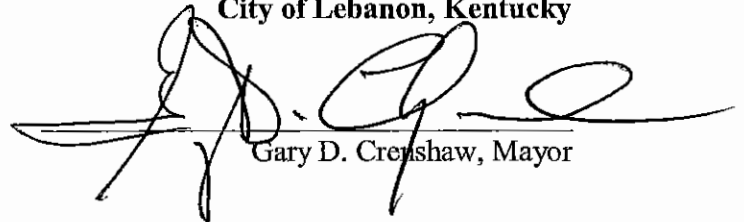
James R. Moraja, Sr., President

Attest:

  
William P. Thompson, Secretary

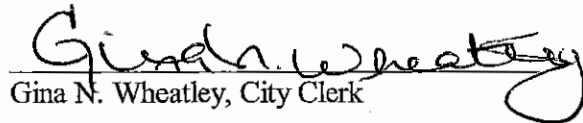
**Guarantor:**

**City of Lebanon, Kentucky**



Gary D. Crenshaw, Mayor

Attest:

  
Gina N. Wheatley, City Clerk

**LEBANON WATER WORKS COMPANY**

**CASE NO. 2017-00417**

**Response to Commission Staff's Request for Information**

**Question No. 3**

**Responding Witnesses: Daren Thompson**

- Q-3. Refer to the proposed tariff sheet "Rate Case Expense Surcharge".
- A. Provide the legal basis for this charge.
  - B. Provide the rationale to include this charge in the tariff and not have it be determined by the Commission in a rate case.
  - C. Provide the basis for recovery of rate case expenses over a 36-month period.
- A-3.
- A. The Rate Case Expense Surcharge was included in the proposed tariff sheet upon the recommendation and advice of the Company's Legal Counsel. According to Legal Counsel, the proposed surcharge is consistent with long-standing judicial<sup>1</sup> and Commission precedent. The Public Service Commission has long recognized that a municipal utility has a right to recover reasonable rate case expense incurred during a Commission review of proposed adjustments to its wholesale rate to public utilities. In Case No. 98-283, which involved an

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<sup>1</sup> See, e.g., *Driscoll v. Edison Light & Power Co.*, 307 U.S. 104, 120-121 (1939) ("Even where the rates in effect are excessive, on a proceeding by a commission to determine reasonableness, we are of the view that the utility should be allowed its fair and proper expenses for presenting its side to the commission."); *West Ohio Gas Co. v. Public Utilities Comm'n*, 294 U.S. 63, 74 (1935); *New Jersey Bell Tel. Co. v. Department of Public Utilities*, 97 A.2d 602 (N.J. 1953); *Southern Bell Tel. & Tel. Co. v. Georgia Public Service Com.*, 49 S.E.2d 38 (Ga. 1948)

adjustment to the City of Owenton's wholesale rate to Tri-Village Water District, the Public Service Commission stated:

Rate case expenses have long been considered as appropriate expenses for inclusion in utility rates. In *West Ohio Gas Co. v. Public Utilities Comm'n*, 294 U.S. 63, 74 (1935), the United States Supreme Court held that such expenses must be included among the costs of operation in the computation of a fair return. It declared that "[t]he charges of engineers and counsel, incurred in defense of its security and perhaps its very life, were as appropriate and even necessary as expenses could well be." *Id.*

As a general matter, reasonable rate case expenses are usually borne by all customers. The present case, however, is not a usual case. The Commission regulates only a portion of Owenton's operations. It does not regulate Owenton's retail operations nor is Owenton required to obtain Commission approval for those rates. As the costs associated with Commission review are clearly associated only with Owenton's wholesale rate, the Commission finds that these costs should be attributed to Owenton's wholesale operations only.<sup>2</sup>

The Commission authorized Owenton to assess a temporary surcharge over a 36-month period to recover its rate case expense. The Public Service Commission has also authorized the cities of Greensburg<sup>3</sup> and

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<sup>2</sup> *Proposed Adjustment of the Wholesale Water Service Rates of the City of Owenton, Kentucky*, Case No. 98-283 (Ky. PSC Feb. 22, 1999) at 9.

<sup>3</sup> *Proposed Adjustment of the Wholesale Water Service Rates of the City of Greensburg*, Case No. 2009-00428 (Ky. PSC Aug. 6, 2010).

Hopkinsville<sup>4</sup> to assess such surcharges to recover reasonable rate case expense.

The surcharge is a reasonable and efficient means to recover a municipal utility's rate case expense. It prevents the municipal utility from recovering amounts in excess of the actual expense incurred, which may occur if the amount is included in the general wholesale rate and the municipal utility does not adjust rates again for a significant period of time. It is easier for the wholesale supplier and customer, as well as the Public Service Commission, to track. It provides a level of predictability for both wholesale supplier and customer.

- B. The Company interprets the request as inquiring why rate case expense should be recovered through a separate surcharge as opposed to inclusion in the wholesale rate. Under the proposed surcharge, the Public Service Commission will determine the level of reasonable rate case expense to be recovered through the surcharge.

As noted in the previous response, the proposed surcharge is a reasonable and efficient means to recover a municipal utility's rate case expense. It prevents the municipal utility from recovering

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<sup>4</sup> *Proposed Adjustment of the Wholesale Water Service Rates of Hopkinsville Water Environment Authority*, Case No. 2009-00373 (Ky. PSC July 2, 2010).

amounts in excess of the actual expense incurred, which may occur if the amount is included in the general wholesale rate and the municipal utility does not adjust rates again for a significant period of time. It is easier for the wholesale supplier and customer, as well as the Public Service Commission, to track. It provides a level of predictability for both wholesale supplier and customer.

The Company also proposed the use of a surcharge based upon actual expense to avoid potential problems associated with the inclusion of an estimated rate case expense in proposed rates. If the proposed wholesale rates included estimated rate case expense and were permitted to become effective without any Public Service Commission proceeding, the proposed rate would have been based upon costs that had not been incurred and would have been unfair to the wholesale customer. Based upon prior proceedings in which the Public Service Commission has limited recovery of rate case expense to the amount set forth in the original filing,<sup>5</sup> if the Company

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<sup>5</sup> See *Electronic Application of Monroe County Water District For Rate Adjustment Pursuant to 807 KAR 5:076*, Case No. 2017-00070 (Ky. PSC Jan. 12, 2018) at 16. The Public Service Commission has indicated that a utility's efforts to periodically report its actual rate case expense, even when such efforts are in direct response to Commission Staff's requests for information are insufficient to support a level that is higher than the estimated level. It has also suggested that the utility may amend its application to seek recovery of a higher level of actual expenses. The Company regards this suggestion as problematic since an amendment to the original filing will effectively reset the statutory review period, require the utility to provide notice of the amendment in accordance with KRS 278.180, and lengthen the time before the issuance of a final decision.

underestimates rate case expense, it will not fully recover its actual costs.

While the Public Service Commission had previously permitted municipal utilities to request surcharges to recover rate case expense after the initial filing of their proposed rates, it revised its policy in Case No. 2014-00392.<sup>6</sup> In that proceeding, the Public Service Commission refused to allow recovery of a municipal utility's rate case expense because the municipal utility had failed to make the request in its initial filing with the Commission. The Company has filed a separate surcharge to comply with the holding in that proceeding.

- C. It is consistent with Public Service Commission precedent. The Public Service Commission has held in prior municipal utility rate proceedings that recovery of rate case expense over a three-year period is reasonable.<sup>7</sup>


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<sup>6</sup> *Proposed Adjustment of the Wholesale Rates of the City of Danville*, Case No. 2014-00392 (Ky. PSC Aug. 13, 2015).

<sup>7</sup> *Proposed Adjustment of the Wholesale Water Service Rates of the City of Owenton, Kentucky*, Case No. 98-283 (Ky. PSC Feb. 22, 1999); *Proposed Adjustment of the Wholesale Water Service Rates of Hopkinsville Water Environment Authority*, Case No. 2009-00373 (Ky. PSC July 2, 2010); *Proposed Adjustment of the Wholesale Water Service Rates of the City of Greensburg*, Case No. 2009-00428 (Ky. PSC Aug. 6, 2010).

## CERTIFICATE OF SERVICE

In accordance with 807 KAR 5:001, Section 8, I certify that Lebanon Water Works Company's March 7, 2018 electronic filing of this Response 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 March 7, 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 Response will be delivered to the Commission on or before March 9, 2018.

  
Damon R. Talley