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July 27, 2009

W. Randall Jones, Esq.  
Rubin & Hays  
Kentucky Home Trust Building  
450 South Third Street  
Louisville, Kentucky 40202-1410

Re: Phase-In of Proposed Rate Adjustment

**PSC STAFF OPINION 2009-008**

Dear Mr. Jones:

Commission Staff acknowledges receipt of your letter of January 22, 2009 regarding the possible phase-in of a proposed rate adjustment in conjunction with a construction project that is financed in part under the terms of an agreement between a water district and Rural Development (RD). I apologize for the delay in responding.

In your letter, you present the following facts:

Oldham County Water District (Oldham District), a water district organized pursuant to KRS Chapter 74, owns and operates facilities used in the distribution and furnishing of water to approximately 7,780 customers in Oldham County, Kentucky.<sup>1</sup>

Oldham District has applied to RD for a loan to finance a construction project. The proposed Letter of Conditions will require Oldham District to adjust its rates to ensure sufficient revenues to service its debt and fund depreciation. Prior to completion of the loan agreement, Oldham District will apply to the Commission for all necessary regulatory approvals, including the issuance of a certificate of public convenience and necessity, authorization to borrow funds, and an adjustment of rates. Oldham District's application will be submitted pursuant to KRS 278.023.

<sup>1</sup> Annual Report of Oldham County Water District to the Kentucky Public Service Commission for the Calendar Year Ending December 31, 2007 at 5, 27.

In lieu of a single rate adjustment, Oldham District wishes to phase-in the adjustment over a four year period to lessen the effect on water district customers. It proposes to adjust its rates annually for four years until reaching RD-required level. If RD accepts this proposal, the Letter of Conditions will provide for four rate schedules and a timetable when each schedule must be placed into effect.

You pose the following question: Is it appropriate to request authorization for a phased rate adjustment over a four year period in an application made pursuant to KRS 278.023?

Commission Staff is unaware of any statutory or regulatory provision that would prevent a water district from seeking and receiving authority for a phased rate adjustment in an application made pursuant to KRS 278.023. The Commission's discretion in such proceedings is very limited. No detailed review of the utility's financial records is conducted nor is the utility required to produce any evidence in support of its rates. See 807 KAR 5:069. While the Commission is permitted to review the utility's proposed construction project and rates and to recommend changes, it may "not modify or reject any portion of the agreement [between the utility and RD] on its own authority" and must issue a certificate of public convenience and necessity and "such other orders as may be required to implement the terms of the agreement no later than thirty (30) days after filing" of any necessary application. KRS 278.023(3).

The Commission has approved the use of phased rate adjustments for water districts and water associations. See, e.g., *Harrison County Water Association*, Case No. 99-409 (Ky. PSC Apr. 27, 2000). In each instance in which such rates were approved, the Commission conducted a thorough review of the utility's financial records in a general rate adjustment proceeding and determined the appropriate revenue requirement; the utility requested that rates necessary to produce the determined revenue requirement be phased-in gradually to avoid rate shock; and the Commission found no adverse effect on the utility's service resulting from the delay in implementing the final rate schedule.<sup>2</sup>

Notwithstanding these cases, Commission Staff, as a matter of public policy, has concerns regarding the use of such applications to implement a phased rate adjustment in light of the limited evidentiary record and the statutory barriers that prevent a thorough Commission review of the proposed rates. While Commission Staff recognizes that RD has a strong interest in ensuring the financial viability of its borrower and promoting reasonable rates, Commission Staff is unfamiliar with the methodologies that RD uses to establish its rate requirements or assess the reasonableness of the

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<sup>2</sup> See *Utilities Operating Co. v. King*, 143 So.2d 854, 858, 45 PUR3d 439, 443 (Fla. 1962) ("[I]n the absence of some showing that the service to the public will suffer by allowing . . . [a] utility to charge rates which will not produce a fair return, the utility and not the Commission has the right of decision as to the rates it will charge so long as they do not exceed those which would produce a fair return as determined by the Commission."); see also *Hardin County Water District No. 1*, Case No. 2006-00410 (Ky. PSC Aug. 2, 2007); *Lockwood Estates Developing Corp.*, Case No. 99-477 (Ky. PSC Apr. 21, 2000).

W. Randall Jones, Esq.

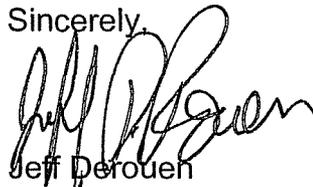
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proposed rates. It, therefore, considers general rate adjustment proceedings to provide a better vehicle for consideration of such adjustments.

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, Executive Advisor, at (502) 564-3940, Extension 259.

Sincerely,

A handwritten signature in black ink, appearing to read "Jeff Derouen". The signature is fluid and cursive, with a large initial "J" and "D".

Jeff Derouen  
Executive Director