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July 28, 2010

Mr. Chris Wilcutt
McGhee Engineering, Inc.
P.O. Box 267
Guthrie, Kentucky 42234

Re: East Logan Water District
Phase 3 System Upgrade Project

PSC STAFF OPINION 2010-018

Dear Mr. Wilcutt:

Commission Staff acknowledges receipt of your letter of July 6, 2010 in which you request on behalf of East Logan Water District ("East Logan District") an opinion regarding the need for a certificate of public convenience and necessity to install a water distribution main extension and upgrade in Logan County, Kentucky.

Based upon your letter and your telephone conversation with Commission Staff, Commission Staff understands the facts as follows:

East Logan District, a water district organized pursuant to KRS Chapter 74, provides water service to 2,837 customers in Logan County, Kentucky. It proposes to install approximately 5,395 linear feet of 12-inch ductile iron water main along Kentucky Highway 68, 1,149 linear feet of 6-inch polyvinylchloride ("PVC") water main along Lindsey Lane and eight master meter vaults. A commercial customer will be added as a result of the proposed extension.

Total estimated cost of the project, including engineering, legal and equipment expenses and contingencies is \$575,250. East Logan District will finance the cost of the project with approximately \$221,000 in surplus funds from a Rural Development grant. The Commission approved the financing plan, which included Rural Development grant, in

Case No. 2008-00201¹ pursuant to KRS 278.023. Rural Development has approved the use of these surplus proceeds for the proposed construction. The proposed construction will not require a rate adjustment. East Logan District will not issue any evidences of indebtedness to finance the proposed construction.

Your letter presents the following question: Must East Logan District obtain a certificate of public convenience and necessity for the proposed project?

KRS 278.020(1) provides:

No person, partnership, public or private corporation, or combination thereof shall commence providing utility service to or for the public or begin the construction of any plant, equipment, property, or facility for furnishing to the public any of the services enumerated in KRS 278.010, except retail electric suppliers for service connections to electric-consuming facilities located within its certified territory and ordinary extensions of existing systems in the usual course of business, until that person has obtained from the Public Service Commission a certificate that public convenience and necessity require the service or construction.

Administrative Regulation 807 KAR 5:001, Section 9(3), further provides:

Extensions in the ordinary course of business. No certificate of public convenience and necessity will be required for extensions that do not create wasteful duplication of plant, equipment, property or facilities, or conflict with the existing certificates or service of other utilities operating in the same area and under the jurisdiction of the commission that are in the general area in which the utility renders service or contiguous thereto, and that do not involve sufficient capital outlay to materially affect the existing financial condition of the utility involved, or will not result in increased charges to its customers.

Under the method of analysis that Commission Staff has historically employed, the construction of the proposed water distribution main upgrade appears to be in the ordinary course of business and would not require a certificate of public convenience and necessity. According to its Annual Report for the calendar year ending December

¹ Case No. 2008-00201, *The Application of East Logan Water District For a Certificate of Public Convenience and Necessity to Construct, Finance and Increase Rates Pursuant to KRS 278.023* (Ky. PSC June 27, 2008).

31, 2009, East Logan District had total utility plant of \$11,741,581.² The proposed water distribution main upgrade represents an increase in East Logan District's net utility plant of 4.9 percent. Such an increase in total utility plant is considered as ordinary. See, e.g., *City of Covington v. Board of Commissioners of Kenton County Water District No. 1*, 371 S.W.2d 20 (Ky. 1963). Moreover, as the funds for the proposed construction will not require the issuance of additional debt or any adjustment in rates, the proposed construction does not appear to materially affect East Logan District's existing financial condition.

Recent legislative action further supports Commission Staff's position that the proposed construction does not require a certificate of public convenience and necessity. In its recent extraordinary session, the Kentucky General Assembly enacted legislation that provides:

Water Districts and Water Associations: A water district created pursuant to KRS Chapter 74 and a water association formed under KRS Chapter 273 that undertakes a waterline extension or improvement project shall not be required to obtain a certificate of public convenience and necessity, notwithstanding KRS 278.020(1), if the water district or water association is a Class A or B utility as defined in the Uniform System of Accounts established by the Public Service Commission, pursuant to KRS 278.220, as the system of accounts prescribed for utilities in Kentucky, and either: (a) The water line extension or improvement project will not cost in excess of \$500,000; or (b) The water district or water association will not, as a result of the water line extension or improvement project, incur obligations requiring Public Service Commission approval pursuant to KRS 278.300. In either case, the water district or water association shall not, as a result of the water line extension or improvement project, increase rates to its customers.

2010 Ky. Acts 1st Spec. Sess. Ch. 1. This Act became effective on July 1, 2010.

Since the proposed construction does not require East Logan to incur any additional obligations that require Commission approval and will not result in an increase in water service rates, the Act would exempt the proposed construction from the requirement to obtain a certificate of public convenience and necessity. As East Logan District had annual revenues in calendar year 2009 of \$1,578,306, it is a Class A water utility³ and falls within the class of water utilities subject to the exemption.

² *Annual Report of East Logan Water District to the Kentucky Public Service Commission for the Year Ended December 31, 2009*, at 13.

³ The Kentucky Public Service Commission's Uniform System of Accounts defines a Class A water utility as a utility "having annual water operating revenues of \$750,000 or more." *Uniform System of Accounts for Class A and B Water Districts and Associations* at 14 (2002) (found at <http://psc.ky.gov/agencies/psc/forms/usoa/0700ab02.pdf>).

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Commission Staff notes that the Commission has previously addressed the use of any surplus proceeds from the sale of revenue bonds to Rural Development. In its Order of June 27, 2008 in Case No. 2008-00201, the Commission stated:

[I]f surplus funds remain after the approved construction has been completed, East Logan [Water District] may use such surplus to construct additional plant facility if RD [Rural Development] approves of the use and the additional construction will not result in a change in East Logan's rates for service. East Logan shall provide written notice of this additional construction in accordance with 807 KAR 5:069, Section 3.

Order at 2. Accordingly, prior to commencing construction, East Logan District should comply with the notice requirements of 807 KAR 5:069, Section 3.⁴ Your request for an opinion does not constitute the required notice.

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 Todd Osterloh, at (502) 564-3940, Extension 439.

Sincerely,



Jeff Derouen
Executive Director

⁴ 807 KAR 5:069, Section 3, provides:

Additional Construction Activity. If surplus project funds remain after the approved construction has been completed, the utility may construct an additional plant facility without prior commission approval if no change in existing rates will result. The utility shall notify the commission in writing of additional construction proposed under this section, and shall attach to the notice a statement of the federal lending agency authorizing the utility to use the remaining project funds in the manner proposed.