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October 11, 2010

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**PSC STAFF OPINION 2010-024**

Re: House Bill 1 - 2010 First Extraordinary Session

Dear Mr. Bates:

Commission Staff acknowledges receipt of your letter of August 17, 2010, in which you submitted on behalf of the Kentucky Municipal Utilities Association several questions related to a provision of House Bill 1 of the 2010 First Extraordinary Session of the Kentucky General Assembly.

The provision at issue reads:

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.

This provision has appeared in prior Acts of the General Assembly. See, e.g., 2005 Ky. Acts Ch. 173; 2006 Ky. Acts Ch. 252. It is effective until June 30, 2012 – the end of the second fiscal year addressed in House Bill 1. See KRS 48.310.

In your letter, you have presented ten questions. Commission Staff's response to these questions is set forth below.

*(1) Whether House Bill 1 allows water districts and water associations to lawfully avoid PSC certificate of convenience and necessity review for projects that are \$500,000 or less, or which are funded by the U.S. Department of Agriculture or HUD.*

KRS 278.020(1) requires a person to obtain a Certificate of Public Convenience and Necessity ("Certificate") prior to commencing construction of any plant, equipment, property, or facility for furnishing water to the public, unless the construction is an ordinary extension of an existing system in the usual course of business. House Bill 1 creates two additional exceptions to this requirement for Class A or B water districts or water associations.<sup>1</sup> These utilities are not required to obtain a Certificate for water main extensions or improvement projects that cost less than \$500,000 or that do not involve the issuance of evidences of indebtedness for which KRS 278.300<sup>2</sup> requires Commission authorization. These projects must also not require the water district or association to increase its rates.

House Bill 1 does not distinguish projects based upon the source of funding. For example, under the provision in question, a Class A water district that proposes to construct a \$2 million water main extension that is funded completely with grants from the Kentucky Infrastructure Authority and does not require a rate adjustment would not require a Certificate.

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<sup>1</sup> The Public Service Commission's Uniform System of Accounts defines a Class A water system as a water system "having annual water operating revenues of \$750,000 or more." A Class B water system is a water system "having annual water operating revenues of \$250,000 or more but less than \$750,000." Kentucky Public Service Commission, *Uniform System of Accounts for Class A/B Water Districts and Associations* at 14 (2002) (found at <http://psc.ky.gov/agencies/psc/forms/usoa/0700ab02.pdf>).

<sup>2</sup> KRS 278.300(1) provides:

No utility shall issue any securities or evidences of indebtedness, or assume any obligation or liability in respect to the securities or evidences of indebtedness of any other person until it has been authorized so to do by order of the commission.

Commission approval is not required for notes issued for proper purposes and that are payable at periods of not more than two years from the date of issuance. KRS 278.300(8). Likewise, Commission approval is not required for the issuance of securities or evidences of indebtedness that are subject to the supervision or control of the federal government or any agency of the federal government. KRS 278.300(10).

House Bill 1 does not specifically address construction projects of water districts and associations that are financed through agreements with the U.S. Department of Agriculture or U.S. Department of Housing and Urban Development. KRS 278.023 governs these types of projects. KRS 278.023 does not eliminate the requirement that a water district or association obtain a Certificate before commencing construction, but does limit Commission review over the project and provides for expedited approval procedures.

*(2) Whether waterline extension and improvement projects can be kept lawfully "under the wire" by utilizing a piecemeal approach. In other words, can a \$3,000,000 project be parsed into \$500,000 or less sub-projects or phases, each of which would not trigger PSC certificate of convenience and necessity approval requirements?*

A project cannot be severed into smaller projects to circumvent the legal requirement to obtain a Certificate. It is possible, however, that multiple construction projects that are related but whose individual cost does not exceed \$500,000 could be appropriately severed and viewed on a stand-alone basis. Each case must be decided on its own facts and circumstances. See, e.g., Case No. 9021, *Oldham County Water Dist.* (Ky. PSC Oct. 23, 1984) (finding that construction of water mains, storage facilities, and pumping stations are "interdependent" and should not be considered separately).

*(3) Whether a waterline extension or improvement project, irrespective of total or actual project cost, can simply be labeled as a \$500,000 proposal and thereby lawfully avoid PSC certificate approval scrutiny.*

The provision requires that the "water line extension or improvement project will not cost in excess of \$500,000." The Act's language clearly provides that the final total cost is the determining factor. Any water district or water association that relies upon a project's estimated cost in its determining whether to apply for a Certificate does so at its risk.

*(4) Whether House Bill 1 disallows the PSC from conducting a certificate of public convenience and necessity review and how the PSC will ensure that waterline extension or improvement projects do not result in infrastructural and economic inefficiencies.*

House Bill 1 does not affect the Commission's authority to review the proposed water main extensions and improvement projects. The Commission continues to have the authority to investigate projects to ensure that they will not result in infrastructural and economic inefficiencies.

KRS 278.260(1) provides

The commission shall have original jurisdiction over complaints as to rates or service of any utility, and upon a complaint in writing made against any utility by any person . . . that any regulation, measurement, practice or act affecting or relating to the service of the utility or any service in connection therewith is unreasonable, unsafe, insufficient or unjustly discriminatory . . . the commission shall proceed . . . to make such investigation as it deems necessary or convenient. The commission may also make such an investigation on its own motion.

KRS 278.280 provides:

Whenever the commission, upon its own motion or upon complaint as provided in KRS 278.260, and after a hearing had upon reasonable notice, finds that the rules, regulations, practices, equipment, appliances, facilities or service of any utility subject to its jurisdiction . . . are unjust, unreasonable, unsafe, improper, inadequate or insufficient, the commission shall determine the just, reasonable, safe, proper, adequate or sufficient rules, regulations, practices, equipment, appliances, facilities, service or methods to be observed, furnished, constructed, enforced or employed, and shall fix the same by its order, rule or regulation.

House Bill 1 merely exempts certain types of water main extensions and improvement projects from the requirement of a Certificate. It does not prevent the Commission from investigating on its own motion any proposed construction project to ensure that the project's construction will not result in the wasteful duplication of utility facilities or excessive utility investment.

*(5) Whether House Bill 1 prohibits the PSC from investigating the appropriateness or legality of piecemeal projects.*

It does not. The Commission continues to possess the authority to investigate service-related construction. As discussed in the response to Question 2, a project is not exempted from obtaining a Certificate merely because the water district or association has severed the proposed construction project into smaller sub-projects.

*(6) Whether and how the PSC can ensure that water line and improvement projects do not proceed without consideration of the needs and objectives of Kentucky's municipal utilities and their customers.*

As discussed in the response to Question 4, the Commission continues to retain jurisdiction over service of a utility and the authority to investigate the reasonableness and necessity for proposed facilities. Commission Staff actively gathers and reviews information from various sources, such as press reports and filings from other governmental agencies, to remain current on the construction activities of jurisdictional water utilities. To the extent that a municipal utility has concerns about the construction activities of a water district or association, it may file a complaint with the Commission against that utility or otherwise request that the Commission investigate the proposed construction project. See, e.g., Case No. 89-014, *City of Newport v. Campbell County Kentucky Water District* (Ky. PSC Jan. 31, 1990).

*(7) Whether and how persons or entities other than the PSC can ensure that water line and improvement projects do not proceed without consideration of the needs and objectives of Kentucky's municipal utilities and their customers.*

To the extent that the construction of water main extensions and other improvement projects are subject to Commission jurisdiction, a person or entity that is interested in the construction may file a complaint against the constructing water utility or otherwise request that the Commission investigate the proposed construction.

With regard to other forums, Commission Staff notes that the records and actions of most governmental entities involved in the regulation and funding of public water projects (e.g., Kentucky Division of Water, Kentucky Infrastructure Authority, Rural Development, Department of Local Government, local and regional water councils) are subject to public inspection and review. A person may monitor the filings and actions of those entities and may in many instances submit comments or otherwise participate in the review process. Open, frank and frequent discussions between municipal utilities and neighboring water districts and associations are yet another means to ensure the public interest is met.

*(8) Whether and how House Bill 1 will adversely impact water quality management or regional planning. For example, is compliance with wastewater treatment planning under 401 KAR 5:006 (regional wastewater planning) and water supply planning under 401 KAR 8:100 (design, construction and approval) still required? What entity will decide whether an existing municipal utility can provide the service that the proposed project envisions? How will House Bill 1 affect municipal service territories as set out in facilities plans?*

House Bill 1 applies only to the requirement for obtaining a Certificate from the Commission. It has no application to the regulatory review processes of other state agencies and should not affect water quality management or regional planning activities of other state agencies. It should have no effect on facility planning that is conducted pursuant to Title 405, Chapter 5 of the Kentucky Administrative Regulations. Similar provisions in previous Acts have not impacted water quality management or regional planning activities. You may wish to contact those agencies to ascertain their position on the effect of the House Bill 1 provision.

*(9) Whether the PSC retains its authority to prohibit construction of cross-connections which are banned by Kentucky Division of Water regulation 401 KAR 8:020, Section 2(2).*

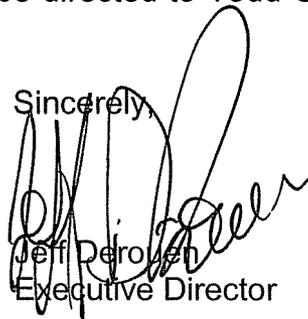
The provision in House Bill 1 does not affect the Commission's existing authority over cross-connections.

*(10) Whether and how House Bill 1 affects PSC regulation 807 KAR 5:066, Section 7, governing construction.*

The provision in House Bill 1 does not exempt water utilities from complying with 807 KAR 5:066, Section 7.

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, Staff Attorney, at (502) 564-3940, Extension 439.

Sincerely,



Jeff Derouen  
Executive Director