COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

CARROLL COUNTY WATER DISTRICT NO. 1	)	
	)	
COMPLAINANT	)	
	)	
V.	)	CASE NO. 2007-00202
	)	
GALLATIN COUNTY WATER DISTRICT	)	
	)	
DEFENDANT	)	

ORDER

Carroll County Water District No. 1 ("Carroll District") has filed a formal complaint against Gallatin County Water District ("Gallatin District") regarding Gallatin District's efforts to provide water service to a real estate tract within Carroll District's territory. At issue is whether a water district's construction of facilities in another water district's territory for the purpose of providing water service to persons located in that territory requires a Certificate of Public Convenience and Necessity ("Certificate"). Finding in the affirmative, we direct Gallatin District to refrain from constructing any facilities to provide water service to the tract in question until it has obtained a Certificate from the Commission.

STATEMENT OF THE CASE

Carroll District is a water district organized pursuant to KRS Chapter 74. It owns and operates facilities that produce and distribute water to approximately 2,764

customers in Carroll, Gallatin, and Owen counties, Kentucky.[1] Approximately 600 of these customers are located in Gallatin County.[2] Its board of commissioners is composed of five residents of Carroll County, two residents of Gallatin County, and two residents of Owen County.[3]

Carroll District was created in 1961[4] and originally encompassed only portions of Carroll County. In 1983, Carroll District's territorial limits were enlarged to include the western portion of Gallatin County from the Carroll-Gallatin County boundary to Kentucky Highway 35. Following the enlargement of its territory, Carroll District constructed distribution facilities in Gallatin County, to include a 200,000-gallon water storage tank, a booster pumping station and approximately 41 miles of water distribution main to serve this area at a total cost of $1,208,000.[5] It financed construction of these facilities with the issuance of $1,197,000 in bonds to the Farmers Home Administration.

In 1997 Carroll District constructed several improvements in Gallatin County, including a 150,000-gallon water storage tank, a pumping station, a new well and 17

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[1] Annual Report of Carroll County Water District No. 1 to the Kentucky Public Service Commission for the Year Ended December 31, 2007 at 5, 27 (hereinafter Carroll District's Annual Report).

[2] Transcript of 11/1/2007 Hearing at 24 (stating that 21 percent of Carroll District's customers are in Gallatin County).

[3] *Id.*

[4] Carroll District's Annual Report at 4.

[5] Case No. 8960, Application of Carroll County Water District for a Certificate of Public Convenience and Necessity: (1) Approving the Construction of Major Additions, Extensions and Improvements; (2) Seeking Approval of the Issuance of Certain Securities; and (3) For an Order Authorizing Adjustment of Water Service Rates and Charges (Ky. PSC Oct. 19, 1984); Carroll District's Responses to Commission Staff's First Data Request at Item 14.

miles of various-sized water main, at a total cost of approximately $2,266,000.[6] Carroll District financed these improvements with the issuance of bonds to Rural Development. The improvements were necessary to relieve strain on existing facilities due to industrial growth in Gallatin County.[7]

As part of this construction, Carroll District extended a 4-inch water distribution main from Knox-Lillard Road and Drury Chapel Road to Kentucky Highway 1330.[8] Crawford Junkyard, which is near the present intersection of Kentucky Highways 1130 and 1039, is the southernmost customer served through this extension.[9]

Gallatin District, a water district organized pursuant to KRS Chapter 74, owns and operates facilities that produce and distribute water to approximately 1,827 customers in Boone, Gallatin, and Grant counties, Kentucky.[10] The record is not clear as to the actual date that the water district was organized. Gallatin County Court records indicate that the Court established the "Gallatin Rural Water District" on September 12, 1960.[11] In 1969, a group of Gallatin County residents applied to the Commission for authority to petition Gallatin County Court to establish a water district to serve Gallatin County. After reviewing the feasibility of such a district, the Commission

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[6] Case No. 1997-00217, The Application of Carroll County Water District No. 1 of Carroll, Gallatin and Owen Counties, Kentucky, for a Certificate of Public Convenience and Necessity to Construct, Finance and Increase Rates Pursuant to KRS 278.023 (Ky. PSC May 19, 1997); Carroll District's Responses to Commission Staff's First Data Request at Item 14; Transcript of 11/1/2007 Hearing at 31-32.

[7] Transcript of 11/1/2007 Hearing at 31; Frank Main, *New Industries in Gallatin Put Strain on Water*, Kentucky Post, June 27, 1995 at 1K.

[8] Transcript of 11/1/2007 Hearing at 64.

[9] *Id.* at 45.

[10] Annual Report of Gallatin County Water District to the Kentucky Public Service Commission for the Year Ended December 31, 2007 (hereinafter Gallatin District's Annual Report) at 5, 27.

[11] Gallatin County Court Order Book 22 at 132; Gallatin District's Response to Commission Staff's First Data Request, Item 1; Gallatin District's Annual Report at 4.

granted the application.[12] No further action appears to have been taken to establish a water district or construct facilities to serve Gallatin County for 15 years.

On December 27, 1985, Gallatin Judge/Executive Clarence Davis ratified the earlier creation of Gallatin District and established its boundaries. In his Order, he described these boundaries as:

> Being all of Gallatin County, Kentucky, excepting therefrom the corporate boundaries of Glencoe and Sparta, Kentucky which are served by Tri-Village Water District, and the corporate boundaries of Warsaw, Kentucky, which is served by Warsaw Water Works and further excepting any other territory heretofore lawfully annexed by either Tri-Village Water District or Warsaw Water Works and **further excepting that part of the county lawfully annexed by Carroll County Water District #1.**[13]

Two years later, Gallatin District applied for a Certificate to construct its first facilities and for Commission approval for its initial service rates.[14]

In 1998, Carroll District petitioned Gallatin County Judge/Executive Clarence Davis to clarify and redefine its boundaries in Gallatin County.[15] On October 8, 1998, County Judge/Executive Davis issued an order that diminished Carroll District's territory in Gallatin County and repositioned its eastern boundary from Kentucky Highway 35 to 1,000 feet east of Kentucky Highway 1130.

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[12] Case No. 5233P, Application of Residents of Gallatin County for a Preliminary Hearing to Determine the Need for the Formation of a Water District (Ky. PSC Jan. 6, 1970).

[13] Gallatin County Court Order Book 24 at 60 (emphasis added); Gallatin District's Response to Commission Staff's First Data Request, Item 1

[14] Case No. 10194, The Application of Gallatin County Water District, Gallatin County, Kentucky, For (1) A Certificate of Public Convenience and Necessity Authorizing the District to Construct a New Water Distribution System; (2) Approval of the Proposed Plan of Financing Said Project; and (3) Approval of the Proposed Water Service Rates and Charges of the District (Ky. PSC Sept. 6, 1988).

[15] Carroll District petitioned the county judge/executives of Carroll, Owen, and Gallatin counties for amendments and clarifications to its boundaries in each of these counties. These judge/executives jointly entered an Order that redefined Carroll District's territory. The Carroll County Judge/Executive and Owen County Judge/Executive signed the Order on September 8, 1998. The Gallatin County Judge/Executive signed it on October 8, 1998. *See* Carroll District's Complaint, Exhibit A.

Carroll District's action followed discussions with Gallatin County officials regarding the modifications of the water district's territory to permit Gallatin District to serve the Kentucky Speedway.[16] A year earlier, a developer had selected a site in Gallatin County, near Sparta, Kentucky, to construct a motor speedway that would seat 175,000 spectators.[17] This site was originally situated in Carroll District's territory. After the 1998 amendment of Carroll District's territory, it was approximately 5,000 feet east of Carroll District's eastern boundary.

Following the diminishment of Carroll District's territory, Gallatin District undertook steps to provide water service to the Kentucky Speedway and the surrounding area. It constructed a ground water well system, treatment facilities and 30,000 linear feet of 10-inch transmission main at a cost of approximately $752,610.[18] There is no record, however, that prior to 2008[19] Gallatin District petitioned to enlarge its territory to include the area in which the Kentucky Speedway is situated or which Carroll District relinquished.

Beginning in late 2000, Gallatin District began focusing upon the provision of water service to areas west of the Kentucky Speedway, to include the area surrounding

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[16] Transcript of 11/1/2007 Hearing at 34. Carroll District officials also recognized that Gallatin District had already constructed facilities and provided water service to some locations along Kentucky Highway 35. *Id.* See also Gallatin District's Response to Commission Staff's First Data Request, Item 1 (containing the minutes of the meetings of Gallatin District's Board of Commissioners for the month of August 1998).

[17] Monica Dias, *NASCAR May Roar into Sparta*, Kentucky Post, Oct. 17, 1997 at 1K.

[18] Case No. 1999-00493, The Application of Gallatin County Water District for a Certificate of Public Convenience and Necessity to Construct and Finance an Improvements Project (Ky. PSC Jan. 25, 2000).

[19] Since 1985, only two revisions to Gallatin District's territorial boundaries have occurred. On February 26, 2004, the Gallatin County Judge/Executive ordered the de-annexation of certain tracts of land adjacent to the city of Warsaw, Kentucky that received water service from that city. On July 8, 2008, the Gallatin County Judge/Executive ordered the annexation of the area along Speedway Boulevard from Kentucky Highway 35 to Kentucky Highway 1039 and extending along the same projected line to a point 1,000 feet west of the junction of Kentucky Highway 1039 and Speedway Boulevard.

a new interchange for Interstate Highway 71 and Kentucky Highway 1039. This interchange, which was intended to provide greater access to the Kentucky Speedway,[20] was located west of Kentucky Highway 1130. Seeing significant economic benefits in the development of the interchange area,[21] Gallatin County Judge/Executive George Zubaty strongly encouraged Gallatin District to extend service to the area.

Gallatin District's Board of Commissioners first discussed water service to the area surrounding the interchange in September 2000. Their discussions centered around the water district's right to serve that area.[22] In subsequent meetings, Gallatin District commissioners discussed the relative rights of Gallatin District and Carroll District to serve the area. Though eventually recognizing that the area fell within Carroll

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[20] *New Interchanges Open For Kentucky Speedway,* Business First of Louisville, May 8, 2002, http://louisville.bizjournals.com/louisville/stories/2002/05/06/daily32.html (last visited Aug. 20, 2008).

[21] Transcript of 11/1/2007 Hearing at 249, 252. Questioned why he supported the extension, Judge/Executive Zubaty testified:

> Well, we already had the - the new interchange was there. I mean, it was there. Here's the new road coming. I mean, it doesn't take a brain surgeon to understand what's going to happen. This place is going to explode.

Id. at 252.

[22]

> [Gallatin County Attorney] Steve [Huddleston] brought to the boards [sic] attention that [Gallatin County] Judge Zubaty is very interested in trying to service the area surrounding the new interstate exchange off HWY1130. He feels that this going to be a huge area for growth. Steve ask [sic] who sets up the boundaries to determine what water district serves each area. Is this something PSC decides? Morris commented that in 1985 the [Gallatin] County gave Carroll County [Water District No. 1] the authority to extend its water line to HWY 35. We made it to 1130 first so we were able to supply the area from HWY 35 west to 1130. Carroll County [Water District No. 1] serves anything west of 1130. No decisions were made at this time.

Minutes of Gallatin District Board of Commissioners' Meeting of 9/14/2000.

District's territory,[23] the Board of Commissioners concluded that Gallatin District facilities should be extended to that area before Carroll District constructed facilities in the vicinity. On September 17, 2001, Gallatin District's Board of Commissioners authorized the construction of a water main from Kentucky Speedway to an area west of Kentucky Highway 1130.

The following year, Gallatin District constructed an 8-inch water main extension of approximately 11,000 feet[24] westward from the Kentucky Speedway to Kentucky Highway 1039 at a total cost of $61,000.[25] Gallatin District used internal funds to finance the water extension. The main extension ran 5,000 feet west along Speedway Boulevard, an access road to the Kentucky Speedway, until reaching Kentucky Highway 1130, then ran south along Kentucky Highway 1130 for approximately 1,800 feet, and then ran west approximately 1,800 feet over a utility easement. Approximately 5,000

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[23] At their meeting on October 12, 2000, the Board of Commissioners and its legal counsel discussed Carroll District's boundaries. While apparently aware of the Order of October 8, 1998 that redefined Carroll District's territory, none of the participants appeared to understand the contents of the Order or the Order's legal significance. Gallatin District's counsel suggested that the water district "proceed and get water to that area." By the Board of Commissioners' meeting of January 10, 2001, the members were apparently aware that the area in question was within Carroll District's territory. The minutes state:

> [Vice Chairman] Vic [Satchwell] asks if Steve [Huddleston] has found out anything about the Service Boundaries. Is that Carroll County's service area? Judge Zubaty stated that we have not found any paperwork giving them the exclusive rights to serve that area. They have applied for a KIA [Kentucky Infrastructure Authority] loan to extend their lines into that area. Morris commented that if we already have a line there then they probably would not get approval.

On September 17, 2001, the Board held a special meeting to consider construction of a water main to Kentucky Highway 1039. One commissioner expressed concern that Carroll District would construct facilities in that vicinity and claim the territory before Gallatin District could complete its proposed water main. The Board voted to "get a bid to run the line from the new road [Kentucky Highway 1039] to the edge of the Speedway property." *See also* Transcript of 11/1/2007 Hearing at 147.

[24] Gallatin District's Board of Commissioners did not authorize engineering and design work on the water main extension until April 2002. The Kentucky Division of Water issued a permit for the water main extension on August 5, 2002. On September 12, 2002, the Board of Commissioners selected Lykins Construction to construct the water main extension.

[25] Gallatin District's Response to Commission Staff's First Data Request, Item 11(a).

feet of the water main extends into Carroll District's territory.[26] It passes within 1,100 feet of Carroll District's nearest water main and terminates approximately 3,000 feet from that water main.[27] Gallatin District did not apply for a Certificate of Public Convenience and Necessity to construct the extension.

At the time of this water main's construction, no person or entity within the area in which the water main extension was located had applied to Gallatin District for water service.[28] No Gallatin District official had any specific knowledge or expectation of when the water main extension would begin serving customers.[29] As of the time of the hearing in this proceeding, the water main had yet to serve any customers or to be placed into service.[30]

In early January 2007, Whitehorse Development Group, LLC ("Whitehorse") approached Carroll District and Gallatin District and advised each that a commercial development planned for its property would require 10,000 gallons of water per day.[31] At that time, Whitehorse owned a 51-acre tract of land in Gallatin County that lay north of Interstate Highway 71 and that Kentucky Highway 1039 bisected. Approximately 27 acres of this tract lay west of Kentucky Highway 1039; the remaining portion lay to the

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[26] *See* Carroll District's Response to Commission Staff's First Data Request, Exhibit 3.

[27] *See* Transcript of 11/1/2007 Hearing at 28; Carroll District's Response to Commission Staff's First Data Request, Exhibit 3.

[28] *See* Transcript of 11/1/2007 Hearing at 147, 239.

[29] *Id.* at 195, 273-274.

[30] *Id.* at 148.

[31] *See* Letter from James L. Smith, Manager, Carroll District, to Adam Chaney, Member, Chaney Land Developers (Mar. 23, 2007). The record contains conflicting evidence regarding the property's need for additional water capacity for a fire suppression system. *See* Letter from Adam Chaney, Member, Whitehorse Development Group, to Jim Smith, Manager, Carroll District (Aug. 1, 2007); Transcript of 11/1/2007 Hearing at 38, 284-86.

east.[32] The tract was completely within Carroll District's territorial boundaries and was approximately 4,700 feet from Carroll District's 4-inch water main and approximately 1,700 feet from Gallatin District's 8-inch main.[33] On January 30, 2007, Whitehorse requested that Gallatin District extend its 8-inch water main to Whitehorse's property line at the intersection of Interstate Highway 71 and Kentucky Highway 1039.[34]

On March 30, 2007, Gallatin District applied to the Kentucky Division of Water for a permit to extend its 8-inch water distribution main approximately 3,970 feet along Kentucky Highway 1039.[35] In its application, Gallatin District identified the project as the "KY 1039 Extension" and stated that the project had no customers.[36] On April 10, 2007, the Kentucky Division of Water issued a permit to Gallatin District for the water main extension.[37]

On or after July 12, 2007, Whitehorse contracted with Denny French, the current Gallatin County Deputy County Judge/Executive and a former chairman of Gallatin District's Board of Commissioners, to provide the labor and materials to construct an 8-inch water main extension along Kentucky Highway 1039 north from its property to Gallatin District's 8-inch main. Mr. French advised Gallatin District's Board of Commissioners on July 12, 2007 that Whitehorse had retained him to construct the

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[32] *See* Letter from Dennis R. Williams, counsel for Whitehorse Development Group, LLC, to Stephen P. Huddleston, counsel for Gallatin District (Sept. 21, 2007) (found at Gallatin District's Response to Commission Staff's First Data Request, Item 5).

[33] Transcript of 11/1/2007 Hearing at 46, 158.

[34] Letter from Adam Chaney, Member, Whitehorse Development Group, to Denny French, Chairman, Gallatin District (Jan. 30, 2007).

[35] Transcript of 11/1/2007 Hearing at 139.

[36] *Id.* at 139-140.

[37] Letter from Donna Marlin, Branch Manager, Drinking Water Branch, Kentucky Division of Water, to Morris R. Courtney, Gallatin District (Apr. 10, 2007).

water main extension and that he intended to begin construction as soon as a highway easement was obtained.[38] Victor Satchwell, chairman of Gallatin District's Board of Commissioners, while noting the ongoing proceeding against Gallatin District regarding service to the Whitehorse property, advised Mr. French and the Board of Commissioners that he was "not opposed to the contractors doing anything."[39]

Using the permit that Kentucky Division of Water had previously issued to Gallatin District as the basis for his authority to perform construction,[40] Mr. French installed the water main extension on September 11, 2007.[41] He notified Gallatin District of the commencement of construction the same day.[42] Seven days later, Gallatin District requested that Mr. French cease construction to comply with the Commission's Order of August 1, 2007 in this proceeding.[43]

On October 31, 2007, Whitehorse sold an 18-acre lot to Love's Travel Stop and Country Store. Whitehorse is currently marketing its remaining property for commercial development.

On July 8, 2008, following Gallatin District's petition to the current Gallatin County Judge/Executive to annex the area in dispute, Gallatin County Judge/Executive Kenny

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[38] Minutes of Gallatin District Board of Commissioners' Meeting of 7/12/2007.

[39] *Id.*

[40] Transcript of 11/1/2007 Hearing at 216-217. Gallatin District states that it never authorized Mr. French to use its permit and was unaware that he was using its permit as the basis for his construction activities. *Id.* at 175.

[41] *Id.* at 232.

[42] *Id.* at 217.

[43] *Id.* at 232.

R. French issued an Order enlarging the boundaries of Gallatin District's territory to include the Whitehorse tract.[44] Carroll District has appealed this Order.[45]

A map of the disputed area is set forth at the end of this Order as Figure 1. It depicts Carroll District's boundaries prior to and after October 8, 1998. It further depicts Gallatin District's boundaries as of December 27, 1985 and after July 8, 2008. The map does not depict areas of Gallatin County that Warsaw or Sparta serve.

PROCEDURE

On May 21, 2007, Carroll District filed a formal complaint against Gallatin District in which it alleged that Gallatin District had violated KRS Chapter 74 by extending water service into Carroll District's territory and requested that Gallatin District be prohibited from serving the Whitehorse property. It further moved that Gallatin District be directed to cease construction of a water line to the Whitehorse property pending a Commission decision on Carroll District's complaint.

On July 17, 2007, the Commission held a hearing on Carroll District's motion. After presenting arguments on the motion, the water districts agreed that Gallatin District should not construct any water lines within Carroll District's territory or allow a third party to connect to its existing water line within Carroll District's territory. On August 1, 2007, the Commission entered an Order implementing this agreement and directed that a copy of that Order be served upon Whitehorse. Whitehorse subsequently moved for and was granted leave to intervene in this matter.

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[44] For a description of the area annexed, see note 19

[45] *Carroll County Water District v Kenny R. French*, Civil Action No 08-CI-00194 (Gallatin Circuit Court filed Aug 5, 2008).

On October 10, 2007, while the parties and Commission Staff conducted discovery, Carroll District advised the Commission that Gallatin District was continuing to construct a water line in Carroll District's territory and moved for an Order to Show Cause against Gallatin District.[46] The Commission directed Gallatin District to respond in writing to the motion and ordered the parties to address the issue at the scheduled hearing.

On November 1, 2007, following completion of discovery, the Commission held a hearing in this matter. Presenting testimony were: James L. Smith, Carroll District Manager; Raymond D. Lykins, Carroll District Superintendent; Donna Shannon Marlin, Manager, Drinking Water Branch, Division of Water, Kentucky Department of Environmental Protection; Morris R. Courtney, Gallatin District Superintendent; Victor Satchwell, Jr., Chairman, Gallatin District; Denny French, Deputy Gallatin County Judge/Executive; George Zubaty, former Gallatin County Judge/Executive; Ron Gastineau, Professional Engineer; Adam Chaney, Principal, Whitehorse Development Group, LLC; Richard W. Carr, Professional Engineer; Lee L. Burgett, Gallatin District Commissioner; and David Franklin Easton, Gallatin District Commissioner. All parties subsequently submitted written briefs.

Following the close of the hearing, Whitehorse submitted an emergency motion for modification of the Commission's Order of August 1, 2007, in which the Commission prohibited Gallatin District from providing water service in Carroll District's territory. Following receipt of Gallatin District's and Carroll District's responses to the motion, the Commission denied the motion.

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[46] The Commission interpreted this motion as a motion for the imposition of civil penalties against Gallatin District for failing to comply with the Commission's Order of August 1, 2007. *See* Order of October 22, 2007.

On April 28, 2008, Gallatin District moved to set aside the Order of August 1, 2007. It renewed this motion on August 12, 2008. Whitehorse has filed responses in support of these motions. Carroll District has filed a response opposing any modification to the August 1, 2007 Order.

DISCUSSION

We first address the Commission's authority to consider the issues presented in Carroll District's complaint. Gallatin District and Whitehorse argue that these issues are outside our jurisdiction. In support of this position, they refer to judicial and administrative precedent that the Commission may not establish an exclusive service territory for utilities.

The Commission's powers are purely statutory.[47] We possess only those powers that are conferred expressly or by necessary or fair implication.[48] As water districts are utilities,[49] Carroll District and Gallatin District are subject to our jurisdiction. Our jurisdiction extends to "all utilities in this state" and is exclusive "over the regulation of rates and service of utilities."[50] We further have the statutory duty to enforce the provisions of KRS Chapter 278.[51]

Except in the provision of retail electric service,[52] the Commission lacks the authority to establish an exclusive service territory. Kentucky courts have previously

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[47] *Boone County Water and Sewer Dist. v. Pub. Serv. Comm'n*, 949 S.W.2d 588, 591 (Ky. 1997).

[48] *Croke v. Pub. Ser. Comm'n*, 573 S.W.2d 927 (Ky. App. 1978).

[49] KRS 278.010(3)(d); KRS 278.015.

[50] KRS 278.040(2).

[51] KRS 278.040(1).

[52] KRS 278.016-.018.

held that utilities do not "have any right to be free of competition."[53] The Commission has applied this principle to water and other types of utilities.[54]

While the Commission lacks any authority to establish an exclusive service territory for water utilities, we clearly possess the authority to consider competing utilities' claims to provide service to a prospective customer to prevent wasteful duplication of facilities or excessive investment.[55] KRS 278.020 limits the construction that a utility may undertake without obtaining prior Commission approval in the form of a Certificate. It states:

> 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.[56]

While exempting ordinary extensions from any requirement for Commission approval, the General Assembly did not define "ordinary extensions."

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[53] *See Kentucky Utilities Co. v. Pub. Serv. Comm'n*, 390 S.W.2d 168, 175 (Ky. 1965).

[54] *See, e.g.*, Case No. 1991-00359, Application of Kentucky-American Water Company For a Certificate of Public Convenience and Necessity Authorizing the Construction of Approximately 49,000 Feet of 24" Main, 400 Feet of 12" Main, 240 Feet of 8" Main with Associated Valves and Fittings, Known as the "Jack's Creek Pipeline" (Ky. PSC Apr. 17, 1992) at 4; Case No. 1991-00316, Mountain Utilities, Inc. v. Equitable Gas Co. (Ky. PSC Apr. 6, 1992) at 3.

[55] *See City of Cold Spring v. Campbell County Water Dist.*, 334 S.W.2d 269, 272 (Ky. 1960) (holding that the Commission has a duty to protect against "ruinous competition" and the power to determine the preferential right of service as between competing utilities), *overruled on other grounds by City of Georgetown v. Pub. Serv. Comm'n*, 516 S.W.2d 842 (Ky. 1974) (holding that KRS 278.020 is not applicable to cities and does not require a city to obtain a certificate of public convenience and necessity to serve an area that a public utility serves).

[56] KRS 278.020(1) (emphasis added).

To define "ordinary extensions," the Commission promulgated Administrative Regulation 807 KAR 5:001, Section 9(3), which 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 this definition, an extension is in the ordinary course of business if it (1) does not result in sufficient capital outlay to materially affect the constructing utility's financial condition or require an increase in the constructing utility's rates; (2) does not conflict with the service of a jurisdictional utility operating within the same area; and (3) does not result in wasteful duplication of plant.

The Commission has previously recognized that utilities have general service areas and that another utility's extension into that area cannot be considered an extension in the ordinary course. In *Columbia Natural Gas Company of Kentucky*,[57] Columbia Natural Gas Company ("Columbia") sought to construct a gas main to serve a customer in an industrial park that Delta Natural Gas Company ("Delta") already served. Rejecting Columbia's contention that the extension was in the ordinary course, the Commission stated:

> Columbia's proposed extension will conflict with Delta's existing service in the area as Delta presently serves existing customers within and immediately adjacent to the industrial park. Since the construction will duplicate Delta's

[57] Case No. 1996-00015, The Application of Columbia Natural Gas of Kentucky, Inc. for an Order Issuing a Certificate of Public Convenience and Necessity to the Extent Such a Certificate Is Required to Construct a Pipeline to Service Cooper Tire, Inc. in Mt. Sterling, Kentucky (Ky. PSC July 10, 1996).

> existing facilities and will interfere with Delta's existing obligation to serve the industrial park, the extension is clearly not in the ordinary course.[58]

We have applied this principle in other proceedings.[59]

In the case at bar, Gallatin District's construction of water main from the Kentucky Speedway to Kentucky Highway 1039 in 2002 and its subsequent efforts to extend this main to the Whitehorse tract clearly involve an extension into Carroll District's general service area. The Whitehorse tract falls completely within Carroll District's territorial limits. Carroll District has a duty to provide water service to all inhabitants within its territory.[60] It has a water distribution main within 4,700 feet of the Whitehorse tract and has incurred significant debt to provide service to western Gallatin County. It has approximately $3,000,000 in outstanding long-term debt related to the construction of facilities to serve Gallatin County.[61] Gallatin District's efforts to supplant Carroll District as the water service provider in Carroll District's territory will affect Carroll District's ability to meet those lending obligations and its obligations to provide service in the remaining portions of its territory. Accordingly, the construction of the water main extension in 2002 and any subsequent construction to connect facilities to this extension cannot be considered in the ordinary course.[62]

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[58] *Id.* at 4.

[59] *See, e.g.*, Case No. 2003-00422, Natural Energy Utility Corporation v. Columbia Gas Company of Kentucky, Inc. (Ky. PSC Sept. 1, 2004).

[60] Ky. OAG 75-719

[61] *See* Carroll District's Response to Commission Staff's First Data Request, Item 14

[62] This result accords with our holding in Case No. 2004-00027, City of Hawesville v. East Daviess County Water Association (Ky. PSC. Mar. 25, 2004), in which a municipal utility brought a complaint against a water association over retail water service to a property. Holding that KRS 278.010(3) exempted municipal utilities from Commission regulation, we dismissed for lack of jurisdiction but noted that, notwithstanding that exemption, the Commission possessed jurisdiction over (Continued on Next Page)

Our examination of KRS Chapter 74 strongly suggests that Gallatin District lacks the legal authority to extend service outside its territorial boundaries. KRS 74.100 limits a water district's authority to extend water mains and laterals to those necessary "to supply water to the residents of the district." Kentucky courts have interpreted this statute as prohibiting a water district from acquiring and operating facilities outside of its territorial boundaries.[63] The Kentucky Attorney General has also opined that a water district may not provide service outside its boundaries and must first annex the area in which the new customers are located.[64] The Commission has previously reached the same conclusion.[65]

While the Commission's jurisdiction does not extend to the enforcement of KRS Chapter 74, a water district's lack of authority to construct, install and operate water distribution mains to serve persons outside of its territorial boundaries has significant implications to issues within our purview.

No utility may construct any facility to be used in providing utility service to the public until it has obtained a Certificate from this Commission.[66] To obtain such

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the dispute if the public utility's construction of facilities to serve the property was not in the ordinary course and a Certificate were required. *Id.* at 4 n.7.

[63] *Olson v. Preston St. Water Dist. No. 1*, 163 S.W.2d 307, 309 (Ky. 1942). KRS 74.280 does not abrogate this finding, as argued by Gallatin District: KRS 74.280 permits a water district to have a facility outside of its territory for the purpose of supplying water to the district. It does not authorize operating a water system that supplies water to the public outside of its territory.

[64] Ky. OAG 76-234.

[65] Case No. 1990-00220, Christian County Water District's Proposed Extension to Collins Bridge Road and the Provision of Service to Certain Customers Who Are Currently Served by South Hopkins Water District, at 5 (Ky. PSC Feb. 20, 1991); Case No. 8505, Application of Campbell County Kentucky Water District for Authority to Acquire and Operate the Silver Grove Water Distribution Facilities at Its Existing Rates; To Construct a Connecting Water Supply Main; and to Assume Certain Financial Obligations; and Also to Reinforce the District's Existing High and Low Pressure Service Systems as Needed (Ky. PSC Aug. 4, 1982).

[66] KRS 278.020(1). *See also* text accompanying footnotes 55 – 56.

Certificate, the utility must demonstrate a need for such facilities and an absence of wasteful duplication.[67] "Need" requires:

> a showing of a substantial inadequacy of existing service, involving a consumer market sufficiently large to make it economically feasible for the new system or facility to be constructed and operated.
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> . . . [T]he inadequacy must be due either to a substantial deficiency of service facilities, beyond what could be supplied by normal improvements in the ordinary course of business; or to indifference, poor management or disregard of the rights of consumers, persisting over such a period of time as to establish an inability or unwillingness to render adequate service.[68]

"Wasteful duplication" is defined as "an excess of capacity over need" and "an excessive investment in relation to productivity or efficiency, and an unnecessary multiplicity of physical properties."[69]

To the extent a water district lacks the legal authority to construct facilities outside its boundaries to serve persons outside those boundaries, it cannot demonstrate a need for such facilities or an absence of wasteful investment. Since it has neither authority to serve the area nor any duty to make extensions to serve that area, it cannot demonstrate a substantial inadequacy of existing service based upon the extra-territorial area's needs. Moreover, the construction of facilities to serve extra-

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[67] *Kentucky Utilities Co. v. Pub. Serv. Comm'n*, 252 S.W.2d. 885 (Ky. 1952).

[68] *Id.* at 890.

[69] *Id.*

territorial areas would result in wasteful duplication, as those facilities cannot lawfully be used to serve their intended customers.[70]

Gallatin District's recent actions to annex the area in question do not substantially alter our analysis. Significant questions exist regarding the lawfulness of the Gallatin County Judge/Executive's action.[71] While KRS Chapter 74 sets forth a detailed process for the annexation of territory, it contains no provisions for the annexation of another water district's territory.[72] The Attorney General has previously found that, given the absence of any express provision for the annexation of another district's territory, KRS 74.110 "cannot be construed to apply to the territory of another water district."[73] If the courts concur with the Attorney General's position, Gallatin District's construction of facilities to serve the area in question will result in wasteful duplication.

Assuming *arguendo* that KRS 74.110 permits a water district to annex the territory of another water district, Gallatin District must still apply for a Certificate before constructing any facilities to serve the Whitehorse tract. The Gallatin Judge/Executive's Order does not strike or otherwise remove the area in question from Carroll District's territory. Hence, Gallatin District's construction of any facilities to serve the Whitehorse tract involves an extension into Carroll District's territory, cannot be considered construction in the ordinary course, and still requires a Certificate.

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[70] One possible exception is the provision of wholesale water service to another utility. In that instance, the need exists outside the water district's territory, but the point of delivery for service to the wholesale customer is generally within the water district's boundaries. Another exception is when a water district contracts with another water district or municipality to operate a water system in the other water district's or municipality's territory. *See* KRS 74.414.

[71] Carroll District has appealed Gallatin County Judge/Executive French's order of annexation. *See* notes 44 – 45.

[72] KRS Chapter 74 establishes a detailed process for the voluntary and involuntary merger of water districts. *See* KRS 74.361; KRS 74.363.

[73] Ky. OAG 63-666 (July 24, 1963).

Based upon the discussion above, we find that Carroll District's complaint should be granted and that Gallatin District should be prohibited from constructing any facilities to serve the Whitehorse tract until it has applied for and received a Certificate for such construction.[74] Construction includes any facilities necessary to connect Gallatin District's existing facilities to any facilities that another party has constructed or installed to serve the Whitehorse tract. We further find that the motions of Gallatin District and Whitehorse to set aside our Order of August 1, 2007 should be denied. Finally, the Commission finds insufficient evidence to warrant the imposition of civil penalties as Carroll District requested in its Motion to Show Cause.

The Commission is dismayed at the apparent disregard that both water districts have exhibited towards KRS Chapter 74 and their cavalier approach to the proper maintenance of their territorial boundaries. Gallatin District constructed a major water main extension with full knowledge that a major portion of this extension lay outside its territory. It made no attempt prior to the construction to amend its territorial boundaries to ensure the facilities were properly within its boundaries. Its officials appear completely unaware of the legal significance of the water district's territorial boundaries or chose to ignore them.

Gallatin District's action was not an isolated incident. On at least four other occasions, it constructed water main extensions outside its territory.[75] The record contains no evidence that, prior to July 8, 2008, it took any action to amend its boundaries to include these facilities. The record further indicates that Gallatin District

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[74] We take no position in this proceeding regarding Gallatin District's contentions that Carroll District is unable to provide adequate service to the Whitehorse tract. Such issue involves the need for Gallatin District's proposed facilities and should be deferred until Gallatin District applies for a Certificate.

[75] Gallatin District's Response to Commission Staff's First Data Request, Item 14.

has yet to annex a large portion of the territory in Gallatin County that Carroll District deannexed in 1998.

Carroll District appears to have had knowledge of some of these intrusions,[76] but took no action to protest these intrusions, to limit them through contractual agreements, or to request revisions to its territorial boundaries. While Carroll District protested against Gallatin District's attempt to serve the Whitehorse property, it appears to have been aware of the existence of Gallatin District's water main extension to Kentucky Highway 1039 for some period before January 2007.

The Commission places all water districts on notice that compliance with KRS 74.110 is not optional. A water district and its management should be fully aware of their territorial boundaries and the significance of those boundaries. They should exercise the highest effort to ensure that those boundaries are observed and remain current. In those instances where boundary revisions are required to ensure adequate and reliable water and sewer service, a water district and its management should act promptly to ensure those revisions are made in accordance with the procedures set forth in KRS Chapter 74. A water district may not provide water service to customers outside its boundaries except under the most extraordinary conditions. The construction of facilities outside those boundaries without proper authorization is unlawful and may serve as a basis for civil sanctions against the water district and its management.[77]

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[76] Transcript of 11/1/2007 Hearing at 88-96.

[77] *See* KRS 74.455; KRS 278.990(1).

CONCLUSION

Having considered the evidence of record and being otherwise sufficiently advised, the Commission HEREBY ORDERS that:

1. Gallatin District shall not construct or install any facility[78] to provide water service within Carroll District's territory without first obtaining a Certificate from the Commission.

2. Gallatin District shall not construct any facility or install any equipment to provide water service to the Whitehorse tract, to include any facility or equipment necessary to connect its facilities to those that another party has constructed or installed, without first obtaining a Certificate from the Commission

3. The motions of Gallatin District and Whitehorse to vacate the Commission's Order of August 1, 2007 are denied.

4. Carroll District's Motion to Show Cause is denied.

Done at Frankfort, Kentucky, this 15th day of September, 2008.

By the Commission

ATTEST:

Executive Director

[78] Any facility includes a meter installation or other equipment to connect a service line or applicant-donated water distribution main extension to the existing 10-inch water main extension that Gallatin District constructed in 2002.

Figure 1

1983 Carroll WD Area

1983 Carroll WD Area deannexed in 1998

1983 Carroll WD Area deannexed in 1998 and annexed to Gallatin WD in 2008

1983 Carroll WD Area annexed to Gallatin WD in 2008

1985 Gallatin WD Area

CARROLL COUNTY
WATER DISTRICT #1 Pipelines

- 3" Diameter
- 4" Diameter
- 6" Diameter
- 8" Diameter
- 10" Diameter

Points of Interest

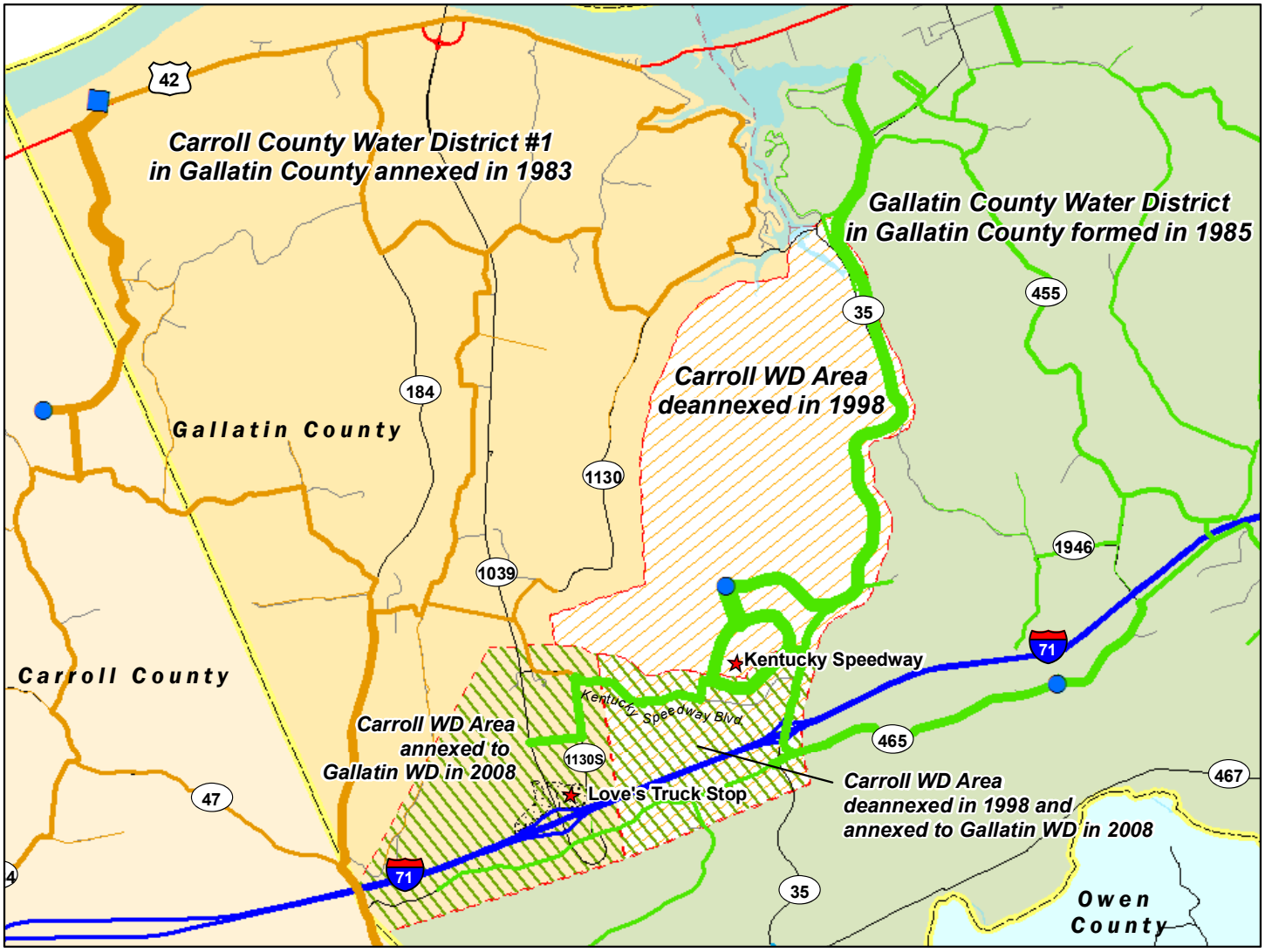
Whitehorse Properties

Water Treatment Plants

Water Tanks

GALLATIN COUNTY
WATER DISTRICT Pipelines

- 3" Diameter
- 4" Diameter
- 6" Diameter
- 8" Diameter
- 10" Diameter
- 12" Diameter



Interstates

State Roads

US Highways

Local Roads

County Boundary Lines

Natural Water Features (Rivers, Lakes)

0 5,000 10,000 15,000 20,000 Feet

Figure 1 of an Order of the Kentucky Public Service Commission for Case No. 2007-00202

Information from the Water Resource Information System, maintained by the Kentucky Infrastructure Authority, and from maps and information in the record in Case No. 2007-00202.