

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF NORTHERN KENTUCKY)	
WATER DISTRICT (A) FOR AUTHORITY TO ISSUE)	
PARITY REVENUE BONDS IN THE APPROXIMATE)	CASE NO. 2000-481
AMOUNT OF \$16,545,000; AND (B) A CERTIFICATE)	
OF CONVENIENCE AND NECESSITY FOR THE)	
CONSTRUCTION OF WATER MAIN FACILITIES)	

O R D E R

Northern Kentucky Water District (“NKWD”) has applied for, inter alia, authorization to issue approximately \$16,720,000 in revenue bonds. By this Order, we authorize the proposed bond issuance.

NKWD is a water district that is organized pursuant to KRS Chapter 74. It owns and operates facilities used to distribute and furnish water to approximately 57,135 retail customers in Boone, Campbell, Kenton, and Pendleton counties, Kentucky.¹ It also provides wholesale water service to Boone District, Pendleton County Water District, and the cities of Florence, Bromley, Taylor Mill, and Walton.

On October 27, 2000, NKWD applied to the Commission for authority to issue \$16,720,000 of revenue bonds and for a Certificate of Public Convenience and Necessity to construct certain improvements and additions to its existing water

¹ Annual Report of Northern Kentucky Water Service District for the Year Ended December 31, 2000 at 29.

treatment and distribution facilities.² By earlier Orders in this proceeding, we have addressed the issues that NKWD's application for Certificates of Public Convenience and Necessity has presented.

NKWD proposes to use the proceeds from the proposed bond issuance in the following manner:³

Redemption of 2000 Bond Anticipation Notes ("BANs")	\$ 7,600,000.00
Construction Fund	7,144,150.00
Bond Issuance Costs	122,025.00
Interest on BANs	138,277.78
Underwriters Discount	325,400.00
Debt Service Reserve	1,389,251.25
Contingency	<u>865.97</u>
Total	<u>\$16,720,000.00</u>

NKWD states that the proceeds of the BANs that will be redeemed were used to provide interim financing for construction projects totaling \$7,565,939.⁴ NKWD intends to use the monies deposited to its Construction Fund to finance the construction of additional facilities.⁵

NKWD has neither sought nor received a Certificate of Public Convenience and Necessity for several of the projects that will ultimately be funded through the proposed

² The Attorney General is the only party to intervene in this matter. He has not stated any objections to the proposed application.

³ NKWD's Application, Exhibit 18 at 2.

⁴ For a list of these projects, see NKWD's Response to Commission Staff's First Set of Interrogatories and Requests for Production of Documents, Item 4(c).

⁵ The total cost of these new facilities is \$7,615,785. See NKWD's Response to Commission Staff's Second Set of Interrogatories and Requests for Production of Documents, Item 3.

bond issuance.⁶ This failure requires us to consider whether a Certificate of Public Convenience and Necessity must be obtained for all construction projects that are financed through the issuance of revenue bonds⁷ or through BANs⁸ that are subsequently refinanced through the issuance of revenue bonds.

KRS 278.020(1) governs the need for a Certificate of Public Convenience and Necessity. It provides:

No person, partnership, public or private corporation, or combination thereof shall . . . 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 such person has obtained from the Public Service Commission a certificate that public convenience and necessity require . . . the construction [emphasis added].

⁶ NKWD originally presented some of these projects to the Commission but did not reveal that their ultimate source would be from the issuance of revenue bonds. See Case No. 98-079, The Application of Northern Kentucky Water Service District For Permission or Certificate to Construct Various Normal Extensions to Its Water System; to Make Replacements; to Install Betterments in the Existing Water Treatment Plants; to Make Studies of Its Water Supply Needs; and to Increase Storage Capacity [Funding Will Be From Cash Flows and Notes Authorized By Statute] (Ky.PSC, June 9, 1998).

⁷ Revenue bonds are generally issued for periods that exceed 10 years in length. Generally, these debt instruments are payable over a period that coincides with the service life of the facilities that their issuance finances. Because of the length of the period for which they are payable, utilities must obtain prior Commission authorization before issuing such instruments. See KRS 278.300(1).

⁸ BANs are short-term notes that are generally issued for a period not to exceed 2 years. They are generally intended to provide interim financing for utility projects until the utility can consolidate a sufficient amount of debt to issue long-term revenue bonds in a cost-effective manner. BANs also provide a utility with flexibility in the timing of its bond issuances. They allow a utility to delay the issuance of revenue bonds to take advantage of anticipated changes in bond market conditions. Because they generally do not exceed a period of 2 years, BANs generally do not require Commission authorization. See KRS 278.300(8).

Unless a utility intends to construct a facility that is an “ordinary extension” in the “usual course of business,” it must obtain a Certificate of Public Convenience and Necessity for its proposed facility.

Because KRS 278.020(1) failed to define “ordinary extension” in the “usual course of business,” the Commission promulgated Administrative Regulation 807 KAR 5:001, Section 9(3). This regulation provides:

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 [emphasis added].

When viewed together, KRS 278.020(1) and Administrative Regulation 807 KAR 5:001, Section 9(3) clearly identify those facilities for which a Certificate of Public Convenience and Necessity is not required. No Certificate of Public Convenience and Necessity is necessary for facilities that do not result in the wasteful duplication of utility plant, do not compete with the facilities of existing public utilities, and do not involve a sufficient capital outlay to materially affect the existing financial condition of the utility involved or to require an increase in utility rates.

The method used to finance the cost of proposed facilities does not determine whether those facilities require a Certificate of Public Convenience and Necessity. Neither KRS 278.020(1) nor Administrative Regulation 807 KAR 5:001, Section 9(3), mentions financing. We fail to discern how the mere use of revenue bonds or BANs

automatically affects whether a project is to be considered outside the usual course of business.⁹ We have recognized this principle in earlier proceedings.¹⁰

Neither NKWD nor any other utility should misconstrue today's holding. While a utility is not required per se to obtain a Certificate of Public Convenience and Necessity for the construction of facilities whose costs are eventually financed with long-term debt instruments, those projects are subject to Commission review.¹¹ When a utility ultimately seeks Commission authorization to issue its long-term debt instruments, we must investigate the purposes and uses of the proposed issuance and determine whether the proposed issuance is necessary for the utility's proper performance of its service to the public. See KRS 278.300(3). Should we determine that the proposed usage is improper, inappropriate, unnecessary or unreasonable, we will act accordingly to protect the utility's ratepayers, including the disallowance of the portion of the bond issuance related to the unreasonable or unnecessary expenditure.

This approach properly places the burden of obtaining the necessary Commission approvals and the risk of potential adverse regulatory action upon the

⁹ For example, if a utility with a net utility plant in excess of \$200 million constructs a \$100,000 project, the capital outlay is not material even if financed through debt instruments. If, on the contrary, the same utility constructed a \$30 million project with internally generated funds, the size of the capital outlay would still be material even if no debt was issued.

¹⁰ Case No. 9846, Application of Kenton County Water District No. 1 (A) to Issue Revenue Bonds in the Approximate Amount of \$21,930,000; (B) to Construct Additional Plant Facilities of Approximately \$19,214,000; and (C) Notice of Adjustment of Rates Effective May 1, 1987 (Ky.PSC Oct. 7, 1989) at 2.

¹¹ Regardless of the source of funding, if the proposed construction will require the utility to seek a rate adjustment, will involve capital outlay sufficient to materially affect the utility's financial condition, or will duplicate existing utility facilities or compete with the existing facilities of the public utilities, the utility must still obtain a Certificate.

utility. In those instances where the Commission has issued a Certificate of Public Convenience and Necessity for the construction of a facility, the Commission has determined that the facility's construction is reasonable. The utility can construct the facility with reasonable certainty that the costs associated with the facility will be recovered through its rates. For those facilities for which no certificate is obtained, a determination on the reasonableness of a utility's decision to construct those facilities is not made until the utility's next application for rate adjustment or for authorization to issue long-term debt instruments to finance the facility's construction. Such application may not be made until the facilities in question are constructed. In those instances, the utility has no assurance at the time of construction that the Commission will permit recovery of the facility's costs through the utility's rates.¹²

Our review of the record of this proceeding also indicates considerable confusion on NKWD's part regarding the type of facilities that require a Certificate of Public Convenience and Necessity and the documents required to support an application for a Certificate. To avoid such confusion in future cases, the Commission suggests that NKWD seek at periodic intervals Commission review and approval of its long-term construction plans in a manner similar to that provided in Case No. 9846.¹³ We further recommend that, to avoid confusion and delay when submitting future applications for a Certificate of Public Convenience and Necessity, NKWD carefully review the discussion

¹² If a utility desires greater assurance of its recovery of a facility's costs through rates, it retains the option of funding the facility's construction through long-term debt instruments immediately rather than through the issuance of BANs.

¹³ Case No. 9846, Application of Kenton County Water District No. 1 (A) to Issue Revenue Bonds in the Approximate Amount of \$21,930,000; (B) to Construct Additional Plant Facilities of Approximately \$19,214,000; and (C) Notice of Adjustment of Rates Effective May 1, 1987 (Ky.PSC Oct. 7, 1989).

in the final Order of that proceeding that relates to applications for Certificates of Public Convenience and Necessity.¹⁴

Our review of the record further indicates that NKWD has apparently constructed a facility, an addition to its Fort Thomas Water Treatment Plant that cost an estimated \$1.9 million, that requires a Certificate of Public Convenience and Necessity without obtaining such a certificate. In a prior proceeding, the Commission declared that this project should be considered as an extension in the ordinary course of business and did not require a Certificate.¹⁵ NKWD subsequently revised the scope and nature of the project. In its revised form, this project involved a significant capital outlay to materially affect NKWD's financial condition.¹⁶ NKWD, however, made no attempt to inform the Commission of these revisions or to seek a Certificate for the revised project. The Commission admonishes NKWD and its management for failing to comply with KRS 278.020(1) and advises them that our response to future occurrences will not be so lenient.

Having considered the evidence of record and being otherwise sufficiently advised, the Commission finds that NKWD's proposed bond issuance is for the lawful objects within NKWD District's purposes, is necessary and appropriate for and consistent with the proper performance by NKWD of its service to the public, and will not impair its ability to perform that service.

¹⁴ Id. at 3 – 5.

¹⁵ Case No. 98-079, Order of June 9, 1999 at 6. NKWD labeled the facility as Project VV and advised the Commission that its total estimated cost was \$200,000.

¹⁶ NKWD's Response to Commission Staff's First Set of Interrogatories and Requests for Production of Documents, Item 7.

IT IS THEREFORE ORDERED that:

1. NKWD is authorized to issue approximately \$16,720,000 in parity revenue bonds.

2. The proceeds of the issuance authorized herein shall be used only for the purposes set forth in NKWD's application.

Nothing contained herein shall be deemed a warranty or finding of value of securities or financing authorized herein on the part of the Commonwealth of Kentucky or any agency thereof.

Done at Frankfort, Kentucky, this 30th day of August, 2001.

By the Commission

ATTEST:


Executive Director