

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF HARDIN COUNTY WATER )	
DISTRICT NO. 1 FOR A DECLARATORY )	
ORDER THAT PROPOSED WATERWORKS )	
IMPROVEMENTS TO MAINTAIN ADEQUATE )	
AND RELIABLE WATER SERVICE TO THE )	CASE NO.
FORT KNOX MILITARY INSTALLATION DO )	2019-00067
NOT REQUIRE A CERTIFICATE OF PUBLIC )	
CONVENIENCE AND NECESSITY )	

ORDER

On February 26, 2019, Hardin County Water District No. 1 (Hardin District No. 1) submitted an application pursuant to 807 KAR 5:001, Section 19, for a declaratory order that certain proposed capital improvements to the water treatment and distribution facilities at the Fort Knox Military Installation (Fort Knox) do not require a Certificate of Public Convenience and Necessity (CPCN). No party has requested to intervene in this matter. A representative from Fort Knox provided a letter, which Hardin District No. 1 submitted with its application, indicating that Fort Knox agrees that the projects at issue are necessary and, as proposed, would be funded by the United States Government (Government).<sup>1</sup> Hardin District No. 1 responded to one request for information from Commission Staff on May 8, 2019, and supplemented its responses on May 16, 2019.

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<sup>1</sup> Addison, Kevin, *Letter Re: Fort Knox ISDC Projects* (dated Feb. 22, 2019) (attached as an exhibit to the Application at p. 129 of 130).

Hardin District No. 1's application for a declaratory order is now before the Commission for a decision.<sup>2</sup>

### BACKGROUND

Hardin District No. 1 is a water district organized pursuant to KRS Chapter 74 that owns and operates facilities that produce and distribute water to the public in portions of Breckinridge, Hardin, and Meade counties.<sup>3</sup> Hardin District No. 1 provides retail service to over 10,000 customers in Hardin County, Kentucky and provides wholesale water service to Meade County Water District and the cities of Vine Grove and Hardinsburg. Hardin District No. 1 also provides sanitary sewer service to approximately 8,814 retail customers in Hardin County, Kentucky.<sup>4</sup> Hardin District No. 1 also provides water service to Fort Knox pursuant to special contract it entered with the Defense Logistics Agency (DLA) on September 30, 2011 (hereinafter the Contract) and provides sewer service to Fort Knox pursuant to a separate contract.<sup>5</sup>

Under terms of the September 30, 2011 contract with DLA, Hardin District No. 1 agreed to provide "potable water utility services" to the Fort Knox Military Installation, and the Government transferred "all rights, title and interest" in its potable water utility system at Fort Knox to Hardin District No. 1 in consideration for the payment of \$8,903,000.00, payable over a ten-year period at an annual interest rate of three percent per annum. In

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<sup>2</sup> See 807 KAR 5:001, Section 19 (7) (indicating that the Commission may dispose of an application for a declaratory order based solely on the basis of the written application and any response thereto); 807 KAR 5:001, Section 19 (1) (indicating that the Commission "may" issue a declaratory order upon application).

<sup>3</sup> Application at p. 2.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.* at 3-5.

lieu of making monthly payments for the purchase price, the Contract required Hardin District No. 1 to credit the Government's monthly bill in the amount of \$85,968.00 for ten years following the purchase. However, the Contract simultaneously created a monthly Purchase Price Recovery Surcharge in the amount of \$85,968.00 for ten years to compensate Hardin District No. 1 for the purchase cost of the water system, which would be offset by the credit discussed above.

The Contract provides for a monthly utility service charge to cover Hardin District No. 1's operation and maintenance expenses and the cost of renewals and replacements for the water system at Fort Knox.<sup>6</sup> It requires Hardin District No. 1 to maintain separate accounting for amounts used to provide service to Fort Knox. It requires Hardin District No. 1 to routinely compare the accumulation of the "costs invested in owning and operating the Fort Knox potable water utility, plus G&A costs" against revenues received from the Fort Knox monthly utility service charge.<sup>7</sup> The Contract then provides:

If HCWD1 collects excess funds on its rate charges, the excess funds will remain within the separate account for future use on the Fort Knox potable water utility system only. When total revenue requirements are higher than current rates, HCWD1 will request a rate adjustment.<sup>8</sup>

The Contract indicates that rate adjustments shall be subject to the jurisdiction of the Commission in accordance with FAR 52.241-7: *Changes in Rates or Terms and Conditions of Service for Regulated Services*.<sup>9</sup>

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<sup>6</sup> Contract at B.2.2.1.

<sup>7</sup> Contract at Preamble.

<sup>8</sup> *Id.*

<sup>9</sup> Contract at G.4; I.5.3.

The Contract identified Initial System Deficiency Corrections (ISDC), which were defined as projects “necessary to reach the standards typically maintained by the [Hardin District No. 1] on its utility systems so that subsequent renewals and replacements will permit the longterm safe and reliable operation of the utility system.”<sup>10</sup> The Contract specifically enumerated the ISDCs to be completed and required Hardin District No. 1 to complete them within five years of executing the Contract.<sup>11</sup> The Contract provided for an Initial System Deficiency Corrections Surcharge (ISDC Surcharge) in the amount of \$473,831.00 to be charged each month for 60 months following the execution of the Contract,<sup>12</sup> although that charge was lowered to \$399,792.35 after 20 months.<sup>13</sup> Hardin District No. 1 has collected \$25,464,714.00 through the ISDC Surcharge and has \$17,787,821.00 remaining from the ISDC Surcharge.<sup>14</sup> The Contract indicated that the purpose of the ISDC Surcharge was to fund the ISDCs and the amount of the surcharge was based on the estimated costs of the ISDCs.

After Hardin District No. 1 entered into the Contract, Department of Defense (DoD) officials expressed concerns regarding water pressure, water taste, and general water quality.<sup>15</sup> In response to those concerns, Hardin District No. 1 retained Stantec

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<sup>10</sup> Contract at C11.2 (defining ISDCs); *see also* Contract at B.5 (identifying specific ISDCs to be completed and their estimated cost).

<sup>11</sup> Contract at B.5 (identifying specific ISDCs to be completed and their estimated cost); Contract at C11.2 (stating that the ISDCs need to be completed with 5 years of the contract start date).

<sup>12</sup> Contract at B.3 (providing the amount, period, and term of the ISDC Surcharge).

<sup>13</sup> Contract Amendment/Modification No. 00033 (dated February 1, 2017) (produced as part of Hardin District No. 1’s response to Commission Staff’s First Request for Information, Item 1).

<sup>14</sup> Hardin District No. 1’s response to Commission Staff’s First Request for Information (Staff’s First Request), Item 6.

<sup>15</sup> Application at p. 5.

Consulting Services, Inc. (Stantec), to perform hydraulic and water quality modeling and to develop a capital improvements plan designed to address the concerns of the DoD officials.<sup>16</sup> Hardin District No. 1 provided the results of that study and a capital improvements plan to the Government in 2015, and the Government requested that Hardin District No. 1 submit a proposal for modifications to the initial plan.<sup>17</sup> On September 4, 2015, Hardin District No. 1 submitted a Technical Proposal Submittal, which reported the results of its studies and proposed capital improvement projects to be substituted for ISDCs that had not yet been commenced.<sup>18</sup> Following additional negotiations with the Government, Hardin District No. 1 submitted a final version of the proposal on June 1, 2016, which was accepted by the Government and executed as an amendment to the Contract on August 10, 2016 (2016 Amendment).<sup>19</sup>

The 2016 Amendment eliminated a number of ISDC projects as proposed and substituted 17 capital improvement projects.<sup>20</sup> The substitute capital improvement projects and the estimated costs of projects as shown in the amendment are below:

Project No.	Project Names	Estimated Cost
1.	Muldraugh WTP Improvements	\$4,845,000.00
2.	1.5 MG Old Ironsides Tank	\$5,054,000.00
3.	1.5 MG Education Center Tank	\$5,060,000.00
4.	Park Road 14' Main Extension	\$290,000.00
5.	Automatic Flusher Installed in Dietz Area	\$13,000.00
7.	Line Improvements—North Frazier Area	\$30,000.00
8.	Line Improvements—7th Armor Division Cut Off Road	\$143,000.00

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<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> Application at pg. 5–6; *see also* Contract Amendment/Modification No 00029.

<sup>20</sup> Contract Amendment/Modification No. 00029 (dated August 10, 2016).

9.	Decommission Central WTP and Large Diameter Mains	\$322,000.00
10.	Installation of Check Valves New Education Center Tanks	\$70,000.00
11.	Remove Frazier Tank	\$76,000.00
12.	Remove Van Voorhis Tank	\$60,000.00
13.	Remove Prichard Tank	\$76,000.00
14.	Automatic Flusher Installed in Dietz Area	\$13,000.00
15.	Automatic Flusher Installed in Prichard Area	\$13,000.00
16.	Remove HRC Tank	\$76,000.00
17.	Remove Fort Knox High School Tank	\$76,000.00
18.	Remove Old Ironside Tank	\$76,000.00
TOTAL		\$16,293,000.00 <sup>21</sup>

The 2016 Amendment also indicated that \$12,208,104.00 in proceeds from the ISDC Surcharge that had previously been collected by Hardin District No. 1 for the projects designated as ISDCs would be reallocated toward completion of the projects agreed to in the amendment.<sup>22</sup> The amendment stated that the rest of the \$16,293,000.00 cost for the new projects would be drawn from available funds in Hardin District No. 1's Fort Knox Water Fund Reserve.<sup>23</sup> The amendment provides that "[n]o additional funding is required for the modification" and states that the amendment did not affect the amount obligated under the Contract or the total value of the Contract.<sup>24</sup>

However, Hardin District No. 1 acknowledged that the \$16,293,000.00 estimate for the projects shown in the 2016 Amendment is no longer valid. Specifically, Hardin District No. 1 has since obtained bids for construction that were below the estimated costs for the

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<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

two projects with the highest estimated cost in the 2016 Amendment.<sup>25</sup> The 2016 Amendment estimated the construction costs for the two water tanks to be \$8,814,833.00, whereas Hardin District No. 1's engineer has recommended that it accept bids for the construction of both projects in the total amount of \$5,555,000.00, which results in a reduction in the estimated costs of the capital projects in the amount of \$3,309,833.00.

Conversely, Hardin District No. 1 acknowledged a significant increase in the estimated cost of the Muldraugh WTP Improvements project from \$4,845,000 in the 2016 Amendment to a current range of \$8,000,000 to \$13,000,000.<sup>26</sup> Hardin District No. 1 indicated that the cost of the Muldraugh WTP Improvements project increased because Hardin District No. 1 determined that additional work was necessary on the Muldraugh WTP.<sup>27</sup> Hardin District No. 1 explained that a detailed evaluation of the Muldraugh WTP was unavailable at the time of the 2016 Amendment.<sup>28</sup> Hardin District No. 1 identified a "few" of the new improvements to the Muldraugh WTP that it determined were "either necessary or highly desirable to meet the intent of the project."<sup>29</sup> However, it indicated that a final determination as to which improvements will be made as part of the Muldraugh WTP Improvements project will be determined at a later date based on the availability of

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<sup>25</sup> See Hardin District No. 1's Supplemental Response to Staff's First Request, Item 8 (showing that Hardin District No. 1 obtained four bids from construction contractors ranging from \$5,555,000.00 to \$7,295,000.00 for construction of the two water tanks); Firm Fixed Price Proposal Submittal (dated June 1, 2016) at Table 3, *attached as exhibit to Application* (indicating that the estimated construction costs for the two water tanks were \$8,814,833.00).

<sup>26</sup> See Hardin District No. 1's Supplemental Response to Staff's First Request, Item 8.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

funds.<sup>30</sup>

## DISCUSSION

KRS 278.020(1)(a) generally requires a utility to obtain a CPCN before beginning the construction of any plant, equipment, property, or facility. However, a CPCN is not required for “ordinary extensions of existing systems in the usual course of business.”<sup>31</sup> An “ordinary extension . . . in the usual course of business” is not defined in KRS 278.020 or elsewhere in KRS Chapter 278. For that reason, the Commission promulgated 807 KAR 5:001, Section 15(3),<sup>32</sup> which states:

Extensions in the ordinary course of business. A certificate of public convenience and necessity shall not 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* 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.<sup>33</sup>

The Commission has interpreted 807 KAR 5:001, Section 15(3), as stating that no CPCN is required for extensions “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

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<sup>30</sup> *Id.*

<sup>31</sup> KRS 278.020(1)(a)1

<sup>32</sup> Case No. 2000-00481, *Application of Northern Kentucky Water District (A) For Authority to Issue Parity Revenue Bonds in the Approximate Amount of \$16,545,000; and (B) A Certificate of Convenience and Necessity for the Construction of Water Main Facilities* (Ky. PSC Aug. 30, 2001), Order at 4.

<sup>33</sup> 807 KAR 5:001, Section 15(3) (emphasis added).



involved or to require an increase in utility rates.”<sup>34</sup> Applying those criteria, the Commission has previously found that proposed extensions necessary to serve a large, sophisticated customer and wholly funded by that customer pursuant to an agreement with that customer do not require a CPCN, in part, because they will not affect the financial condition of the utility and will not result in an increase in charges to other customers.

For instance, in Case No. 2018-00164,<sup>35</sup> the Commission held that a CPCN was not required for upgrades proposed by the Natural Energy Utility Corporation (NEUC) to a natural gas pipeline necessary to serve a large industrial customer, stating:

Pursuant to the Agreement, the new industrial customer will pay 100 percent of the proposed construction project costs. The Uniform System of Accounts requires customer contributions to be recorded as a credit to the cost of construction of the gas plant, so the plant construction funded by those contributions will not be recovered from NEUC's other customers. Therefore, the proposed project will not materially affect the utility's existing financial condition and will not require an adjustment of its rates.

Similarly, in Case No. 2014-00292, the Commission found that East Kentucky Power Company's (EKPC) construction of a landfill gas to energy facility did not require a CPCN, in part, because it was being constructed pursuant to a special contract in which a wholesale customer agreed to cover all construction and operational costs such that the construction would not materially affect EKPC's financial condition and would not result in an increase in rates to other customers.<sup>36</sup>

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<sup>34</sup> Case No. 2000-00481, Order at 4.

<sup>35</sup> Case No. 2018-00164, *The Filing of a Special Contract by Natural Energy Utility Corporation*, (Ky. PSC Sept. 6, 2018), Order at 3.

<sup>36</sup> Case No. 2014-00292, *Application of East Kentucky Power Cooperative, Inc. for an Order Declaring the Glasgow Landfill Gas to Energy Project to Be an Ordinary Extension of Existing Systems In*

The circumstances of this matter are similar to those in the NEUC and EKPC matters discussed above. The proposed projects will be used to provide service to the Government pursuant to its special contract with Hardin District No. 1; the Government agreed to fund the construction costs for the projects as proposed; the Contract requires Hardin District No. 1 to maintain separate books to separately account for the costs of service to the Government; and the Government agreed to pay all operational expenses necessary to provide service. Thus, as in the cases discussed above, those facts support a finding that the proposed projects will not materially affect the existing financial condition of the utility involved or result in increased charges to other customers.

There could be a situation where the size of a project in relation to the size of a utility might materially affect the existing financial condition of the utility or potentially result in increased charges to customers, as those terms are used in 807 KAR 5:001, Section 15(3), despite an agreement by a customer to cover all costs. However, there is a limited risk of nonpayment when the counterparty to a contract is the Government. Moreover, this is a very unique situation because the Government has already paid the funds necessary to complete the projects as proposed in the 2016 Amendment, and pursuant to the Contract, those funds have been specifically allocated to the projects at issue. The funds will either be spent on the projects or will not be spent at all under the current terms of the Contract. Thus, as proposed, the projects at issue would not materially affect Hardin District No. 1's existing financial condition or result in an increase in rates.

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*the Usual Course of Business and a Joint Application of Farmers Rural Electric Cooperative Corporation and East Kentucky Power (Ky. PSC Apr. 2, 2015).*

However, as noted above, the scope and estimated cost of the Muldraugh WTP Improvements project are in flux. Hardin District No. 1 indicated that it found that additional work would be necessary to complete that project, but it could not state the full nature of the necessary work. Likewise, Hardin District No. 1 estimated that the cost of the project would increase from \$4,845,000 to between \$8,000,000 and \$13,000,000. Most importantly, Hardin District No. 1 does not currently have an agreement with the Government for the increased scope or cost of the project, so the financing for the project, which was the primary basis for the reasoning in the previous paragraph, is currently unknown. Thus, the Commission is not able to find that the Muldraugh WTP Improvements project would not materially affect the existing financial condition of the Hardin District No. 1 or result in increased charges to other customers.

The Commission does find that the other proposed projects will not materially affect the existing financial condition of the Hardin District No. 1 or result in increased charges to its other customers. Most of the other projects are small in scope and the estimated costs of the two largest projects actually decreased by about a third (a total decrease of \$3,309,833 for both projects). For that reason, the total cost of those projects is well within the unused proceeds of the ISDC Surcharge that have been allocated pursuant to the Contract, as amended, for use to complete those projects such that the cost of the projects will not materially affect Hardin District No. 1's financial condition or result in an increase in rates. Thus, the Commission finds that Project Nos. 2, 3, 4, 5, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, and 18<sup>37</sup> identified in the table above will not materially

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<sup>37</sup> The Commission observes that there is no Project No. 6, because it was deleted from the proposal during the negotiations between HCWD1 and Government, but the other projects were not renumbered.

affect the existing financial condition of the utility or result in increased charges to its customers as those terms are used in 807 KAR 5:001, Section 15(3).

The Commission notes that it reached a different conclusion in the case in which it approved the Contract between Hardin District No. 1 and the Government. In that case, the Commission held that certain ISDCs funded through the ISDC Surcharge did require a CPCN, stating, in part:

We do not agree with Hardin District's contention that because the improvements will be funded through the tariffed rate, the cost of the facilities should be considered immaterial.<sup>38</sup>

However, the order in that case provided no further explanation as to why the cost of the projects at issue necessitated a CPCN.<sup>39</sup> Moreover, while the Commission continues to agree that the estimated cost of such facilities is not immaterial, estimated costs are only one factor to be considered in determining whether a particular extension will materially affect the existing financial condition of the utility or result in increased charges to its customers. As discussed above, the relevant facts in this matter support the Commission's finding that the proposed projects, except for the Muldrough WTP, will not have a material effect on Hardin District No. 1's financial condition or its rates. Thus, following the more recent precedent of the cases cited above, customer funding of facilities is a factor to be considered in determining whether a project is exempt for the requirements of a CPCN, and to the extent that the findings in the December 4, 2011 Order in Case No. 2011-00416 imply otherwise, those findings are modified by this Order.

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<sup>38</sup> Case No. 2011-00416, Application of Hardin County Water District No. 1 for Approval of a Contract with United States Army to Provide Water Service to the Fort Knox Military Installation (Ky. PSC Dec. 4, 2012), Order 4, FN 10.

<sup>39</sup> *See id.* at 3–4.

However, the proposed projects will not qualify for the ordinary course of business exception if they result in wasteful duplication or conflict with the certificate or service of another utility. There is no real question that the proposed extensions do not conflict with certificate or service of another utility because the extensions are improvements to Fort Knox's water system for the purpose of providing water service to Fort Knox pursuant to the Contract. Additionally, the evidence indicates that the projects, other than the Muldraugh WTP Improvements project, will not result in wasteful duplication because the projects were initially proposed pursuant to a plan developed by a third party engineer at the request of the Government to correct water pressure and quality issues; the scope of the projects were agreed to by the Government following several months of negotiations; and Hardin District No. 1 indicated that the projects are necessary to correct the service issues raised by the Government, among other things. Thus, the Commission finds that Project Nos. 2, 3, 4, 5, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, and 18 as described in this matter will not result in wasteful duplication or conflict with the existing service or certificates of another utility.

Having reviewed the record and being otherwise sufficiently advised, the Commission finds that a CPCN is not required for Project Nos. 2, 3, 4, 5, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, and 18 identified in the table above. However, the Commission's findings are based on the record of this matter, so any material changes to those projects or the terms and conditions of the Contract regarding those projects not identified herein may affect the Commission's findings that a CPCN is not required for those projects. The Commission makes no finding regarding whether a CPCN is required for the Muldraugh

WTP Improvements project because neither the scope nor the cost of that project is sufficiently defined to make such a determination.

The Commission also notes that KRS 278.160(1) requires, among other things, that “each utility shall file with the commission . . . schedules showing all rates and conditions for service established by it and collected or enforced.” Section 13 of 807 KAR 5:011, requires each utility to “file a copy of each special contract that establishes rates, charges, or conditions of service not contained in its tariffs.” That regulation applies to contract amendments that establish new rates, charges, or conditions of service not contained in a utility’s tariff.

The Contract contains rates and conditions of service subject to the jurisdiction of the Commission. Hardin District No. 1 filed the Contract with the Commission and requested approval for the same, which was previously granted. However, Hardin District No. 1 filed a number of amendments to the Contract in response to Request for Information in this matter that had not been previously filed with the Commission. To comply with KRS 278.160 and 807 KAR 5:011, Section 13, Hardin District No. 1 must file any amendment to the Contract that changes the rate, charges, or conditions of service.

IT IS THEREFORE ORDERED that:

1. Hardin District No. 1’s request for a declaratory order is granted in part and denied in part.
2. Project Nos. 2, 3, 4, 5, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, and 18, as described in this matter, are properly classified as ordinary extensions of existing systems

in the usual course of business, and a CPCN, pursuant to KRS 278.020(1), is not required for their construction.

3. No decision can be made at this time as to whether the Muldraugh WTP Improvements project is an ordinary extension of existing systems in the usual course of business or whether its construction requires a CPCN pursuant to KRS 278.020(1), for the reasons discussed in the findings above.

4. Within 30 days of the date of this Order, Hardin District No. 1 shall file with the Commission any amendment to the Contract that changed any rates, charges, or condition of service.

5. Any documents filed in the future pursuant to ordering paragraph 4 shall reference this case number and shall be retained in the post-case correspondence file.

6. This case is closed and removed from the Commission's docket.

By the Commission

ENTERED  
MAY 30 2019  
KENTUCKY PUBLIC  
SERVICE COMMISSION

ATTEST:



Executive Director



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