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John W. Clay  
Vice Chairman

Caroline Pitt Clark  
Commissioner

May 15, 2008

CERTIFICATE OF SERVICE

RE: Case No. 2008-00137  
McCreary County Water District

I, Stephanie Stumbo, Executive Director of the Public Service Commission, hereby certify that the enclosed attested copy of the Commission's Order in the above case was served upon the addressee by U.S. Mail on May 15, 2008.

---

Executive Director

SS/rs  
Enclosure



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COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF MCCREARY COUNTY )  
WATER DISTRICT FOR A CERTIFICATE OF )  
PUBLIC CONVENIENCE AND NECESSITY TO ) CASE NO. 2008-00137  
CONSTRUCT, FINANCE, AND INCREASE )  
RATES PURSUANT TO KRS 278.023 )

ORDER

On April 15, 2008, McCreary County Water District ("McCreary District") applied for a Certificate of Public Convenience and Necessity to construct a waterworks improvement project, authority to issue revenue bonds, and an adjustment in rates for water and sewer service. The proposed project consists of the installation of approximately 46,000 linear feet of 3-inch, 4-inch and 6-inch water main and appurtenances and a 50,000-gallon water storage tank. McCreary District proposes to fund the project with the proceeds from the issuance of \$325,000 in Waterworks Revenue Bonds<sup>1</sup> to Rural Development ("RD"), a grant of \$446,000 from RD, and a grant of \$500,000 from Kentucky Infrastructure Authority ("KIA").

McCreary District's application was made pursuant to KRS 278.023, which requires the Commission to accept agreements between water utilities and the U.S. Department of Agriculture or the U.S. Department of Housing and Urban Development

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<sup>1</sup> While McCreary District refers to the bonds to be issued as "water revenue bonds," RD has expressly conditioned its purchase of the bonds and the issuance of the proposed grant on McCreary District's bond resolution containing "a combined pledge of water and sewer revenues." Letter from Kenneth Slone, RD State Director, to Raymond Taylor, Chairman, McCreary District (April 2, 2008).

and to issue the necessary orders to implement the terms of such agreements within 30 days of satisfactory completion of the minimum filing requirements. Given that minimum filing requirements were met in this case on April 15, 2008, KRS 278.023 does not grant the Commission any discretionary authority to modify or reject any portion of this agreement.

Pursuant to KRS 278.023(3), which permits the Commission to recommend changes to the agreement between the water utility and the federal agency, we recommend RD reconsider one condition to the proposed financing plan. RD requires that McCreary District adjust its rates for water *and sewer service*. We note that the proposed project does not involve any improvements or additions to McCreary District's existing sewer facilities. In effect, RD is requiring an adjustment of sewer service rates that is unrelated to the proposed construction project.

In at least one instance, the Commission has rejected a proposed rate adjustment that was part of an RD financing agreement which involved an adjustment of rates that were unrelated to the proposed construction project. In Case No. 1997-00112,<sup>2</sup> the Commission denied Mountain Water District's request made pursuant to KRS 278.023 to adjust its water service rates despite provisions in the water district's agreement with RD that required such adjustment. The agreement had provided for RD's purchase of \$176,000 of water and sewer revenue bonds to finance the construction of a \$1.9 million sewer project. In denying the request, we stated:

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<sup>2</sup> Case No. 1997-00112, The Application of Mountain Water District of Pike County, Kentucky, for a Certificate of Public Convenience and Necessity to Construct, Finance and Increase Rates Pursuant to KRS 278.023 (Ky. PSC Mar. 11, 1997).

While Mountain has presented a proposed construction project to the Commission, as well as its plan of financing for that construction, the project involves only an expansion of Mountain's sewer system not its water distribution system. Due to the fact that federal financing is involved, the requirements of KRS 278.023 certainly apply to the sewer construction project as well as to Mountain's method of financing it. However, no construction involving Mountain's water distribution system is included in the project which has been presented to the Commission. As the proposed increase in water rates is not related to the proposed construction project, and does not involve any other construction project financed in whole or in part under the terms of an agreement between Mountain and a federal agency, the provisions of KRS 278.023 do not apply.<sup>3</sup>

In a subsequent Order, the Commission advised RD that "[t]he Commission does not expect RD to place such conditions in any further agreements."<sup>4</sup>

In the course of this proceeding, we have carefully re-examined KRS 278.023 and have concluded that KRS 278.023 does not allow the Commission the discretion to reject the portion of the financing agreement between RD and McCreary District that requires an adjustment of the water district's sewer rates. The statute clearly provides that we "may not modify or reject any portion of the agreement on . . . [our] own

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

<sup>4</sup> Case No. 1997-00112, Order of April 1, 1997 at 5. *But see* Case No. 2004-00206, The Application of McCreary County Water District of McCreary County, Kentucky, for a Certificate of Public Convenience and Necessity to Construct, Finance and Increase Rates Pursuant to KRS 278.023 (Ky. PSC June 29, 2004); Case No. 2006-00404, The Application of Powell's Valley Water District for a Certificate of Public Convenience and Necessity to Construct, Finance and Increase Rates Pursuant to KRS 278.023 (Ky. PSC Oct. 5, 2006); Case No. 2007-00048, The Application of Knott County Water District for a Certificate of Public Convenience and Necessity to Construct and Finance Pursuant to KRS 278.023 (Ky. PSC Mar. 6, 2007).

authority.”<sup>5</sup> To the extent that our decision in Case No. 1997-00112 implies a contrary holding, we today overrule that holding.

While the Commission reluctantly accepts the premise of KRS 278.023 that conflicting federal agency and Commission requirements may delay or jeopardize construction projects that are subject to federal agency financing and oversight, we do not accept the view that KRS 278.023 should be used for the wholesale circumvention of Commission review of a water utility’s rates and charges that are unrelated or remotely related to a proposed construction project. We hold the position that the General Assembly, when it enacted KRS 278.023, intended to provide only for the expedited review of RD-funded construction projects, not the total elimination of state regulatory review of water and sewer utility rates.<sup>6</sup>

While we recognize the practical considerations that lead RD to require an adjustment in McCreary District’s sewer service rate in this case and to require similar adjustments of other water districts and water associations in future cases, we respectfully submit that RD should refrain from requiring specific rate adjustments that are unrelated to proposed construction projects in its financing agreements and instead encourage those utilities to apply for rate adjustments under normal statutory procedures.

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<sup>5</sup> KRS 278.023(3).

<sup>6</sup> Likewise, we are of the opinion that the General Assembly, when enacting KRS 278.023, did not intend to strip citizens of any right to participate in the review of the rates that a water district or water association assesses him or her for water and sewer service. KRS 278.023, however, has produced such a result.

IT IS THEREFORE ORDERED that:

1. McCreary District is granted a Certificate of Public Convenience and Necessity for the proposed construction project.

2. McCreary District's proposed plan of financing with RD is accepted.

3. McCreary District is authorized to issue Waterworks Revenue Bonds to RD in the amount of \$325,000 at an interest rate not exceeding 4.125 percent per annum, maturing over 40 years.

4. The proceeds from the proposed bond issuance shall be used only for the purposes specified in McCreary District's application.

5. Notwithstanding Ordering Paragraph 4, if surplus funds remain after the approved construction has been completed, McCreary District may use such surplus to construct additional plant facility if RD approves of the use, and the additional construction will not result in a change in McCreary District's rates for service. McCreary District shall provide written notice of this additional construction in accordance with 807 KAR 5:069, Section 3.

6. McCreary District shall file a copy of the "as-built" drawings and a certified statement that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the substantial completion of the construction certified herein.

7. McCreary District shall monitor the adequacies of the expanded water distribution system after construction. If the level of service is inadequate or declining, or the pressure to any customer is outside the requirements of 807 KAR 5:066,

Section 5(1), McCreary District shall take immediate action to ensure that the level of service conforms to the regulations of the Commission.

8. McCreary District shall notify the Commission one week prior to the actual start of construction and at the 50 percent completion point.

9. The rates set out in Appendix A are the rates approved for service rendered on and after the date of this Order.

10. Within 30 days of the date of this Order, McCreary District shall file with the Commission its revised tariffs setting out the rates approved herein.

11. Three years from the date of this Order, McCreary District shall file an income statement, along with any pro forma adjustments, in sufficient detail to demonstrate that the rates approved herein are sufficient to meet its operating expenses and annual debt service requirements.

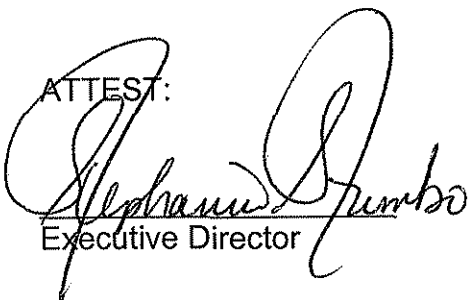
12. The Executive Director shall serve a copy of this Order upon the RD's State Director.

Nothing contained herein shall be deemed a warranty of the Commonwealth of Kentucky, or any agency thereof, of the financing herein accepted.

Done at Frankfort, Kentucky, this 15<sup>th</sup> day of May, 2008.

By the Commission

ATTEST:

  
Executive Director



APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2008-00137 DATED MAY 15, 2008

The following rates and charges are prescribed for the customers in the area served by McCreary County Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

Monthly Water Rates

Residential and Non-Residential Rates:

|          |               |                        |
|----------|---------------|------------------------|
| First    | 2,000 Gallons | \$15.55 Minimum Bill   |
| All over | 2,000 Gallons | 5.75 Per 1,000 Gallons |

Federal Correction Facility Rates:

|          |                   |                          |
|----------|-------------------|--------------------------|
| First    | 1,950,000 Gallons | \$11,212.00 Minimum Bill |
| All over | 1,950,000 Gallons | 5.75 Per 1,000 Gallons   |

Riverwoods Rates:

|          |                 |                         |
|----------|-----------------|-------------------------|
| First    | 450,000 Gallons | \$1,860.00 Minimum Bill |
| All over | 450,000 Gallons | 5.75 Per 1,000 Gallons  |

Cumberland Falls State Park Rates:

|          |                 |                         |
|----------|-----------------|-------------------------|
| First    | 600,000 Gallons | \$2,600.00 Minimum Bill |
| All over | 600,000 Gallons | 3.48 Per 1,000 Gallons  |

Whitley County Water District Rate: \$3.48 Per 1,000 Gallons

Oneida, Tennessee Rate: \$3.48 Per 1,000 Gallons

Monthly Sewer Rates

Residential and Non-Residential Rates:

|          |                |                        |
|----------|----------------|------------------------|
| First    | 2,000 Gallons  | \$12.25 Minimum Bill   |
| Next     | 8,000 Gallons  | 5.64 Per 1,000 Gallons |
| Next     | 10,000 Gallons | 4.85 Per 1,000 Gallons |
| All over | 20,000 Gallons | 4.25 Per 1,000 Gallons |

Federal Correctional Facility Rates:

|          |                   |                         |
|----------|-------------------|-------------------------|
| First    | 1,300,000 Gallons | \$5,520.00 Minimum Bill |
| All over | 1,300,000 Gallons | 5.75 Per 1,000 Gallons  |