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September 20, 2006

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Northern Kentucky Water District
2835 Crescent Springs Road
P. O. Box 18640
Erlanger, KY 41018-0640

CERTIFICATE OF SERVICE

RE: Case No. 2006-00315
Northern Kentucky Water District

I, Beth O'Donnell, 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 September 20, 2006.

Executive Director

BOD/jc
Enclosure



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Honorable David Edward Spenard
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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF NORTHERN KENTUCKY)
WATER DISTRICT FOR A CERTIFICATE OF)
CONVENIENCE AND NECESSITY FOR THE) CASE NO. 2006-00315
CONSTRUCTION OF SUBDISTRICT F)
WATER MAIN EXTENSIONS, FINANCING)
AND SURCHARGE)

ORDER

Northern Kentucky Water District ("NKWD") has applied for a Certificate of Public Convenience and Necessity to construct certain water main extensions and for authority to assess a surcharge to customers within its proposed Subdistrict F. Having reviewed the application and being otherwise sufficiently advised, the Commission finds that:

1. NKWD, a water district organized under KRS Chapter 74, provides retail and wholesale water service to Boone, Campbell, Kenton, and Pendleton counties, Kentucky.
2. NKWD proposes to create for administrative, financing, and ratemaking purposes a subdistrict known as "Subdistrict F."
3. Under NKWD's proposal, Subdistrict F will consist of the following areas in Campbell County, Kentucky:
 - a. Grandview Road
 - b. Amy Lou Drive
 - c. Heck Road
 - d. Steffen Road

- e. Licking Pike (Existing 8 to Ripple Creek)
 - f. Licking Pike (from Trapp Pike to Rifle Range Road)
 - g. Licking Pike (from Rifle Range Road to Subdistrict D)
 - h. Flagg Springs Pike (from Kennedy Drive to Ivor Road).
4. Areas of the proposed Subdistrict F are not contiguous, but widely dispersed. Portions of Subdistrict F territory are as much as 9 miles apart.
5. NKWD proposes to construct approximately 25,300 linear feet of 8-inch and 13,100 linear feet of 12-inch water transmission mains and related appurtenances within Subdistrict F to serve 136 additional customers. Approximately 44 of these customers have contracted for water service.
6. The proposed project is divided into 3 packages. The geographical location of each project is show on Figure I. The characteristics of each package are set forth in Table I below:¹

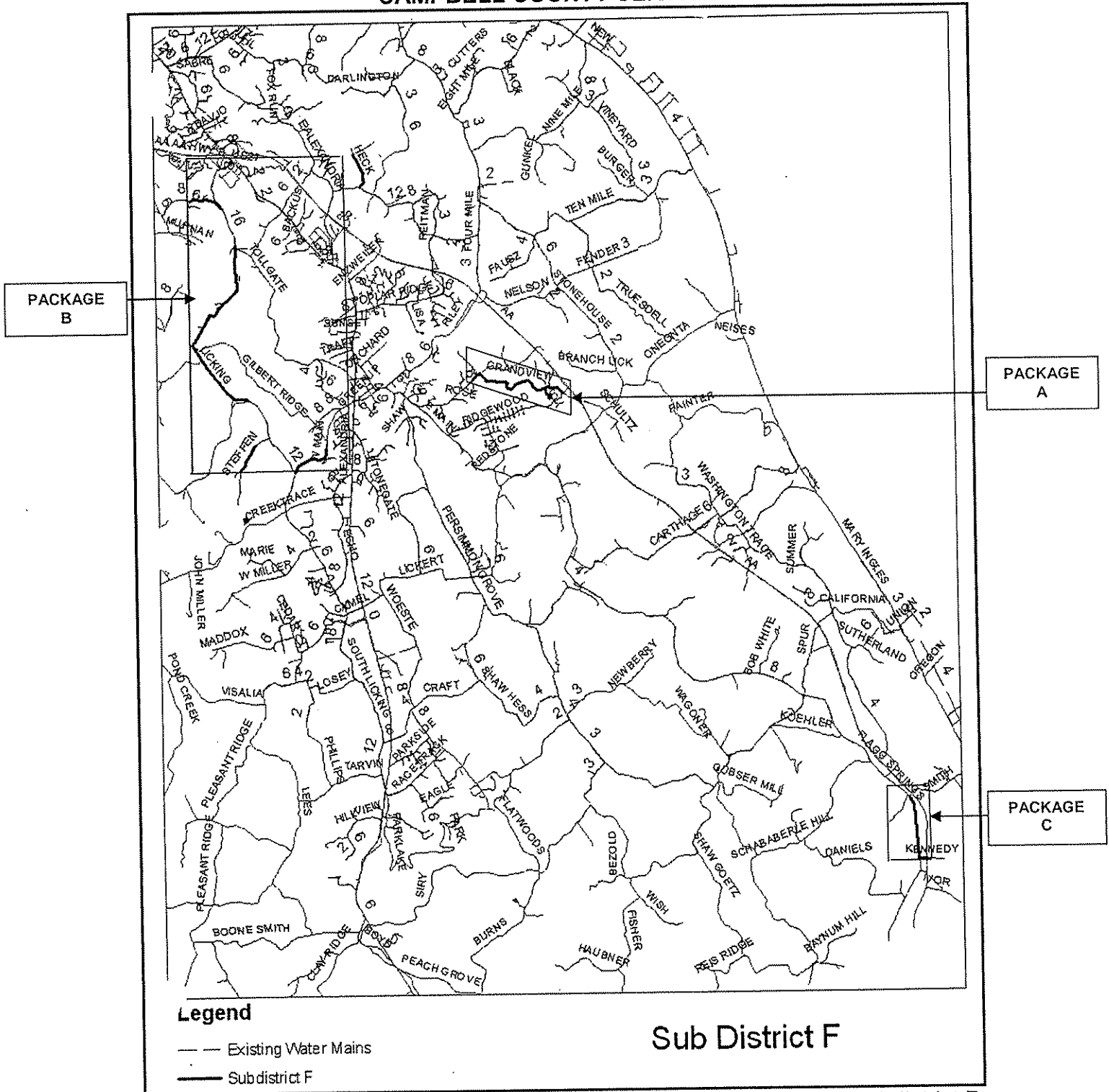
TABLE I					
Package	Cost	Total Available Customers	Customers Contracting for Service	Main Extension	Cost Per Foot
A	\$ 737,690	55	26	11,300	\$65.28
B	\$1,188,972	66	18	20,900	56.89
C	\$ 447,709	15	0	5,300	84.47

¹ See NKWD's Application at Exhibit A. Table I assumes that Engineering, Geotechnical, Geotechnical Inspection, Administrative and Legal Fees, and Contingencies are equally allocated to each package. If these costs were excluded, Table I would appear as follows:

Package	Cost	Total Available Customers	Customers Contracting for Service	Main Extension	Cost Per Foot
A	\$485,286	55	26	11,300	\$42.95
B	\$936,568	66	18	20,900	44.81
C	\$195,305	15	0	5,300	36.85

Table I does not assume that Flagg Springs Market has executed a contract for water service.

**FIGURE I
NORTHERN KENTUCKY WATER DISTRICT
CAMPBELL COUNTY SERVICE**



Source: NKWD's Application, Exhibit C. The boxed areas represent Subdistrict F territory.

7. The total construction cost is approximately \$2,539,803.
8. Persons residing within the proposed Subdistrict F currently receive water service through cisterns and wells.²
9. No public or municipal utility currently provides water service to the proposed Subdistrict F.
10. The proposed project will not compete with any other water utility in the area.
11. Quest Engineering, Inc. of Lexington, Kentucky prepared the plans and specifications for the proposed construction.
12. The Division of Water, Department of Environmental Protection of the Kentucky Environmental and Public Protection Cabinet has approved the plans and specifications for the proposed construction.
13. Construction of the proposed project will not result in the wasteful duplication of existing facilities nor result in uneconomic or wasteful competition between public utilities.
14. NKWD proposes to fund the total construction cost from the following sources:
 - a. Appropriated funds of \$1,288,000 from the Kentucky State Treasury;³
 - b. A grant of \$25,000 from the Campbell County Fiscal Court;

² See Water Resource Information System, Kentucky Water Project Profile No. WX21037552, <http://wris.ky.gov/KIAProjs/> (last visited Sep. 19, 2006).

³ The Kentucky General Assembly appropriated this amount toward the projects in its 2005 General Session. See 2005 Kentucky Acts chap. 173, Part IA9b(21); Legislative Research Commission, Fiscal Biennium 2004-2006 Commonwealth Budget – Final Budget Memorandum at 211 (Apr. 27, 2005).

- c. A contribution of \$55,000 from Flagg Springs Market;⁴
- d. Proceeds of existing and future debt instruments of \$1,171,803.

15. NKWD has budgeted \$250,000 in its current capital budget (Fiscal Year 2006) and \$500,000 in its Fiscal Year 2007 capital budget towards the proposed project. It proposes to obtain the remaining funds through the issuance of bond anticipation notes.

16. NKWD has allocated the funds that it will use for the proposed project to various debt instruments in the following manner: ⁵

- a. \$250,000 from the proceeds of a general revenue bond issuance to occur in 2006;⁶
- b. \$500,000 from Series 2003 B Bonds Payable;⁷
- c. \$421,803 from a future issuance of bond anticipation notes.

17. Of the \$1,171,803 which NKWD is funding through debt instrument proceeds, NKWD has designated \$175,515 as a “hydraulic improvement contribution” that should be funded through general rates. This amount represents the difference in cost between using 12-inch water mains and 8-inch water mains on certain portions of

⁴ NKWD Application at Exhibit F.

⁵ See Letter from John Scheben, Design Supervisor, Northern Kentucky Water District, to John N. Hughes, NKWD legal counsel (Aug. 25, 2006). In Northern Kentucky Water District, Case No. 2005-00148 (Ky.PSC. Apr. 28, 2006), at 17-18, the Commission approved rates for general service that included recovery of the debt service for the debt instruments listed in Findings Paragraphs 16a and 16b.

⁶ Id. On April 28, 2006, the Commission authorized NKWD to issue \$29,000,000 in parity revenue bonds. See Northern Kentucky Water District, Case No. 2005-00148 (Ky.PSC Apr. 28, 2006) at 26. As the financial exhibit which NKWD filed with its application makes no reference to any bond issuance in 2006, the Commission assumes that, as of July 20, 2006, NKWD had yet to issue these bonds.

⁷ See Northern Kentucky Water District, Case No. 2002-00105 (Ky.PSC Apr. 30, 2003) (authorizing parity bond issuance of \$30,270,000) at 28.

the proposed construction. NKWD states that the benefits of the use of the larger size mains accrue to all water customers, not merely those customers within Subdistrict F.

18. Of the \$1,171,803 which NKWD is funding through debt instrument proceeds, NKWD has designated \$750,000 as an "extension contribution." This amount represents the share of project costs that all NKWD customers will be funding through general service rates.

19. NKWD proposes that the remaining portion of the cost of the proposed construction be apportioned to customers within Subdistrict F through a monthly surcharge not to exceed \$30. It estimates that such a surcharge will recover approximately \$246,288 of the extension's cost, exclusive of any interest on debt instruments issued to finance the proposed construction.⁸

20. In its application NKWD does not state an interest rate upon which the proposed surcharge is based or state a period of time during which the surcharge will be assessed.

21. The proposed Subdistrict F will not be served by common utility plant.

22. The proposed Subdistrict F does not share any common geographic characteristics.

⁸ NKWD allocated \$246,288 of the total cost to Subdistrict F customers using the following methodology: It calculated the present value of a monthly surcharge payment of \$30 made over a 25-year period as \$5,131. It assumed that Subdistrict F would have an average of 48 customers over a customer paying assume 48 customers served through Subdistrict F facilities over a 25-year period and paying a monthly surcharge of \$30. Telephone conversation between John N. Hughes, NKWD legal counsel, and Gerald Wuetcher, Deputy General Counsel, Public Service Commission (Sep. 12, 2006).

23. NKWD has not demonstrated that any of the appropriated funds for the proposed project are dependent upon the subdistrict's total population meeting certain economic or demographic characteristics.⁹

Based upon these findings, the Commission makes the following conclusions of law:

1. The public convenience and necessity require the construction of the proposed project.

2. No rational basis exists to support the proposed creation of Subdistrict F as currently drawn.

3. "Where a subdistrict is created for rate-making purposes, the areas placed within that subdistrict should have some common characteristic or interest. The proponent of the subdistrict's creation bears the burden of demonstrating the reasonableness of the subdistrict's boundaries. At a minimum, it should demonstrate that the subdistrict's territories are served by common utility plant and facilities or share common geographic characteristics. Absent such demonstration, any rate that is based solely on a customer's location within the subdistrict's territory may be deemed unreasonable."¹⁰

4. A utility bears the burden of demonstrating that a proposed charge or rate is reasonable.¹¹

⁹ Funding for previous subdistrict construction projects required that a certain percentage of the subdistrict's households meet defined income levels. See, e.g., Northern Kentucky Water Service District, Case No. 2000-171 (Ky.PSC May 31, 2000) at 2.

¹⁰ Northern Kentucky Water Service District, Case No. 2000-171 (Ky.PSC May 31, 2000) at 8.

¹¹ KRS 278.190(3).

5. NKWD has failed to demonstrate that its formulation and calculation of the proposed surcharge results in a fair and reasonable rate.

6. NKWD's proposed plan of financing the construction does not involve the immediate issuance of any long-term evidences of indebtedness and, therefore, does not require Commission authorization.¹² Prior to the issuance of any long-term evidences of indebtedness that will refund or retire any bond anticipation notes used to finance the proposed construction, however, NKWD should seek Commission authorization for such action.

IT IS THEREFORE ORDERED that:

1. NKWD is granted a Certificate of Public Convenience and Necessity to proceed with the proposed construction as set forth in its application.

2. NKWD shall obtain approval from the Commission prior to performing any additional construction not expressly authorized by this Order.

3. Any deviation from the construction approved shall be undertaken only with the prior approval of the Commission.

4. NKWD shall furnish documentation of the total costs of this project including the cost of construction and all other capitalized costs, including, but not limited to, engineering, legal, and administrative expenses, within 60 days of the date that construction is substantially completed. Construction costs shall be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for water utilities prescribed by the Commission.

¹² KRS 278.300(8). The Commission has previously authorized the issuance of the bonds referenced in Findings Paragraph 16a. Northern Kentucky Water District, *supra* note 6.

5. NKWD shall file with the Commission 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 certificated herein.

6. NKWD shall require construction to be inspected under the general supervision of a licensed professional engineer with a Kentucky registration in civil or mechanical engineering, to ensure that the construction work is completed in accordance with the contract drawings and specifications and in conformance with the best practices of the construction trades involved in the project.

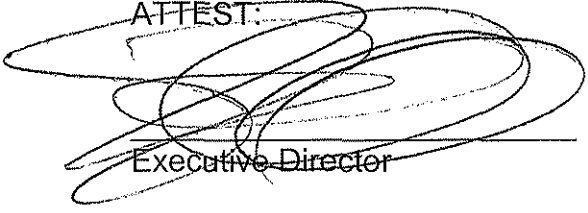
7. NKWD shall notify the Commission 7 days prior to the actual start of construction and at the 50 percent completion point.

8. The proposed surcharge for Subdistrict F is denied.

Done at Frankfort, Kentucky, this 20th day of September, 2006.

By the Commission

ATTEST:



Executive Director