

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION OF EXISTING WATER) ADMINISTRATIVE
DISTRIBUTION MAIN EXTENSION POLICIES) CASE NO. 386

O R D E R

The proceeding involves an examination of existing water distribution main extension policies. In this Order, we identify proposed revisions to Administrative Regulation 807 KAR 5:066 to encourage water main extensions, establish uniform rules for the acquisition of customer-constructed facilities, reduce the transaction costs associated with water main extensions, and better allocate the cost of such extensions. We further declare our intention to promulgate an amended regulation to implement these proposed revisions.

Administrative Regulation 807 KAR 5:066, Section 11, establishes the current policy for water distribution main extensions in Kentucky. This regulation requires a water utility to extend its distribution mains 50 feet without charge to serve an applicant for water service. 807 KAR 5:066, Section 11(1). It permits a water utility, for water main extensions that exceed 50 feet in length per applicant, to require an applicant or group of applicants to deposit the total cost of the excessive footage over 50 feet per customer but directs reimbursement of this deposit as additional customers connect to the main extension. 807 KAR 5:066, Section 11(2)(a). The regulation also permits water utilities initially to impose the entire cost of a water distribution main extension to

real estate subdivision developments upon the subdivision s developer; however, water utilities must refund to such developers, for a period of not less than 10 years, a sum equal to the cost of fifty (50) feet of the extension installed for each new customer connected during the year whose service line is directly connected to the extension. 807 KAR 5:066, Section 11(3).

The basic provisions of Administrative Regulation 807 KAR 5:066, Section 11, have been in effect for over 40 years with only modest changes.¹ While the regulation has not changed significantly, the water utility industry in Kentucky and the nature of the Commission s jurisdiction have changed. At the time the regulation was promulgated, the Commission s jurisdiction did not extend to water districts or water associations.² The number of such entities was still small. Virtually all water utilities subject to Commission jurisdiction were investor-owned utilities operating within urban areas. Treated water was unavailable to large portions of Kentucky. Suburban development in Kentucky had not yet occurred on a large scale. When promulgating the regulation, the Commission sought to encourage the extension of water service and to achieve a fair allocation of cost of these extensions.

¹ We promulgated our regulation dealing with water distribution main extensions, which is currently codified as Administrative Regulation 807 KAR 5:066, Section 11, on November 28, 1959. The only significant revision to this regulation occurred in 1992 when the Commission permitted water utilities to use an alternative refund plan. See 807 KAR 5:066, Section 11(2)(b)(2); 19 Ky. Admin. Reg. 1968, 3368 (1992).

² Water districts were statutorily exempted from Commission jurisdiction prior to 1964. 1936 Ky. Acts 299.

Today the majority of water utilities subject to Commission regulation are water districts and water associations.³ Most operate in rural areas and have a low customer density. Many are heavily dependent upon financial assistance from federal and state government to extend water service. In recent years, the areas in which these utilities operate have seen increasing urbanization and development.

In recent years, water utilities have increasingly questioned the Commission's policies regarding water main extensions. In Administrative Case No. 375,⁴ several water utilities argued that the existing extension policy places an unreasonable burden on existing customers and should therefore be modified. Other water utilities have sought deviations, on a case-by-case basis, to reimbursement provisions.⁵ Moreover, the recent efforts to expand the delivery of water service to Kentuckians have suggested that existing policies require reexamination.⁶

Noting these changes, this Commission, on November 2, 2000, initiated this proceeding to investigate water main distribution practices within this state. In our Order initiating this proceeding, we stated that this proceeding would have three stages:

³ In 1964, the General Assembly eliminated this exemption and declared that water districts were public utilities subject to Commission jurisdiction. 1964 Ky. Acts 722. In 1972, it made a similar declaration regarding water associations. 1972 Ky. Acts 1462.

⁴ Administrative Case No. 375, An Investigation Into the Design and Use of System Development Charges.

⁵ See, e.g., Case No. 98-468, Proposed Revisions to the Mainline Extension Policy of Northern Kentucky Water Service District (Sept. 4, 1998); Case No. 99-050, North Marshall Water District's Proposed Rules for Water Main Extensions to Real Estate Subdivisions (April 10, 2000).

⁶ See, e.g., Ky. Exec. Order 96-1339 (Oct. 3, 1996); 2000 Ky. Acts Chap. 529.

[1] collection of information; [2] identification of problem areas and potential solutions; and [3] identification of necessary revisions to existing administrative regulations and promulgation of administrative regulations to implement those revisions.

In the first phase of our investigation, we issued interrogatories to every water utility regarding its water distribution main extension practices, its experience complying with Administrative Regulation 807 KAR 5:066, Section 11, its proposed revisions to that regulation, and its comments upon the general effect of that regulation on efficient land development. To encourage complete and forthright responses, we granted limited immunity to all responding utilities and declared that none of the information set forth in their responses would be used to initiate adverse administrative proceedings for violations of Administrative Regulation 807 KAR 5:066. Approximately 93 water utilities responded to these interrogatories.

Following their submission of these responses, the Commission reviewed these responses and prepared a summary of them. Based upon these responses, the Commission has identified the following areas of concern:

- Extension of water distribution mains to real estate subdivisions
- Allocation of infrastructure costs related to or associated with water main distribution extensions
- Allocation of costs for self-financed water distribution main extensions

Our review of the responses indicated widespread dissatisfaction with the existing rules regarding water main distributions to real estate developments. The majority of utilities responding indicated that the present rules unfairly allocate the cost of such extensions, permit real estate developers to unfairly recover the cost of such

main extensions through refunds and through the sale of real estate lots, and, in some instances, effectively remove a water utility's ability to control its financial future. They urge elimination of the refunding requirements contained in Administrative Regulation 807 KAR 5:066, Section 11(3).

The Commission finds that extensive revision to this provision, if not elimination, is in the public interest. We agree that, in areas of rapid real estate development, the current regulation seriously encumbers a water utility's ability to manage its finances. Rather than focusing on building and upgrading its infrastructure in accordance with long-term plans, these utilities must devote funds to refunding extensions over which they may have limited control in planning and constructing.

We also note that the current regulation's provisions appear overly generous when compared to those of most other states. A majority of states do not require any refunds for a water main extension to a real estate development or they base the refund upon the revenue stream that the extension's new customers provide. The current regulation, therefore, may have the unintended consequence of encouraging land development that is not otherwise economically feasible or appropriate. At a minimum, the regulation requires revision to ensure that the cost of extensions to real estate developments is more fairly allocated and not wholly absorbed by customers not served by the extension.

Another issue of concern is the development of uniform rules for the construction of water main extensions and the acceptance of water mains that are privately financed and constructed. Currently many utilities fail to establish rules that govern the engineering, planning, and operational aspects of such main extensions. As a result,

the transactional costs and implementation time related to planning and constructing water mains are inflated. We find that requiring uniform rules that apply to the construction of water main extensions should speed the extension of water service to unserved areas and reduce the cost of such extensions.

We also find a lack of uniform rules dealing with the allocation of costs for infrastructure related to water distribution main extensions. For example, the current regulation and most water utility tariffs are silent on the allocation of costs for line upsizing or the construction of related improvements. The Commission finds that, under the current regulation, the cost of these related improvements may not be properly allocated to the party who benefits from these related improvements. To ensure a more efficient and fair allocation of such costs, the current regulation should be amended to require water utilities to address these issues in their tariffs.

Finally, we find that the current regulation fails to promote self-financed water distribution main extensions. Administrative Regulation 807 KAR 5:066, Section 11(2)(b)(1), currently allows a water utility to require an applicant or group of applicants to deposit the total cost of the excessive footage over 50 feet per customer. The utility must reimburse this deposit as additional customers connect to the main extension. Customers who connect after the construction of the water main extension, however, are not required to make any contribution to the construction of the water main extension. Most water utilities argue, and we agree, that this provision discourages potential customers from joining self-financed water main extensions and creates an incentive to delay applying for service. It unfairly penalizes those persons who exercise

initiative to resolve their water supply needs while rewarding those who do not. Based upon our review of the comments and our analysis of the current regulation's effects, we find that the regulation should be amended to provide that all customers who connect to a self-financed water main extension within 10 years of its placement in service should be required to pay a proportionate share of the water main extension's cost.

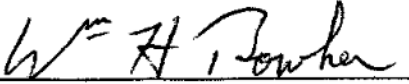
To correct the deficiencies in the existing regulation, the Commission has filed with the Legislative Research Commission a notice of intent to promulgate an administrative regulation setting forth the principles described in this Order. A copy of this notice of intent is appended. Through the process set forth in KRS Chapter 13A, we hope to ensure that our regulatory policies encourage reasonable extensions of water service in Kentucky and fairly and equitably allocate the cost of such extensions.

Finding that the purpose of this proceeding has been achieved, the Commission HEREBY ORDERS that this proceeding is closed and shall be removed from our docket.

Done at Frankfort, Kentucky, this 15th day of August, 2002.

By the Commission

ATTEST:

Deputy 
Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN ADMINISTRATIVE CASE NO. 386 DATED AUGUST 15, 2002

AUG 15 2002

Susan C. Wenderlich
REGULATIONS COMPILER

NOTICE OF INTENT TO
PROMULGATE ADMINISTRATIVE REGULATION

Date: August 14, 2002

Kentucky Public Service Commission

- (1) **Regulation Number and Title:** 807 KAR 5:066. Water.
- (2) The Kentucky Public Service Commission intends to amend the administrative regulation governing the subject matter cited above.
- (3) A public hearing to receive oral and written comments on the proposed administrative regulation has been scheduled for September 23, 2002, at 1:30 p.m., Eastern Daylight Time, in Hearing Room 1, 211 Sower Boulevard, Frankfort, Kentucky.
- (4) (a) The public hearing will be held if:
 1. It is requested, in writing, by at least 5 persons, or an administrative body, or an association having at least 5 members; and
 2. A minimum of 5 persons, or the administrative body or association, agrees, in writing, to be present at the public hearing.
- (b) If a request for a public hearing, and agreement to attend the public hearing, are not received from the required number of people at least 10 calendar days prior to September 23, 2002, the public hearing will be cancelled.
- (5) (a) Persons wishing to request a public hearing should mail their written requests to the following address: Gerald Wuetcher, Assistant General Counsel, Kentucky Public Service Commission, 211 Sower Boulevard, P.O. Box 615, Frankfort, Kentucky, 40602; telephone (502) 564-3940; facsimile (502) 564-7279.
- (b) On a request for a public hearing, a person shall state:
 1. "I agree to attend the public hearing."; or
 2. "I will not attend the public hearing."
- (6) (a) KRS Chapter 13A provides that persons who desire to be informed of the intent of an administrative body to promulgate an administrative regulation governing a specific subject matter may file a request to be informed by the administrative body.
- (b) Persons who wish to file this request may obtain a request form from the Kentucky Public Service Commission at the address listed above.
- (7) Information relating to the proposed administrative regulation:
 - (a) The statutory authority for the promulgation of an administrative regulation relating to this subject is as follows: KRS 278.040(3) provides that the Commission may promulgate, pursuant to KRS Chapter 13A, reasonable regulations to implement the provisions of KRS Chapter 278. KRS 278.040(2) grants the Commission exclusive jurisdiction over utility rates and services. KRS 278.012 states that water associations are subject to the Commission's jurisdiction. KRS 278.015 expressly subjects water districts to Commission jurisdiction. KRS 278.030 requires every utility

to furnish adequate, efficient and reasonable service. KRS 278.280(2) authorizes the Commission to prescribe rules for the performance of any service or the furnishing of any commodity of the character furnished or supplied by the utility. KRS 278.280(3) authorizes the Commission, upon petition of any person or group of persons, to compel a utility to make any reasonable extension of service.

(b) The proposed amendment will modify the provisions of the existing administrative regulation that deal with extensions of water service and will generally amend the existing administrative regulation to conform with the existing provisions of KRS Chapter 13A.

(c) The Necessity and Function of the proposed administrative regulation is as follows: The proposed amendment is necessary to avoid discouraging applicants for water service from self-financing water main extensions and to establish uniform rules for same. In establishing uniform rules for a utility's acquisition of customer-constructed facilities, the proposed amendment will reduce transaction costs and construction delays. Eliminating the requirement that a water utility refund the cost of extensions to a developer will ensure that those responsible for the cost of construction will be those who will actually pay for it.

(d) The proposed amendment will establish uniform rules for the acquisition and acceptance of customer-constructed facilities and for the allocation of costs for the upsizing of water mains and construction of related facilities. It also will eliminate the requirement that a water utility refund the cost of water main extensions within a real estate subdivision development, thereby encouraging more economical land use development and enabling a water utility to better control and manage its finances and plan for future development.

(e) The administrative regulation will be implemented and enforced as soon as it becomes effective.