

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF MALLARD POINT)	
DISPOSAL SYSTEMS, INC. FOR AN)	CASE NO.
ADJUSTMENT OF RATES PURSUANT)	2003-00284
TO THE ALTERNATIVE RATE FILING)	
PROCEDURE FOR SMALL UTILITIES)	

ORDER

Mallard Point Disposal Systems, Inc. (“Mallard Point”) applied to the Commission for authority to adjust its sewer rates pursuant to 807 KAR 5:076. Mallard Point proposes to increase its rate for residential service from \$31.10 to \$45.16, an increase of \$14.06 or 45.2 percent. The proposed sewer rates will generate annual revenues of \$188,463, \$57,915 or 44.36 percent over Staff’s normalized test-period revenues from sewer service of \$130,548.

By this Order, we grant Mallard Point a Certificate of Public Convenience and Necessity (“Certificate”) to rehabilitate its 50,000 GPD wastewater treatment plant, approve the proposed plan of financing, deny the requested rates, and approve an increase in the residential sewer rate of \$6.93 to \$38.03, an increase of 22.28 percent. The rate approved herein will generate additional annual revenue of \$159,653, an increase of \$29,105 or 22.29 percent over Staff’s normalized operating revenues from sewer rates.

BACKGROUND

Mallard Point, a sub-chapter S Corporation formed for the purpose of providing sewage treatment services, is a utility subject to Commission jurisdiction. KRS

278.010(3)(d); KRS 278.015; KRS 278.040. It provides retail sewer service to 327 residential customers in the subdivisions of Mallard Point, Harbor Village, and Cedar Hills, all of which are located in Scott County, Kentucky. Mallard Point also provides sewer service to one commercial customer, the Northern Elementary School. This is the first application for a rate adjustment that has been submitted by Mallard Point since 1994.¹

PROCEDURE

Pursuant to a request by Mallard Point, Commission Staff assisted in the development and preparation of two separate applications, which Mallard Point filed on July 7, 2003. The first application was for a Certificate and approval of financing, which the Commission docketed as Case No. 2003-00283.² The second application is a request for an increase in rates, which the Commission docketed as Case No. 2003-00284. By its Order of October 6, 2003, the Commission consolidated Case Nos. 2003-00283 and 2003-00284 into Case No. 2003-00284.

The Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention (“Attorney General”), Marvin Baker, Doug Beall, Angela Beall, Winston Faircloth, Carl Jason, Bob Marlowe, Judith Marlowe, Ronald Nail, Kristy

¹ See Case No. 1994-00266, The Application of the Mallard Point Disposal Systems, Inc. for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities (February 4, 1995).

² Case No. 2003-00283, The Application of the Mallard Point Disposal Systems, Inc. for (1) a Certificate of Public Convenience and Necessity to Construct the Proposed Wastewater Improvement Project; and (2) the Approval of the Proposed Plan of Financing.

Nail, Quinn Richter, Traci Richter, Peggy van der Gaag, Jeroen van der Gaag, Robert Warhus, and Charles F. Knapp intervened.

Pursuant to a request of the Attorney General, the Commission established a procedural schedule on August 21, 2003 and scheduled an informal conference that was held on August 28, 2003. Upon the requests of the parties the Commission has modified its procedural schedule four separate times during this proceeding. All parties engaged in extensive discovery.

Commission Staff ("Staff") performed a limited financial review of Mallard Point's operations, and on November 21, 2003 released its report ("Staff Report") recommending that Mallard Point be allowed to increase its sewer rate from \$31.10 to \$37.39, an increase of \$6.29 or 20.23 percent. Staff's recommended rate would generate annual revenues from sewer service of \$156,944, \$31,519 less than Mallard Point's requested revenue of \$188,463. The Order issuing the Staff Report also gave the parties leave to file written comments upon Staff's findings and recommendations or to request a conference or hearing no later than December 8, 2003.

On December 5, 2003, the Attorney General filed his written comments to the findings and recommendations of the Staff Report. Mallard Point filed its acceptance of the Staff Report on December 8, 2003. A group of Intervenors³ jointly filed their comments on December 8, 2003 and requested that the Commission schedule a hearing.

³ Winston Faircloth, Robert Warhus, Bob Marlowe, Judith Marlowe, and Jeroen van der Gaag.

A public hearing was held on February 13, 2004 to receive evidence relating to Mallard Point's Certificate, financing, and rate applications. The only witness appearing on behalf of Mallard Point was Mark Smith, Mallard Point's sole stockholder and manager. Mallard Point, Winston Faircloth, Bob and Judith Marlowe, Peggy and Jeroen van der Gaag, Robert Warhus, Marvin Baker, and the Attorney General submitted post-hearing comments.

STAFF REPORT RECOMMENDATIONS

The following are the Commission's modifications to the findings and recommendations contained in the Staff Report:

Failure to Maintain Records

In its report, Staff noted that Mallard Point had failed to retain its invoices and canceled checks in its last rate case proceeding.⁴ Staff also noted that in his response to the August 20, 1997 Report of Examination, Mr. Smith agreed to maintain bank reconciliations and vendor invoices and to stop the practice of commingling of funds. Upon conducting its field review in this proceeding, Staff discovered that Mallard Point had not followed through on those commitments in that Mallard Point could not produce monthly bank reconciliations, vendor invoices, or a formal receipts and disbursements journal. In reviewing the bank statements, Staff found that Mr. Smith was still commingling his private funds with those of Mallard Point.

According to the Attorney General, Mallard Point lacks the ability to provide basic information about its operations and financial condition, and the commingling of Mr.

⁴ See Case No. 1994-00266, The Application of the Mallard Point Disposal Systems, Inc. for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities (February 2, 1999).

Smith's funds is problematic.⁵ Accordingly, the Attorney General requests that the Commission incorporate the following mandates in its Order: (1) require Mallard Point to maintain its invoices; (2) require Mallard Point to cease commingling its funds with those of Mr. Smith; (3) prohibit Mallard Point from engaging in non-regulated activity unless it conforms to KRS 278.2201 and KRS 278.2213; (4) require Mallard Point to maintain monthly bank reconciliations; and (5) require Mallard Point to maintain a formal receipts and disbursements journal.⁶

The position of the remaining Intervenors is that the Commission should deny the requested rate increase based upon Mallard Point's inability to provide supporting documentation. Intervenors point to Smith's disregard of, and failure to follow, Commission Staff's recommendations as contained in the prior case. The Intervenors request that the case be dismissed and that the Commission order Mallard Point to implement a record retention system for a year before seeking a future rate increase.

Mallard Point claims that Mr. Smith had complied with those commitments for a couple of years, but quit because he "[w]as unable to keep up with a growing business that was quickly outstripping its humble beginnings."⁷ According to Mallard Point, Mr. Smith now realizes the importance of segregating Mallard Point's business from his own personal affairs, both physically and financially.⁸ As of January 1, 2004, Mallard Point

⁵ Written Comments of the Attorney General to the Commission Staff Report at 3-4.

⁶ Id. at 4-5.

⁷ Mallard Point's Post Hearing Brief at 3.

⁸ Id.

states that the operations have been computerized, the accounts are being reconciled, the invoices are being maintained, and the regulated utility funds are no longer being commingled with Mr. Smith's.⁹

The Commission is troubled by the lack of documentary evidence that Mallard Point was able to present in this proceeding. Given this lack of evidence, Mallard Point's inability to maintain its financial records, and Mallard Point's failure to keep its prior commitments, the Commission is of the opinion that the Attorney General's recommended mandates are reasonable.

Therefore, the Commission finds that Mallard Point should (1) establish a filing system to maintain its vendor invoices; (2) cease the practice of commingling Mr. Smith's private funds with those of the regulated utility, Mallard Point; (3) cease the practice of engaging in non-regulated activity unless it conforms to KRS 278.2201 and KRS 278.2213; (4) perform bank reconciliations on a monthly basis; and (5) maintain a formal receipts and disbursements journal. To ensure that Mallard Point remains in compliance, the Commission also finds that Mallard Point should file quarterly reports containing legible copies of the vendor invoices, copies of the chemical and maintenance reimbursement invoices, bank reconciliations, and the cash receipts and disbursements journal for the months in that quarter.

Chemicals

In its report, Staff proposed to adjust test-period chemical expense of \$2,000 by \$650 to a pro forma level of \$2,650. According to Mallard Point, its licensed operator provides the chemicals used at its wastewater treatment facility and the monthly

⁹ Id.

payments to Mr. Norton that are in excess of the routine maintenance fee are the chemical cost reimbursements, which totalled \$2,650 in the test period. Staff recommended that Mallard Point cease its arrangement with Mr. Norton and either purchase its own chemicals or require Mr. Norton to produce an invoice prior to reimbursement.

The Attorney General's position is that an expense should be borne by the shareholder unless those expenses are proven to be beneficial to the ratepayers in providing service and that the mere inclusion of an expense in the application does not compel anything.¹⁰ According to the Attorney General, Mallard Point does not have the actual chemical invoices and is unable to verify the chemical costs or the types of chemicals being used at its treatment facilities.¹¹ Because Mallard Point lacks support for the chemical cost, the Attorney General proposes that Staff's recommended pro forma operating expenses be reduced by \$2,650 to eliminate chemical expense.¹² All of the Intervenor's filing comments to the Staff Report are in agreement with the Attorney General's position.

Mallard Point argues that, "[t]he clean and continuous operation of Mallard Point's treatment facilities establish that during 2002 Mr. Norton purchased chemicals and used them at the plant."¹³ The 2002 discharge reports are Mallard Point's proof

¹⁰ Written Comments of the Attorney General to the Commission Staff Report at 1-2.

¹¹ Id. at 2.

¹² Id.

¹³ Mallard Point's Post Hearing Brief at 4.

that the chemicals purchased by Mr. Norton were used at its treatment plant, and that they were, therefore, beneficial to the ratepayers.¹⁴ To ensure that this problem does not recur in future rate case proceedings, Mallard Point states that beginning January 1, 2004, it has instituted a policy requiring the presentation of a paid invoice prior to reimbursement.¹⁵

Given the results of its annual inspections and the discharge reports, the Commission finds that Mallard Point did use chemicals in the treatment of its effluent during the calendar year 2002. Therefore, it is reasonable to include some level of chemical cost in the test-period operating expenses. The limited documentation¹⁶ that was made available for Staff's review is sufficient proof in this instance that \$2,650 is within the range of reasonableness for this expense. Accordingly, the Commission denies the Attorney General's and Intervenors' proposal to eliminate chemical expense from Mallard Point's pro forma operations.

Maintenance Supplies

In its report, Staff proposed to adjust test-period pro forma operating expenses by \$6,699 to include maintenance supplies expense. Included in this amount is \$5,146 of reimbursements to Charlie Hanson, the outside contractor responsible for Mallard Point's daily maintenance. As it did with the chemical arrangement, Staff recommended that Mallard Point cease its arrangement with Mr. Hanson and either purchase its own

¹⁴ Id.

¹⁵ Id. at 4-5.

¹⁶ Canceled checks that were subsequently lost by Mallard Point.

maintenance supplies or require Mr. Hanson to produce an invoice prior to reimbursement.

Again, the Attorney General's position is that an expense should be borne by the shareholder unless those expenses are proven to be beneficial to the ratepayers in providing service and that the mere inclusion of an expense in the application does not compel anything.¹⁷ Since Mallard Point does not have the actual invoices, the Attorney General claims that Mallard Point is unable to verify either the cost of the maintenance supplies or its statement that the supplies were used at its treatment facilities.¹⁸ Accordingly, Mallard Point lacks support for its allegations concerning reimbursements to Mr. Hanson and, therefore, maintenance supplies expense should be reduced by \$5,146 to eliminate this cost.¹⁹ All of the Intervenors filing comments to the Staff Report are in agreement with the Attorney General's position.

Mallard Point contends that its discharge reports clearly show that in the calendar year 2002 preventive maintenance was being performed at its treatment facilities.²⁰ Therefore, Mallard Point concludes that Mr. Hanson did purchase belts, motors and grease to maintain the plant's equipment.²¹

¹⁷ Written Comments of the Attorney General to the Commission Staff Report at 1-2.

¹⁸ Id. at 2.

¹⁹ Id.

²⁰ Mallard Point's Post Hearing Brief at 4.

²¹ Id.

The Commission believes that results of its annual inspections and the discharge reports show that the proper amount of maintenance was performed at Mallard Point's treatment facilities. Again, the limited documentation²² that was made available for Staff's review is sufficient proof in this instance that maintenance expense of \$6,699 is within the range of reasonableness. Accordingly, the Commission denies the Attorney General's and Intervenors' proposal to reduce maintenance supplies expense by \$5,146 to eliminate reimbursements paid to Mr. Hanson.

Rate Case Expense

The legal invoices that were provided by Mallard Point prior to the hearing showed that the cost of this rate case was \$15,293. In its report, Staff recommended that pro forma operating expenses be increased by \$5,098 to reflect amortizing the cost of this rate case over 3 years.

According to the Attorney General, the ratepayers should not have to reimburse Mallard Point for legal fees above and beyond an amount that corresponds to a reasonable legal expense for presenting a rate application of a normal utility.²³ The Attorney General contends that it is not the responsibility of the Commission or the Intervenors to prove that legal expenses are appropriate; that responsibility lies with Mallard Point.²⁴ Accordingly, the Attorney General requests that legal fees be reduced to a normal level and that the legal fees incurred for representation at the Mallard Point

²² Canceled checks that were subsequently lost by Mallard Point.

²³ Written Comments of the Attorney General to the Commission Staff Report at 3.

²⁴ Id.

Homeowners' Association ("Homeowners' Association") be removed because those fees are not utility related.²⁵ All of the Intervenors are in agreement with the Attorney General's position.

Mallard Point argues that it is entitled to recover the time spent by its legal counsel during this proceeding, including the time spent at the Homeowners' Association.²⁶ According to Mallard Point, the majority of its legal expense of \$23,046 was attributable to "discovery responses and motion practice" with the Intervenors.²⁷ Mallard Point claims that the record adequately supports its legal fees and that, therefore, the Attorney General's and the Intervenors' position on rate case amortization should be rejected.²⁸

The Commission is in agreement with the Attorney General's position that the ratepayers should not have to reimburse Mallard Point for legal fees above and beyond an amount that corresponds to a reasonable legal expense for presenting a rate application of a normal utility. Because of the lack of records, Mallard Point was required to respond to duplicative data requests and motions. Therefore, the Commission finds that Mr. Smith and ratepayers should share equally in the legal fees incurred by Mallard Point. An equal sharing of the legal fees and the elimination of the legal representation at the Homeowners' Association results in a amortization expense of \$3,741, for a decrease to Staff recommended amortization of \$1,357.

²⁵ Id.

²⁶ Mallard Point's Post Hearing Brief at 4.

²⁷ Id.

²⁸ Id.

Summary

Based on the modifications to the recommendations and findings of the Staff Report, the Commission finds that Mallard Point's pro forma operations should be as follows:

	Staff Pro Forma Operations	Commission Adjustments	Commission Pro Forma Operations
Operating Revenues	\$ 130,673	\$ 0	\$ 130,673
Operating Expenses	104,441	(7,746)	96,695
Net Operating Income	\$ 26,232	\$ 7,746	\$ 33,978
Interest Expense	38,386	0	38,386
Income Available for Debt Service	<u>\$ (12,154)</u>	<u>\$ 7,746</u>	<u>\$ (4,408)</u>

REVENUE REQUIREMENT DETERMINATION

Based upon the Commission's findings and determinations herein, Mallard Point requires an increase in revenues of \$17,594, determined as follows:

Operating Expenses	\$ 96,695
Divided by: Operating Ratio	÷ 88%
Subtotal	\$ 109,881
Add: Interest Expense	+ 38,386
Total Revenue Requirement	\$ 148,267
Less: Late Payment Penalties	- 125
Revenue Requirement – Sewer Rates	\$ 148,142
Less: Normalized Revenue – Sewer Rates	- 130,548
Increase	<u>\$ 17,594</u>

RATE DETERMINATION

Using the revenue requirement determined reasonable herein, the Commission calculates a residential equivalent rate of \$35.29 as follows:

Revenue Requirement – Sewer Rates	\$ 148,142
Divided by: 12 Months	÷ 12
Monthly Revenue Requirement	\$ 12,345
Divided by: End-of-Period Customer Level	÷ 349.8
Monthly Rate	<u>\$ 35.29</u>

IT IS THEREFORE ORDERED that:

1. The recommendations and findings contained in the Staff Report, as modified herein, are adopted and incorporated by reference into this Order as if fully set out herein.

2. Mallard Point's proposed rate would produce revenue in excess of that found reasonable herein and should be denied.

3. The rate set forth in Appendix A is approved for service rendered by Mallard Point on and after the date of this Order and will produce gross annual revenues as found reasonable herein.

4. Mallard Point's request for a Certificate to rehabilitate its 50,000 GPD wastewater treatment plant is approved.

5. Mallard Point's proposed financing plan for the rehabilitation of its wastewater treatment plant is approved.

6. Mallard Point shall file its quarterly reports within 15 days of the close of the reporting quarter. The initial quarterly report shall be filed by July 15, 2004 and contain the information for the first and second quarter of the calendar year 2004.

7. Mallard Point shall file the following information in its quarterly reports:

- a. Legible copies of vendor invoices.
- b. Legible copies of chemical and maintenance reimbursement invoices.
- c. Copies of monthly bank reconciliations.
- d. Copies of the cash receipts and disbursements journal for the months in that quarter.

8. Within 30 days of the date of this Order, Mallard Point shall file with the Commission its revised tariff setting out the rate approved herein.

9. Three years from the date of this Order, Mallard Point shall file an income statement, along with any pro forma adjustments, in sufficient detail to demonstrate that the rate approved herein is sufficient to meet its operating expenses and annual debt service.

Done at Frankfort, Kentucky, this 27th day of May, 2004.

By the Commission

ATTEST:



Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2003-000284 DATED May 27, 2004

The following rate is prescribed for the customers in the area served by the Mallard Point Disposal Systems, Inc. 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 RATE

Residential Equivalent Rate	\$	35.29
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