COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ALTERNATIVE RATE FILING ADJUSTMENT FOR DELAPLAIN DISPOSAL COMPANY	))	CASE NO. 2010-00349

ORDER

On August 31, 2010, Delaplain Disposal Company ("Delaplain") applied pursuant to 807 KAR 5:076 for an adjustment to its rates for sewer service. Commission Staff, having performed a limited financial review of Delaplain's operations, has prepared a report of its findings and recommendations regarding the proposed rates. A copy of this report is attached to the Order.

Having received the report and being otherwise sufficiently advised, the Commission, on its own motion, HEREBY ORDERS that:

1. Within 14 days of the date of this Order, Delaplain shall file with the Commission its written comments on and objections to the findings and recommendations contained in the Staff Report. Delaplain may file with such submission any additional evidence for the Commission's consideration.

2. Delaplain's failure to object to a finding or recommendation contained in the Staff Report within 14 days of the date of this Order shall be deemed as agreement with that finding or recommendation.

3. No later than 14 days from the date of the Order, Delaplain shall notify the Commission in writing whether this matter may be submitted for decision based upon the existing record and without hearing.

4. Unless Delaplain requests that this matter be submitted for decision upon the existing record, a formal hearing in this matter shall be held on June 9, 2011 at 10:00 a.m., Eastern Daylight Time, in Hearing Room 1 of the Commission's offices at 211 Sower Boulevard, Frankfort, Kentucky, and continuing until completed.

5. Delaplain shall publish notice of the scheduled hearing in this matter in accordance with 807 KAR 5:011, Section 8(5), and shall file proof of publication with the Commission no later than June 1, 2011.

6. Delaplain shall be limited in its opening statement at the hearing in this matter to five minutes or less.

7. Delaplain shall file with the Commission, no later than June 1, 2011, a list of the persons it intends to call as witnesses at the scheduled hearing and a summary of each witness's expected testimony.

8. Any exhibits that a party wishes to introduce at hearing shall be marked with the party's name and a sequential number (e.g., Delaplain Exhibit 1). References to a witness or type of examination are not necessary.

9. Unless the Commission directs otherwise, all parties shall file with the Commission responses to requests for information made at hearing no later than June 15, 2011.

10. Pursuant to KRS 278.360, the record of the formal hearing in this matter shall be by videotape.

11. Commission Staff shall make a written exhibit list and shall file this with the Commission along with all exhibits and a copy of the videotranscript of the hearing.

By the Commission

ENTERED

MAY 11 2011

KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Executive Director

STAFF REPORT

ON

DELAPLAIN DISPOSAL COMPANY

CASE NO. 2010-00349

Delaplain Disposal Company ("Delaplain") applied to the Commission for authority to adjust its sewer rates pursuant to 807 KAR 5:076. To evaluate the requested increase, Commission Staff ("Staff") performed a limited financial review of Delaplain's test period operations for the calendar year ending December 31, 2009. The scope of Staff's review was limited to obtaining information as to whether the test-period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

Mark Frost and Jason Green of the Commission's Division of Financial Analysis performed the limited review. This report summarizes Staff's review and recommendations. Mr. Green is responsible for the pro forma revenue adjustment and the calculation of the recommended rates. Mr. Frost is responsible for all pro forma operating expense adjustments and the revenue requirement determination.

Appendix A to this report is Delaplain's proposed pro forma operating statement. Staff's proposed pro forma operating statement for Delaplain is shown in Appendix B. Appendix C contains an explanation of each pro forma adjustment rejected or proposed by Staff.

The Commission has historically used an operating ratio approach[1] to determine the revenue requirement for small, privately-owned utilities. This approach is used primarily when there is no basis for a rate-of-return determination or the cost of the utility has fully or largely been funded through contributions. Staff finds that the operating ratio method should be used to determine Delaplain's revenue requirement. Staff further finds that an operating ratio of 88 percent will allow Delaplain sufficient revenues to cover its reasonable operating expenses and to provide for reasonable equity growth.

Using an 88-percent operating ratio, Delaplain determined that its pro forma operations support a revenue requirement from rates of $445,234, which is $173,460, or 63.8 percent, over Delaplain's normalized revenues from rates of $271,774.[2] Staff's recommended pro forma operations and an operating ratio of 88 percent result in a revenue requirement from rates of $308,664, an increase of $36,891, or 13.6 percent, over Staff's normalized revenue from rates of $271,773. Table 1 is a comparison of Delaplain's requested revenue requirement to the revenue requirement recommended by Staff.

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[1] Operating Ratio is defined as the ratio of expenses, including depreciation and taxes, to gross revenues.

$$\textit{Operating Ratio} = \frac{\textit{Operating Expenses + Depreciation + Taxes Other Than Income Taxes}}{\textit{Gross Revenues}}$$

[2] Application, Attachment A, Revenue Requirement Calculation.

Table 1: Revenue Requirement Comparison				
	Delaplain		Staff	
Operating Expenses	$	387,020	$	266,838
Divided by: Operating Ratio	÷	88%	÷	88%
Net Operating Income	$	439,795	$	303,225
Add: Interest Expense	+	5,439	+	5,488
Requested Revenue Requirement	$	445,234	$	308,713
Less: Interest Income	-	0	-	49
Revenue Requirement - Sewer Rates	$	445,234	$	308,664
Less: Normalized Operating Revenue	-	271,773	-	271,773
Increase in Revenue from Rates	$	173,461	$	36,891
Percentage Increase		63.8%		13.6%

Because Delaplain's proposed rates will produce annual revenues that are greater than the revenue requirement determined reasonable herein, Staff recommends that the Commission deny Delaplain's proposed rates and approve the rates set forth in Appendix D, which will produce revenues of $308,355.

Signatures

Mark C Frost

Prepared by: Mark C. Frost
Financial Analyst, Water and Sewer
Revenue Requirements Branch
Division of Financial Analysis

Jason Green

Prepared by: Jason Green
Rate Analyst, Communications, Water
and Sewer Rate Design Branch
Division of Financial Analysis

APPENDIX A
STAFF REPORT, CASE NO. 2010-00349
DELAPLAIN'S REQUESTED
PRO FORMA OPERATIONS

Account Titles	Actual Operations	Pro Forma Adjustments	Pro Forma Operations
Operating Revenues:			
Residential - Flat Rate	$ 29,817	$ 570	$ 30,387
Commercial - Measured	240,861	525	241,386
Total Operating Revenues	$ 270,678	$ 1,095	$ 271,773
Operating Expenses:			
Operation & Maint. Exp:			
Owner/Manager Fee	47,218	0	47,218
Sludge Hauling	31,800	(2,400)	29,400
Utilities	46,160	3,561	49,721
Other-Labor, Materials & Exp	58,458	0	58,458
Operating Supplies	3,806	0	3,806
Routine Maintenance Fee	0	0	0
Maint. - Treatment & Disposal	50,494	8,645	59,139
Outside Services Emp.	57,141	0	57,141
Insurance	5,105	0	5,105
Miscellaneous	3,274	0	3,274
Total Operation & Maint. Exp.	$ 303,456	$ 9,806	$ 313,262
Depreciation	16,247	33,687	49,934
Amortization	9,732	6,333	16,065
Taxes Other than Income Tax	7,487	272	7,759
Total Operating Expenses	$ 336,922	$ 50,098	$ 387,020
Net Operating Income	$ (66,244)	$ (49,003)	$ (115,247)
Other Income:			
Interest Dividend Income	49	(49)	0
Other Deductions:			
Interest - Long-Term Debt	5,488	(49)	5,439
Net Income	$ (71,683)	$ (49,003)	$ (120,686)

APPENDIX B
STAFF REPORT, CASE NO. 2010-00349
STAFF'S RECOMMENDED
PRO FORMA OPERATIONS

Account Titles	Actual Operations	Pro Forma Adjustments	Ref.	Pro Forma Operations
Operating Revenues:				
Residential - Flat Rate	$ 29,817	$ 570	(a)	$ 30,387
Commercial - Measured	240,861	525	(a)	241,386
Total Operating Revenues	$ 270,678	$ 1,095		$ 271,773
Operating Expenses:				
Operation & Maint. Exp:				
Owner/Manager Fee	47,218	(42,950)	(b)	4,268
Sludge Hauling	31,800	(3,000)	(c)	28,800
Utilities	46,160	11,957	(d)	58,117
Other-Labor, Materials & Exp	58,458	(31,500)	(e)	26,958
Operating Supplies	3,806	0		3,806
Routine Maintenance Fee	0	30,000	(e)	30,000
Maint. - Treatment & Disposal	50,494	(7,573)	(f)	42,921
Outside Services Emp.	57,141	(23,489)	(g)	33,652
Insurance	5,105	(2,529)	(h)	2,576
Miscellaneous	3,274	0		3,274
Total Op. & Maint. Exp.	$ 303,456	$ (69,084)		$ 234,372
Depreciation	16,247	(2,523)	(i)	13,724
Amortization	9,732	1,251	(j)	10,983
Taxes Other than Income Tax	7,487	272	(k)	7,759
Total Operating Expenses	$ 336,922	$ (70,084)		$ 266,838
Net Operating Income	$ (66,244)	$ 71,179		$ 4,935
Other Income:				
Interest Dividend Income	49	0		49
Other Deductions:				
Interest - Long-Term Debt	5,488	0		5,488
Net Income	$ (71,683)	$ 71,179		$ (504)

STAFF'S RECOMMENDED
PRO FORMA ADJUSTMENTS

a. Normalized Operating Revenues. In its 2009 Annual Report, Delaplain reported test-period revenue from sewer rates of $270,678.[3] The reported revenues from sewer rates are comprised of revenue from residential customers of $29,817, and revenues from commercial customers of $240,861.[4]

Applying its current rates to the test-period billing information for its commercial customers, Delaplain calculated normalized revenue from commercial customers of $241,386.[5] Delaplain developed its normalized revenue from residential customers of $30,387 by applying the $10.73 per month flat residential rate to the end-of-period customer level of 236.[6] To reflect its normalized revenue calculations, Delaplain is proposing to increase test-period operating revenues of by $1,095. Staff finds that Delaplain's calculations are reasonable and accurately reflect the anticipated future revenues. Therefore, Staff recommends that the Commission accept Delaplain's proposed operating revenue adjustment.

b. Owner/Manager Fee. In 2009, Elbert Ray, Delaplain's President and Chief Engineer, received $46,550 as compensation for oversight of Delaplain's day-to-

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[3] Annual Report of Delaplain Disposal Company to the Public Service Commission of the Commonwealth of Kentucky for the Calendar Year Ended December 31, 2009 at 8.

[4] Id.

[5] Application, Attachment A, Adjustment A, Revenue.

[6] Id.

day operations and for various engineering services.[7] Delaplain contends that its aging infrastructure requires Mr. Ray to closely monitor its operations to ensure that critical repairs are made so it operates within the parameters of its KPDES permit.[8] This need coupled with cash flow restrictions has required Mr. Ray to spend on average 22 hours per month performing his oversight duties, which Delaplain concludes is reasonable.[9] Delaplain provided a proposal from a local engineering firm to demonstrate that Mr. Ray's hourly billing rate of $175 is "within the market levels for similar experience levels and responsibilities."[10]

In Case No. 2007-00436, the Commission stated that "the reasonableness of the [owner-manager] fee will depend on the circumstances of the particular utility, to include its owner's responsibilities and duties and the size and complexity of the sewer utility's operations."[11] It further stated that, as payment of an owner-manager fee is not an arms-length transaction, the utility must demonstrate by substantial evidence that the fee is reasonable. In Case No. 1991-00282,[12] Commission Staff determined that "a

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[7] Delaplain's Response to Commission Staff's Second Information Request, Item 2.

[8] Id.

[9] Id.

[10] Id. The proposal does not identify the local engineering firm, nor does Delaplain identify the firm.

[11] Case No. 2007-00436, Application of Farmdale Development Corporation for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities (Ky. PSC Jul. 30, 2008) at 6-7.

[12] Case No. 1991-00282, Application of Delaplain Disposal Company for A Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities, (Ky. PSC Jan. 15, 1992).

utility of Delaplain's size should not require the services of an engineering firm in the daily management and operation." [13] The Commission found that Staff's determination was reasonable and supported by the evidence of record.[14]

Delaplain has not demonstrated that, given its operations, the fee paid to Mr. Ray is reasonable. According to invoices that Delaplain provided, in 2009 Mr. Ray spent 266 hours managing the operations of Delaplain and approximately 46 percent or 120 hours of these hours were devoted to the review and signing of checks. By multiplying the 120 hours by Mr. Ray's hourly rate of $175, Staff determined that Delaplain paid Mr. Ray $21,000 to review and sign approximately 245 checks.[15] Staff is of the opinion that $21,000 to compensate Mr. Ray for signing 245 checks is unreasonable and excessive. Upon its review of Mr. Ray's invoices, Staff has determined that the services being performed by Mr. Ray do not require the expertise of an engineer nor do they differ significantly from those of other similarly sized sewer utilities to require greater administrative oversight and a larger administrative salary.

Staff notes that, in proceedings involving similarly-sized sewerage treatment facilities, the Commission has consistently found $3,600 to be a reasonable amount for the owner/manager fee. In the absence of any factor that distinguishes Delaplain's operations from those entities or the duties of Delaplain's owners from those of other

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[13] Id., Staff Report at 5.

[14] Id., Order dated January 15, 1992 at 2.

[15] Delaplain's Response to Commission Staff's First Information Request, Item 2, 2009 Cash Disbursements Ledger, Account – Cash Operating.

utility owners, Staff recommends that the Commission limit the owner/manager fee in this case to $3,600, resulting in a decrease of $42,950 to operating expenses.

c. Sludge Hauling Expense. Delaplain proposes to reduce its test period sludge hauling expense of $31,800 by $2,400.[16] According to Delaplain, Martin Sanitation removed 98 loads of sludge from its facilities in 2009.[17] By multiplying the 98 loads by Martin Sanitation's present fee of $300 per load, Delaplain arrived at its pro forma expense level of $29,400.[18] The test-period invoices from Martin Sanitation show that 106 loads of sludge were removed in 2009. Staff determined that 10 of the loads reported in January 2009 were actually removed in December 2008. Adjusting sludge hauling expense to eliminate the 10 loads results in a $3,000 decrease.[19]

d. Fuel and Power. Delaplain proposes to increase its test-period utilities expense of $46,160 by $3,561 to reflect an 8.1 percent increase in Kentucky Utilities Company's ("KU") rates that occurred in July 2010.[20] Using the $7 per month increase in the average customer's bill that appeared in a July 31, 2010 Lexington Herald-Leader newspaper article and the average customer bill of $86.41 as reported on KU's webpage, Delaplain calculated the 8.1 percent increase in KU's electricity rates.

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[16] Application, Attachment A, Adjustment B, Sludge Hauling Expense.

[17] Id.

[18] Id.

[19] Delaplain's Response to Commission Staff's First Information Request, Item 4(c). Martin Sanitation Invoice No. 15663 10 Loads (12/02/08 – 12/30/08) $3,000.

[20] Application, Attachment A, Adjustment D, Utilities Expense.

In Case No. 2009-00548, the Commission granted Kentucky Utilities Company an increase in its base electricity rates.[21] Staff is of the opinion that the percentage methodology proposed by Delaplain does not accurately reflect the impact KU's base rate increase will have on Delaplain's pro forma fuel and power expense. Staff is further of the opinion that applying the base rates that the Commission approved to Delaplain's test-period electricity usage is a more accurate and reasonable methodology.

Delaplain receives electric service at seven different metering points and is billed with three separate rate classifications: General Service – three phases; PS Secondary; and Private Outdoor Lighting – Mercury Vapor 7,000 Lumens. Applying the new rate schedules to Delaplain's 2009 electric bills, Staff calculates a pro forma electric expense of $55,924, which is $6,203 greater than Delaplain proposed. Accordingly, Staff recommends that the Commission deny Delaplain's proposed adjustment and increase utility expense by $11,967 to reflect the correct expense level of $55,924.

e. Routine Maintenance. Delaplain misclassified payments of $31,500 to Lilly Wastewater Management Inc. ("Lilly"), its licensed operator, in Account No. 701-C Other – Labor, Materials and Expense. Delaplain is currently paying Lilly a monthly routine maintenance fee of $2,500, or $30,000 annually. To correct this error, Staff recommends that the Commission reduce Account 701-C Other – Labor, Materials and Expense by $31,500 and increase Account 710-A, Routine Maintenance Service Fee by $30,000, which results in a net reduction to pro forma operating expenses of $1,500.

[21] Case No. 2009-00548, Application of Kentucky Utilities Company for an Adjustment of Base Rates (Ky. PSC Jul. 30, 2010).

f. Repairs and Maintenance. Delaplain proposes to increase its test period repairs and maintenance expense of $50,494 by $8,645 to reflect a three-year average of the amounts that were reported in Account No. 714, Maintenance of Treatment and Disposal Plant.[22] For the three-year period from 2007 through 2009, Delaplain reported a total maintenance expense of $177,416, which results in an average annual expense of $59,139.[23]

Delaplain contends that the rate reduction that occurred in 2007 resulted in the postponement of many 2009 repair projects due to insufficient funds.[24] Delaplain further contends that the 2009 repairs and maintenance expense of $50,494 was constrained or understated, when compared to the amounts that were reported in 2007 and 2008.[25] For these reasons, Delaplain proposed to use a three-year average to generate funding necessary to complete the deferred repair projects.[26] According to Delaplain, the Commission uses averaging on a frequent basis to normalize expenses that are subject to significant variations, such as storm damage repairs.[27]

Delaplain has not demonstrated that its repairs and maintenance expense is subject to significant variations. Many factors affect the annual level of maintenance

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[22] Application, Attachment A, Adjustment C, Repairs and Maintenance Expense.

[23] Id.

[24] Delaplain's Response to Commission Staff's First Information Request, Item 5(c).

[25] Id.

[26] Id.

[27] Id.

expense. These factors make it virtually impossible to project future levels and render Delaplain's averaging approach inaccurate. For instance, upon review of the general ledgers and invoices for the three-year period proposed by Delaplain, Staff found that Delaplain had incorrectly expensed nonrecurring/capital expenditures totaling $55,725.[28] Table 1 is a comparison of the annual unadjusted and adjusted repairs and maintenance expenses for the three-year period.

Table 1: Three Year Comparison				
	Reported		Adjusted	
Repairs & Maintenance - 2007	$	65,058	$	41,606
Repairs & Maintenance - 2008		61,864		37,164
Repairs & Maintenance - 2009		50,494		42,921
Subtotal	$	177,416	$	121,691

Reducing the three total maintenance expenses by $55,725 results in an average annual expense of $40,564,[29] which is $9,930 below the reported test-period level. In reviewing the comparison in Table 2, Staff concludes that the variations in the adjusted expense amounts are significant and, therefore, Delaplain's proposed use of a three-year average is unsupported. Accordingly, Staff recommends that the Commission deny Delaplain's proposed adjustment and that repairs and maintenance expense be reduced by $7,573[30] to remove the capital expenditures that were incorrectly expensed in 2009.

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[28] $23,452 (Calendar Year 2007) + $24,700 (Calendar Year 2008) + $7,573 (Calendar Year 2009) = $55,725.

[29] $177,416 (Three Year Total Maintenance Expense) - $55,725 (Nonrecurring/Capital Expenditures) = $121,691 ÷ 3 Years = $40,564.

[30] $2,046 (Install New Main Motor, Starter and Power Control) + $2,065 (Sludge Withdraw Piping to Digester) + $1,967 (Purchase and Install Transformer) + $1,495 (Surge Pump) = $7,453.

g. Outside Services. Delaplain reported a test-period outside service expense of $57,141, which includes $43,030 in payments to Ray Consultants, an affiliated company, and a $4,025 payment to Steve Singleton, Delaplain's Secretary and Treasurer.

Ray Consultants billed Delaplain for 660 hours for administrative services and 11 hours for accounting services. Ray Consultants' hourly rates include: a payroll tax factor; an employee benefit factor; an office overhead factor; and an adjustment to market factor.

Table 2: Hourly Rates				
	Administrative		Accounting	
Hourly Wage Rate	$	27.92	$	20.25
Payroll Tax Factor		2.25		1.55
Employee Benefit Factor		6.76		28.44
Overhead Office Factor		32.39		32.39
Error Adjustment		(4.37)		0.00
Adjustment to Market	+	0.00	+	22.37
Total Billable Hourly Rate	$	64.95	$	105.00

Payroll Tax Factor - In calculating the payroll tax factor, Ray Consultants uses the billable hours per employee. By using the billable hours, Ray Consultants is charging to Delaplain the payroll taxes that are not directly related to the services that are being provided. To correctly allocate the payroll taxes directly related to the services being provided to Delaplain, Staff is of the opinion that the payroll tax factor should be based upon the actual hours each employee works in a year, or 2,080 hours per employee.

Employee Benefit Factor - Ray Consultants calculates the employee benefit factor by using the billable hours per employee. For the reason stated above, Staff proposes revising the employee benefit factor to reflect actual hours each employee works in a year, or 2,080 hours per employee.

Office Overhead Factor - In the test period, Ray Consultants incurred office overhead of $61,541 and allocated 35 percent, or $21,733, of that office overhead to Delaplain. Staff considers a $21,733 allocation of office overhead to be excessive for a utility of Delaplain's size. It is the utility's responsibility to demonstrate the reasonableness of its expenses, especially when they result from transactions between affiliated companies.

Adjustment to Market - Ray Consultants increased the hourly accounting rate to reflect a $22.37 adjustment to "approximate what would be paid to a 3rd party."[31] Staff is of the opinion that Delaplain has not provided reasonable justification for the adjustment to market rate of $22.37. Delaplain could avoid this cost by hiring a part-time employee to perform the accounting service. Staff is reducing the billable rate for the accounting services by this fee.

Table 3 contains the hourly rates for Ray Consultants as revised by Staff. Using the revised hourly rates and the actual hours billed by Ray Consultants in the test period, Staff calculates a fee of $23,566,[32] which is $19,464 less than the test-period amount. Accordingly, Staff recommends the Commission reduce outside service expense by that amount.

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[31] Delaplain's Response to Commission Staff's Second Information Request, Item 2(b).

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$35.27 (Staff's Administrative Rate) x 660 (Hours)	$	23,278
$26.18 (Staff's Accounting Rate) x 11 (Hours)	+	288
Pro Forma Administrative & Accounting	$	23,566

Table 3: Staff Revised Hourly Rates				
	Administrative		Accounting	
Hourly Wage Rate	$	27.92	$	20.25
Payroll Tax Factor		2.20		1.61
Employee Benefit Factor		5.15		4.32
Total Billable Hourly Rate	$	35.27	$	26.18

In reviewing Mr. Singleton's invoice,[33] Staff determined that many of the services being provided are duplicative of those being performed by the CPA and do not directly benefit Delaplain's ratepayers. Accordingly, Staff recommends that outside service expense be decreased by an additional $4,025 to eliminate the fee paid to Mr. Singleton.

h. Insurance. Delaplain reported a test-period insurance expense of $5,105. The insurance invoices for the policy period of September 4, 2010 through September 4, 2011 total $2,576, which is $2,529 below the reported test period amount.[34] Accordingly, Staff recommends that insurance expense be reduced by $2,529.

i. Depreciation. Delaplain proposes to increase its test-period depreciation expense of $16,247 by $33,687 to reflect: (1) 12 months of depreciation for utility plant placed in service in 2009; (2) depreciating over three years repairs totaling $5,765 that were completed in 2010; and (3) depreciating over five years capital projects of

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[33] Delaplain's Response to Commission Staff's Second Information Request, Item 3.

[34] Id. Item 5(b). $1,595 (Cincinnati Insurance – Commercial Package) + $981 (Cincinnati Insurance – Boiler and Machinery) = $2,576.

$154,872 that Delaplain contends will ensure the reliable operation of its treatment plant.[35]

Delaplain contends that it is operating under stringent cash flow restrictions caused by its 2008 rate reduction and the 30 percent flow reduction experienced in 2009 and 2010.[36] For this reason Delaplain states that:

> No improvements are currently being authorized unless required to keep the plant operating. When sufficient cash flows can reasonably be projected from rates or surcharges, then Delaplain will be able to develop a projected date for construction start and completion as well as identify any required approvals that may be obtained.[37]

According to Delaplain, the cash flow restrictions are the basis for the proposed depreciation periods of three to seven years and the requested lives will generate "a cash flow sufficient to fund proposed projects in a reasonably brief period of time."[38] Delaplain contends that it lacks access to capital markets to fund the capital projects and must fund these projects with the cash flow generated by the abbreviated depreciation lives.[39]

In a prior decision, the Commission found that, for utilities under its jurisdiction, "[a]djustments for post test-period addition to utility plant in service should not be

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[35] Application, Attachment A, Adjustment E, Depreciation and Amortization Expense.

[36] Delaplain's Responses to Commission Staff's Initial Information Request, Item 7(c).

[37] Id.

[38] Id., Item 7(e).

[39] Id.

requested unless all revenue, expenses, rate base and capital have been updated to the same period as plant additions."[40] In addition, all applications for a general rate adjustment shall be supported by either a 12-month historical test period, which may include adjustments for known and measurable changes, or a fully forecasted test period.[41]

Because Delaplain is unwilling to obtain the financing that is necessary to fund its capital projects and is unable to state a date certain that its proposed capital projects will be constructed, Staff is of the opinion that the proposed depreciation adjustment fails to meet the regulatory criteria of being known and measurable. Furthermore, the purpose of depreciation is to allow a utility to recover the capital expenditure in plant over its estimated useful life and not to generate funds to finance the capital investments that are being depreciated.

The uncertainty of the timing of the project also means that Delaplain is unable to comply with the matching principal as set forth in Case No. 10481.[42] It is important for a utility to match the proposed recovery period of a capital expenditure to its expected life. Failure to properly match the two periods will result in recovering costs that provide a benefit to future rate-payers from the current customer base. Delaplain's proposal to use accelerated depreciation lives results in current customers subsidizing the rates of Delaplain's future customers.

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[40] See Case No. 10481, Notice of Adjustment of the Rates of Kentucky-American Water Company Effective on February 2, 1989 (Ky. PSC Aug. 22, 1989) at 5.

[41] KRS 278.192.

[42] See supra note 39.

Accordingly, Staff recommends that the Commission deny Delaplain's proposal to include depreciation of $30,974 for its projected capital projects. Staff further recommends that depreciation expense be adjusted to eliminate depreciation on utility plant that was funded by Contributions In Aid of Construction and to reflect depreciating the 2009 and 2010 capital projects over their estimated useful lives. Staff's recommendations result in a decrease to depreciation expense of $2,523 as shown in Table 4.

Table 4: Staff's Recommended Depreciation Adjustment					
Contributions In Aid of Construction				$	496,566
Divided by: Utility Plant in Service				÷	1,231,309
Percentage of Contributed Property					40.328%
Multiplied by: Depreciation Expense - 2011				$	(14,902)
Pro Forma Adjustment - CIAC Supported UPIS				$	(6,010)
Plant Description	Cost	Year	Dep. Lives		
Equipment	$ 1,341	2009	7		192
Pump	$ 2,266	2009	7		324
Manhole	$ 6,200	2009	7		886
Equipment	$ 1,258	2009	7		180
Motor starter & power control	$ 2,046	2009	7		292
Sludge withdrawal piping, digester	$ 2,065	2009	7		295
Install transformer	$ 1,967	2009	7		281
Surge pump	$ 1,495	2009	7		214
Air Header Repair	$ 1,088	2010	7		155
Comminutor, Effluent Pumps	$ 2,485	2010	7		355
Air Headers	$ 2,192	2010	7		313
Pro Forma Adjustment				$	(2,523)

j. Rate Case Amortization. Delaplain proposes to increase its test-period operating expenses by $6,333 to reflect amortizing estimated rate case cost of $19,900 over three years.[43] As of the date of the Staff Report, Delaplain has paid $3,752 for the preparation and processing of this rate case: $1,352 to Ray Consultants, and $2,400 to

[43] Application, Attachment A, Adjustment F, Amortization of Rate Case Expense.

Kentucky Small Utility Consulting. Amortizing the $3,752 over three years results in an amortization of rate case cost of $1,251. Staff recommends that the Commission include this amount of amortization in Delaplain's pro forma operating expenses.

k. KPDES Permit. Delaplain proposes to increase taxes other than income tax expense of $7,487 by $272 to reflect amortizing the cost of its KPDES permit of $1,360 over the five-year permit life.[44] Staff is of the opinion that Delaplain's proposed adjustment meets the ratemaking criteria of being known and measurable and that the adjustment is correct. Accordingly, Staff recommends that the Commission accept the adjustment as proposed.

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[44] Id. Adjustment G, Taxes Other Than Income Taxes.

APPENDIX D
STAFF REPORT, CASE NO. 2010-00349
STAFF'S RECOMMENDED RATES

	Proposed Rates
Residential	$ 12.19 per month
Commercial/Industrial	$ 8.67 per 1,000 gal.

Elbert C Ray
President
Delaplain Disposal Company
P. O. Box 4382
Lexington, KY 40544-4382