

Commonwealth of Kentucky  
Before the Public Service Commission

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PUBLIC SERVICE  
COMMISSION

In the Matter of:

APPLICATION OF MALLARD POINT DISPOSAL )  
SYSTEMS, INC. FOR AN ADJUSTMENT OF RATES ) Case No. 2005-00235  
PURSUANT TO THE ALTERNATIVE RATE FILING )  
PROCEDURE FOR SMALL UTILITIES )

POST-HEARING COMMENTS  
OF THE ATTORNEY GENERAL

The Attorney General submits his Post-Hearing Comments on the Application of Mallard Point Disposal System, Inc., for an adjustment in rates.

**DEPRECIATION ON CONSTRUCTION WORK IN PROGRESS ("CWIP")**

In Case No. 2005-00284, the Public Service Commission granted a Certificate of Public Convenience and Necessity for Mallard Point to rehabilitate a 50,000 GPD treatment plant. Work began on this rehabilitation in December 2004; however, as of the date of the public hearing, the project is not complete. While Mallard Point indicates that it will complete the project, the date of completion is uncertain.

The Commission Staff Report, which uses a test period ending 31 December 2004, establishes a depreciation expense that includes a depreciation expense amount for the investment in the 50,000 GPD Renovation project. The Commission should remove this portion of the depreciation expense amount because the work corresponding to the renovation project is not in service.

In reviewing the depreciation expense for an application for an adjustment in rates for the Kentucky-American Water Company, the Commission notes the following in Case No. 10069.

Kentucky-American increased its accumulated depreciation reserve and depreciation expense by \$132,793 to reflect depreciation on \$5,717,165 of CWIP, which included \$3,215,075 of construction projects completed, but not yet transferred to Utility Plant In Service ('UPIS').

Depreciation is included as a rate-making expense in recognition that physical assets are consumed in the process of providing a service or product. However, if the asset is not yet in service it is not being consumed and ratepayers should not be charged depreciation. (footnotes from Commission Order omitted)<sup>1</sup>

In reviewing the depreciation expense for an application for an adjustment in rates for Columbia Gas of Kentucky, the Commission notes the following in Case No. 10498.

Depreciation cannot be allowed on CWIP because plant under construction is not yet in service and it is improper to expense the cost of an asset prior to the asset becoming productive. (footnotes from the Commission Order omitted).<sup>2</sup>

More recently, in reviewing the depreciation expense for an application for an adjustment in rates for the Delta Natural Gas Company, the Commission notes the following in its 10 November 2004 Order for Case No. 2004-00067.

In the determination of the proposed depreciation expense adjustments, Delta and the AG included depreciation

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<sup>1</sup> Ky PSC Case No. 10069, Order, 31 July 1996.

<sup>2</sup> Ky. PSC Case No. 10498, Order, 6 October 1989. Note: In its 11 June 1990 rehearing Order, it was noted that Columbia had properly excluded CWIP from its calculation of depreciation.

expense on CWIP. Neither offered any explanation or justification as to why depreciation on CWIP was included in the proposed depreciation expense adjustments.

CWIP represents the total of the balances of work orders for gas plant under construction. As such, this gas plant is not available for or providing service to customers. Depreciation, as defined in the Uniform System of Accounts, means the loss in service value not restored by current maintenance, which is incurred in connection with the consumption or prospective retirement of the gas plant. Consequently, the Commission generally does not calculate depreciation expense on CWIP. In the event a utility proposed to recognize new plant additions occurring after test-year end, it might be appropriate to recognize a level of depreciation expense on the new plant additions. However, in this case, Delta did not propose the recognition of any new plant additions occurring after test-year end. Accordingly, the Commission finds that depreciation expense on CWIP should not be included for rate-making purposes. (footnotes from the Commission Order omitted)

With regard to the depreciation expense, the Staff Report removes certain 1986 Sewer Plant Additions that became fully-depreciated on 31 December 2005,<sup>3</sup> due to the fact that the associated depreciation expense for these assets will not be an on-going expense after 2005.<sup>4</sup> The Staff adjustment is consistent with 807 KAR 5:001 § 10 (7), which states, in part, the following: "Upon good cause shown, a utility may request pro forma adjustments for known and measurable changes to ensure fair, just and reasonable rates based on the historical test period." The removal of the depreciation for the 1986 Plant Additions is consistent with Commission regulation and precedent.

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<sup>3</sup> Mallard Point Response to Item No. AG-1-11.

<sup>4</sup> Commission Staff Report, pages 8 and 9.

Given that the Commission is reducing depreciation expense for the recognition of a known and measurable post-test year change, the Attorney General does not object to the recognition of depreciation expense for new plant additions placed into service through the same time period, 31 December 2005. The CWIP for the renovation project does not fall into this category, and (as per Delta, Case No. 2004-00067) the recognition is proper only for new plant additions placed into service post-test year rather than CWIP.<sup>5</sup>

Setting rates that recover depreciation expense for CWIP for the renovation project runs directly contrary to Commission precedent. Further, the renovations do not fall within the "known and measurable" exception, because the date on which the renovation will be complete is only speculation. By comparison, the Commission routinely rejects post-test year adjustments for salary increases in the absence of an actual approval of the increase rather than a mere good-faith projection or estimate.<sup>6</sup>

Accordingly, the Attorney General objects to the inclusion of a depreciation expense for the renovation project.

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<sup>5</sup> Further, with regard to depreciation expense for post-test period plant placed into service, the Commission will reflect only those costs for plant additions that are "known and measurable" and "substantial by original cost data or contractor bids." See Ky. PSC Case No. 2002-00105, (Northern Kentucky Water District) Order, 30 April 2003, pages 16 and 17.

<sup>6</sup> Ky PSC Case No. 2003-00034, Order, 19 September 2003 ("Ohio [County Water District] also proposed to increase test year employee salaries and wages by \$14,496 for employee pay raises anticipated to be effective July 1, 2003. At the time of Staff's field visit the pay raise was neither effective nor approved by Ohio's board of Commissioners. Staff recommends that the adjustment be denied as it is not known and measurable.")

WHEREFORE, the Attorney General submits his Post-Hearing Comments.

Respectfully submitted,

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*Certificate of Service and Filing*

Counsel certifies filing of the original and ten photocopies of the Attorney General's Post-Hearing Comments by hand delivery to Beth O'Donnell, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; furthermore, service of the filing was by mailing a true and correct of the same, first class postage prepaid, to James M. Mooney, Moynahan, Irvin & Smith, P.S.C., 110 North Main Street, Nicholasville, Kentucky 40356, and Mark S. Smith, President, Mallard Point Disposal Systems, Inc., 104 Teal Court, Georgetown, KY 40324, all on this 10<sup>th</sup> day of March 2006.

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Assistant Attorney General