Robert A. Patrick
144 Greenwing Ct.
Georgetown, Kentucky 40324

March 6, 2006

Beth O'Donnell, Executive Director
Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40601

Re: Case No. 2005-00235

Dear Ms. O'Donnell:

Enclosed please find the original and ten copies of my post hearing comments in the above referenced matter. I have also sent copies to Assistant Attorney General David Spenard and to James M. Mooney, counsel for the Applicant.

Sincerely,

Robert A. Patrick

Robert A. Patrick

Enclosures

cc: James M. Mooney, Esq.
David E. Spenard, Esq.

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PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:)
Application of Mallard Point Disposal Systems, Inc.)
For an Adjustment of Rates Pursuant to the) Case No. 2005-00235
Alternative Rate Filing Procedure for Small Utilities)

Post Hearing Comments

Analysis of the current financial position of the Applicant and its apparent inability to meet operating expenses from current revenues, resulting in this application for a rate increase, should include consideration of the following:

1. From 1984 until 1989, i.e. the first five years of its existence, the Applicant did not charge its customers, although it had PSC approval to charge a rate of $22.18 per month. (Affidavit of Mark S. Smith, 8/31/04, ¶ 2) Assuming the number of customers averaged between 50 to 100 during that period, the business decision of the Applicant to forgo charging its customers resulted in an earnings loss of between $66,000 and $133,000. While this decision may have benefited the then residents of Mallard Point, it would also promote the development of Mallard Point, since new homeowners would not have to pay for sewer service. This would have also directly benefited the Applicant's Owner, as one of the developers of Mallard Point.

2. Had the Applicant held all or a substantial portion of that amount as retained earnings, it could have been applied to future capital improvements. Had it been used to defray operating expenses it would have substantially reduced the amount subsequently paid out to the Owner in 2003. (See, ¶ 3 below) The decision by management to forego revenues in its early years of operation is one of a series of decisions which have

impaired the financial condition of the Applicant and for which the Applicant now seeks relief at the expense of the ratepayers.

3. According to the Owner, the Applicant began assessing monthly sewer charges of $22.18 to existing customers in 1989. These were increased first to $31.10 per month in 1994, and in 2004 to $35.29 per month. Nonetheless, the Applicant "operated at a loss, which necessitated regular contributions of *capital* from [the Owner] in the form of loans." (Affidavit of Mark S. Smith, 8/31/04, ¶ 3) (Emphasis added.)

4. On March 31, 2003, the Applicant agreed, as part of a refinancing, to convert the Owner's capital contributions to long term debt of the Applicant. The Applicant's financial condition was sufficiently robust, to enable it to refinance existing long term debt and to borrow an additional $280,000, which was paid to the Owner. (Affidavit of Mark S. Smith, 8/31/04, ¶ 7)

5. Had the Applicant retained that additional $280,000 for operating purposes, it could have completed the capital improvements associated with the rehabilitation of the treatment facility. Instead, a company that could not meet its operating expenses increased its long term debt by 40%, paid out the Owner's capital contributions, and passed interest on the long term debt as an expense to the ratepayers. Within months of the refinancing the Applicant applied for a rate increase and a permit to rehabilitate the treatment facility.

6. According to the Applicant, annual interest on the long term debt of $680,000 is $49,045 (Application, item q). This represents 29% of estimated revenues ($169,684) contained in the Staff Report. In addition, the Applicant reports expenses for accounting ($7,200), rent ($6,600), bookkeeping ($5,400), Owner administrative expenses ($3,600), and legal counsel ($5,000). These amounts when combined with interest on long term debt total $76,845 or 45% of estimated revenues. The expenditure 45 cents of every revenue dollar for these expenses, and the fact that the Applicant reports a negative equity position, is crippling the Applicant's ability to obtain bank financing. Increasing the Owner's management fee to pay expenses to the Owner will only make the Applicant's ability to obtain that financing more difficult.

7. The staff report attached to the Commission's Order dated October 12, 2005, recommended that the Commission approve an owner/operator expense of $3,600, consistent with the Commission's long standing position on this issue.

The Applicant has requested approval of an owner/manager fee of $35,000 and has provided a list of activities in support of that request. (Answer to Interrogatory AG-1-7) While no discovery has been taken with respect to the material in this response, it is strange that a disposal system with 397 customers at the end of 2005, and only one complaint in its history, would generate 550 calls annually from customers related solely to the disposal system. One would also not anticipate, given the general economic level of the residents of Mallard Point, that nonpayment of rates would generate an additional 300 calls.

8. Since the Applicant has a licensed operator and another individual who is familiar with the system, it is not clear why the Owner would have to make twice daily inspections of the facility or be personally involved in locating sewer taps, providing facility access to sludge removal personnel, or supervising electricians in connection with pump failures.

9. My intention is not to question the creditability of the Interrogatory response. It is to point out that if the Commission is to consider changing this particular long standing policy, it should do so based upon more than untested assertions in a single application. Such a change will have implications for the ratepayers of at least all privately operated sewer and water systems within the Commonwealth. Any such change should be carefully crafted within the Uniform Accounting System applicable to these systems with guidance regarding expenses that may be authorized and the documentation necessary to support them. Otherwise, there will be no end to the expense requests the Commission will face in future rate adjustment proceedings.

10. In conclusion, I would urge the Commission to consider any rate increase in combination with instructions designed to cabin the exploding administrative expenses of the Applicant and place the Applicant on a sound financial footing by directing more of the revenue received from the ratepayers to the actual operation and improvement of the sewer system itself.

Respectfully submitted,

Robert A. Patrick   March 8, 2006

Robert A. Patrick   Date
Limited Intervener

Attachment

AFFIDAVIT OF MARK S. SMITH

Comes the affiant, Mark S. Smith, President of Mallard Point Disposal Systems, Inc., and after being duly sworn, states as follows:

1. I am the President and sole owner of Mallard Point Disposal Systems, Inc. ("MPDS"), a Kentucky corporation. MPDS was formed in and around 1984, and formally incorporated in 1985, for the purpose of providing sewage treatment services under the regulatory oversight of the Kentucky Public Service Commission ("PSC").

2. MPDS was authorized by the PSC to receive an initial monthly service rate of $22.18 per month but, as a benefit to its ratepayers, it did not bill any of its customers for approximately the first five (5) years of its existence. Sometime in 1989, MPDS began charging its customers its initial monthly service rate, and continued to do so for the ensuing five (5) years. In 1994, MPDS sought, and the PSC granted, an increase of its ten (10) year old rate to $31.10. 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).

3. During these years and thereafter, however, MPDS operated at a loss, which necessitated regular contributions of capital from me in the form of loans. MPDS has and continues to be operated out of my home and truck, with a handful of independent contractors, without an office location, equipment, or support. Until recently, that operating environment impeded orderly businesslike operations and, consequently, evidence of those losses and the need for additional capital was sometimes lacking. Similarly, some of those loans to, and repayments by, MPDS were properly documented and some were not. Most were not. Unfortunately, whatever documentation did exist concerning these matters was inadvertently destroyed by a third party while in the possession of MPDS's accountant. See letter of explanation regarding the inadvertent destruction MPDS's records in the file of PSC staff.

4. On July 7, 2003, because of the increasing age of its facilities and the increasing inability to cover its operating expenses, MPDS sought only its second rate increase in its nearly twenty (20) year existence. During that proceeding, MPDS's poor bookkeeping practices, including the commingling of its funds with my personal accounts, were noted and criticized throughout the proceeding. MPDS acknowledged these errors, and voluntarily agreed to segregate its business from mine, computerize its operations, reconcile its operating accounts, and retain copies of its vendor invoices commencing January 1, 2004. Accordingly, as a part of its Order dated May 27, 2004, the PSC required MPDS to submit quarterly filings containing its monthly bank reconciliations, its receipts and disbursements journal, and copies of vendor, maintenance, and chemical invoices. MPDS was only granted a rate increase to $35.29. See Consolidated Case Nos. 2003-00283 and 2003-00284 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; (2) the Approval of the Proposed Plan of Financing; and (3) an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities.

5. On July 12, 2004, MPDS submitted its first such filing covering the first two (2) quarters of 2004. That filing demonstrates that MPDS has now ceased commingling its money with mine. It also reveals that MPDS's current rate is insufficient to generate the income necessary to cover its day-to-day operating expenses, let alone service the debt on the proposed

loan to rehabilitate is facilities, which loan transaction MPDS is now unable to close. Indeed, from the beginning of the year to date, MPDS has encountered losses in excess of $47,000,00, monies I have loaned to MPDS to keep it operable. When approved depreciation is added, that total loss is in excess of $74,000.00 to date. MPDS intends to seek another adjustment of its rate pursuant to the alternative rate filing procedure for small utilities in the near future in order to address these problems.

6. Prior to 2004, I commingled MPDS receipts with my personal funds, which obscured the true operational cost for MPDS. Only now, since those funds have been segregated, has the magnitude of MPDS's operating deficit been realized. Unfortunately, what records would have helped reconstruct that deficit were inadvertently destroyed. What does exist though, is a detailed operational picture and profile of MPDS as set forth in its filing covering the first two (2) quarters of 2004. All expenses contained therein are recurring, operational, and absent any type of capital expenditure. Consequently, those current expenses provide support for my past loans, which I project to be in excess of a half a million dollars over the past ten (10) years alone.

7. It has recently come to MPDS's attention that it was required to obtain prior PSC approval of a March 31, 2003 refinance and increase of its long-term debt in the approximate amount of $680,000.00 over the course of a twenty (20) year term. A portion of that total in the approximate sum of $400,000.00 represents long-term debt dating back the initial construction, and the additional borrowings in the approximate amount of $280,000.00 were used to repay indebtedness owed to me for loans used to cover the continuing annual operating deficits incurred by MPDS in previous years mentioned above. The purpose of that refinancing was to serve a lawful object within the corporate purposes of MPDS. It was necessary and appropriate for and consistent with the proper performance by MPDS of its service to the public. It has not impaired MPDS's ability to perform that service. Finally, it was reasonably necessary and appropriate for such purpose.

8. MPDS was unaware of its obligation to seek prior approval from the PSC for its March 31, 2003 refinance and increase of its long-term debt in the amount of $680,000.00. Its failure to do so was not intentional, and MPDS now seeks that authorization ex post facto.

9. Further the affiant sayeth naught.

MALLARD POINT DISPOSAL SYSTEMS, INC.

____

Mark S. Smith, President

STATE OF KENTUCKY)
COUNTY OF FAYETTE)

The foregoing was executed before me by Mark S. Smith, President of Mallard Point Disposal Systems, Inc. on this the 31 day of August, 2004.

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NOTARY PUBLIC

My commission expires: January 11, 2007