

**COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION
CASE NO. 2005-00235**

In the Matter of:

APPLICATION OF MALLARD POINT
DISPOSAL SYSTEMS, INC. FOR AN
ADJUSTMENT OF RATES PURSUANT TO THE
ALTERNATIVE RATE FILING PROCEDURE
FOR SMALL UTILITIES

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POST HEARING BRIEF
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Comes now the Applicant Mallard Point Disposal Systems, Inc., and submits its Post Hearing Brief.

INTRODUCTION

The genesis for this action is found in that certain consolidated action for a rate increase and approval for financing filed under the alternative rate adjustment procedure for small utilities by the Applicant here, Mallard Point Disposal Systems, Inc. (Mallard Point), back in July, 2003. *See* In the Matter of Mallard Point Disposal Systems, Inc., Commonwealth of Kentucky, Public Service Commission, Case No. 2003-00284. In that action, Mallard Point sought a certificate of public convenience and necessity for the rehabilitation of its 50,000 gallon wastewater treatment facility, approval for financing the same, and an accompanying adjustment of rates with which to fund that rehabilitation and cover increasing operational costs. *Id.*; Video Recording of Hearing held February 22, 2006 (VRH), 9:17:07-9:17:20.

During that proceeding, Mallard Point was criticized for having failed to maintain adequate business records with which to support its application, VRH 9:18:05-9:18:50, including vendor invoices, bank records and the like, and for having failed to segregate its business affairs from that of its owner and President, Mark S. Smith. Up to that point, Mr. Smith had operated

the utility more as a private business than a regulated entity, doing so out of his home and truck, and subsidizing it out of his own pocket when necessary. VRH 9:17:50-9:18:05. Mallard Point's first rate adjustment application was not until 1994 – ten (10) years after its inception; its second was in 2003. VRH 10:10:30-10:10:38.

At the hearing held in that action, Mallard Point acknowledged its past problems and pledged to correct them going forward. In May 2004, the PSC granted Mallard Point's Application and adjusted its rate and, in an attempt to ensure correction of its past conduct, further ordered it to file quarterly reports of its business activities containing vendor invoices, chemical and maintenance reimbursement invoices, copies of monthly bank statements, and a copy of a cash receipts and disbursements journal, all commencing January 1, 2004. *See* In the Matter of Mallard Point Disposal Systems, Inc., Commonwealth of Kentucky, Public Service Commission, Case No. 2003-00284, Order dated May 27, 2004.

Mallard Point's business practices are now much improved. VRH 9:19:00-9:20:00. It now maintains all invoices and receipts pertinent to its business, reconciles its bank statements every month, and has meticulously separated its finances from that of its owner. VRH 9:20:05-9:20:40. Its office has been moved out of Mr. Smith's truck and home to a business location. VRH 9:15:15. Mallard Point has made and continues to make all of its quarterly filings to the Commission. It has also retained legal and accounting help with all of these things, and in an attempt to keep it compliant.

Mallard Point's quarterly reports have now demonstrated what Mallard Point has known all along – that the last adjusted rate is insufficient to pay the day-to-day obligations of the utility, let alone finance the rehabilitation of the 50,000 gallon wastewater facility. Mr. Smith has loaned Mallard Point approximately \$100,000 since 2004 just in order for the utility to meet

those obligations. VRH 9:19:00-9:19:10. The rehabilitation, which is anywhere between 60% to 80% completed, is still not quite finished. VRH 9:47:35-9:49:55; VRH 9:21:05-9:21:12.

This action was commenced June 20, 2005 upon Mallard Point's Application for another adjustment of rates in order to address these problems. Mallard Point's quarterly reports for 2004 largely provide the basis for its Application, which was initially prepared by Staff. Mallard Point mostly agreed with the Staff's effort, but did modify the Application in some respects, which modifications were the subject of the hearing held in this matter.

ARGUMENT

I

MALLARD POINT'S OWNER/MANAGER EXPENSE SHOULD BE INCREASED TO \$35,000.00.

Commission Staff has recommended that Mr. Smith receive the annual sum of \$3,600 for an Owner/Manager fee, which has historically been the amount allocated by the Commission for that item, VRH 11:06:15-11:06:40, regardless of the amount of time and attention that operator may provide to the utility. VRH 11:06:40-11:07:10. Commission Staff states that that amount was derived from the statutory fee paid to water district commissioners, and argues that it is fair here because Mr. Smith, as the sole shareholder of Mallard Point, could compensate himself for the work that he performs from the net profits from the utility. VRH 11:21:40-11:22:35. Unfortunately, however, Mallard Point is operating at a deficit and no such profits are available with which to do so. VRH 11:22:35-11:22:50.

Unlike a passive owner – or a water district commissioner who only attends meetings – who might be adequately compensated by that small amount, Mr. Smith has been required to spend an increasing amount of time operating Mallard Point over the past several years as it has grown in size. VRH 9:22:00-9:23:40. He now spends 3 to 4 hours per day on Mallard Point business, VRH 10:35:00-10:35:07, is on call twenty four (24) hours and day, three hundred sixty

five (365) days a year, VRH 9:22:20-9:23:05, and personally responds to every customer call for service. But because he did not document his activities, Mallard Point's request was not considered by Commission Staff, VRH 11:07:00-11:07:50, which documentation was the largest impediment to the Commission Staff's refusal to recommend anything more than \$3,600. VRH 11:23:10-11:24:40. By his calculation, the annual sum of \$3,600 would compensate Mr. Smith at the rate of \$0.41 per hour. VRH 9:31:30-9:31:45.

Normal, everyday utility demands on Mr. Smith's time over the past several years, including the test year, include but are not limited to the following:

- A minimum of 550 calls from customers covering an array of topics;
- Weekly correspondence with lab and/or other contractors on compliance chemical testing and monitoring;
- Daily discussions with the licensed plant operator regarding plant operations;
- Daily conversations and supervision of the maintenance contractor for the plant;
- Twice daily personal inspections of the plant facilities;
- Contact with and supervision of electricians on multiple occasions for failures to the systems (pumps, pump stations, etc);
- Monthly contact and scheduling of sludge removal;
- Meet sludge removal personnel to allow access to the plants for same;
- Meet with builders and or property owners to assist the finding of the sewer taps for connection to the system;
- Obtaining and supervising personnel and/or contractors for repairs to leaks within the system, on multiple occasions;
- Supervise and provide oversight to the bookkeeper, and assist in her record keeping;
- Obtain and retain receipts for all expenditures of the utility;
- Make no less than 300 calls per year to customers for the purpose of collection of past due accounts;
- Participate and supervise the shut off of any customer for non payment;
- Meet in person and over the telephone with the accountant on multiple occasions to perform such work as required and needed;
- Meet in person and over the telephone with the attorney on multiple occasions for

clarification of the law with respect to the utility's operation;

- Make contact with and seek direction from the PSC staff for the operation of the utility on multiple occasions;
- Meet with state regulators on multiple occasions for the purposes of inspections and operational conferences;
- Deliver monthly DMRs to the post office for certified mailing to multiple state agencies;
- Meet with plumbers and electricians on multiple occasions to explain how our system works and how to properly install same, as this is the largest pressure system within the state and many plumbers and or electricians are not familiar with how to complete and perform installation.

VRH 9:23:40-9:26:07.

Moreover, none of those duties include the oversight Mr. Smith is required to provide – at the risk of substantial penalty for nonperformance – imposed by the Kentucky Division of Water. VRH 9:28:00-9:29:30. Mallard Point would prefer that Mr. Smith continue to perform these ever increasing duties and responsibilities for the fair and reasonable compensation requested, but if not, Mallard Point will have to hire a contractor or management firm to perform them in the future. VRH 11:43:10-11:45:40.

Given the above duties performed by Mr. Smith, over and above those performed by a passive owner or a water district commissioner who may only attend a monthly meeting, Mallard Point is entitled to recover a fair Owner/Manager fee. Mallard Point requests the sum of \$35,000 as fair compensation for those duties.¹

¹ Such an award would not be a first for the Commission. The Commission has in the past permitted recovery of more than a \$3,600 Owner/Manager fee. *See* In the Matter of The Application of the Knott County Water & Sewer District for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities, Case No. 2002-00292 (\$16,648 manager's salary); *also see* In the Matter of The Application of Delaplain Disposal Company for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities, Case No. 1991-00282 (\$13,692 management fee). Commission Staff Report, pp. 5, 6.

II

MALLARD POINT IS ENTITLED TO DEPRECIATE THE 50,000 GPD WASTEWATER FACILITY DURING THE PERIOD OF ITS RENOVATION.

The general rule regarding an asset under construction is that all costs are capitalized into that asset until it is placed in service. Once placed in service, depreciation can commence over the asset's useful life.

Mallard Point's 50,000 gallon wastewater treatment facility is an asset that is already in service, and has continued to be in service during the period of its rehabilitation beginning December 2004. Answers by Applicant Mallard Point Disposal Systems, Inc. to the Attorney General's First Information Request, Item No. AG-1-3; VRH 9:47:40-9:50:00. Consequently, those rehabilitation costs are and properly have been added to the depreciable asset schedule as they are incurred, because they are being placed in service immediately. Commission Staff has also recommended that that depreciation be allowed as a known and measurable item. VRH 11:13:40-11:15:00.

III

MALLARD POINT'S REPAIR EXPENSE SHOULD BE INCREASED BY \$987.00 BECAUSE THE COST FOR REPLACEMENT OF BLOWER TRANSFORMERS IS A REPAIR EXPENSE, AND NOT A CAPITAL IMPROVEMENT.

Commission Staff moved the \$987.00 cost for the replacement of blower transformers from repair expenses listed on Appendix C of its Report and amortized it.² Commission Staff maintains that this type of repair is nonrecurring, *i.e.* it will not occur on an annual basis, and therefore it is properly amortized. VRH 11:17:21-11:18:06. However, those transformers are neither a major component of Mallard Point's facilities, nor such a major repair so as to extend the useful life thereof or add to their value – and that is the proper standard against which to test

² Staff Report, Appendix C, Comment e., p. 8.

whether an item is a repair expense or a capital improvement. They are “plug in” parts with only a 30-day warranty, and are properly expensed. VRH 9:40:35-9:41:10; VRH 10:06:00-10:06:15. Accordingly, Mallard Point’s proposed repair expense should be increased by an additional \$987.00.

IV

MALLARD POINT IS ENTITLED TO RECOVER THE INTEREST ON THE SHORT TERM DEBT INCURRED ON THE LOANS FROM MR. SMITH USED TO PAY ITS OPERATIONAL SHORTFALL.

Over the past twenty seven (27) to twenty eight (28) months, Mallard Point has been forced to borrow from Mr. Smith amounts approximating \$100,000, VRH 9:20:45-9:21:05, all of which was used by Mallard Point to cover monthly recurring operational expenses, and none of which was used to make capital improvements. *See* Mallard Point’s Quarterly Reports; VRH 10:12:40-10:12:50. Promissory notes memorializing the same may be found attached to Mallard Point’s Quarterly Reports. *See* Mallard Point’s Quarterly Reports³; VRH 10:12:15-10:12:40.

Commission Staff has recommended that Mallard Point not recover these costs because it is Mr. Smith’s obligation to monitor Mallard Point’s financial condition and seek rate relief in a timely manner. Commission Staff Report, p. 12. However, Mallard Point did seek relief from its \$31.10 rate in a timely manner, *see* In the Matter of Mallard Point Disposal Systems, Inc., Commonwealth of Kentucky, Public Service Commission, Case No. 2003-00284, but its requested rate of \$45.16 was denied because of its poor recordkeeping. *Id.*; Order dated May 27, 2004. The new rate was set at \$35.29 which, from the start, would be insufficient to pay the day-to-day obligations of the utility, let alone finance the rehabilitation of the 50,000 gallon wastewater facility.

³ A portion of those loaned monies, while memorialized by promissory notes, have not yet been reported and documented to the Commission, because they have only been loaned in the first two (2) months of 2006. They will be contained in Mallard Point’s 1st quarter filing due April 15, 2006.

Mallard Point was ordered to file quarterly reports of its business activities containing copies of its vendor, chemical, and maintenance reimbursement invoices, its monthly bank statements, and a cash receipts and disbursements journal, all commencing January 1, 2004. *See* In the Matter of Mallard Point Disposal Systems, Inc., Commonwealth of Kentucky, Public Service Commission, Case No. 2003-00284, Order dated May 27, 2004. Mallard Point has done so, and it now seeks to recover the costs identified as a result of that exercise, costs which had to be borrowed from Mr. Smith in order to permit the utility to meet its day-to-day obligations. It would not only be ironic for the Commission to refuse to allow Mallard Point to recover this interest cost – or the principal balance – incurred as a direct result of the very bookkeeping the Commission had ordered, but such a denial would also serve as a *de facto* fine on Mallard Point for its prior poor recordkeeping, particularly here, where those loans were necessary to keep the utility on sound financial footing. At the least, such a denial would be wholly inappropriate, burdensome and overly severe by its mere size and dollar amount.

CONCLUSION

For all of the foregoing reasons, Mallard Point respectfully requests the Commission to award it a flat residential rate that is fair, just and reasonable, and which includes the items addressed hereinabove. Mallard Point also requests the Commission to include in that rate the additional attorney and accounting fees incurred by it during this proceeding.

JAMES M. MOONEY
MOYNAHAN, IRVIN & SMITH, P.S.C.
110 NORTH MAIN STREET
NICHOLASVILLE, KENTUCKY 40356
(859) 887-1200

COUNSEL FOR APPLICANT MALLARD POINT
DISPOSAL SYSTEMS, INC.

CERTIFICATE OF SERVICE

I hereby certify that the original and eight (8) copies hereof were mailed, postage prepaid,

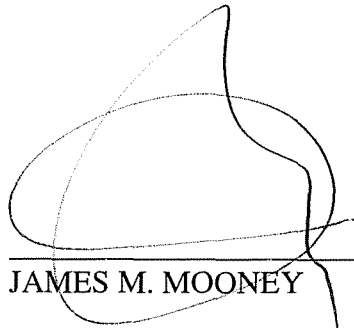
to the following:

Kentucky Public Service Commission
P.O. Box 615
211 Sower Boulevard
Frankfort, Kentucky 40602-0615

and that a copy of the foregoing was mailed, postage prepaid, to the following:

Honorable David Edward Spenard
Office of the Attorney General
1024 Capital Center Drive, #200
Frankfort, KY 40601-8204

on this the 9th day of March, 2006.

A handwritten signature in black ink, appearing to read 'James M. Mooney', is written over a horizontal line. The signature is stylized and somewhat abstract.

JAMES M. MOONEY

COUNSEL FOR APPLICANT MALLARD POINT
DISPOSAL SYSTEMS, INC.

LAW OFFICES
MOYNAHAN, IRVIN & SMITH, P.S.C.
110 NORTH MAIN STREET
NICHOLASVILLE, KENTUCKY 40356

Kentucky Public Service Commission
P.O. Box 615
211 Sower Boulevard
Frankfort, Kentucky 40602-0615

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