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David G. Absher
122 Greenwing Ct.
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October 12, 2005

RE: Case No. 2005-00235

We enclose one attested copy of the Commission's Order in the above case.

Sincerely,

A handwritten signature in black ink, appearing to read "Beth O'Donnell".

Beth O'Donnell
Executive Director

BOD/jc
Enclosure

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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) CASE NO.
THE ALTERNATIVE RATE FILING) 2005-00235
PROCEDURE FOR SMALL UTILITIES)

ORDER

On June 20, 2005, Mallard Point Disposal Systems, Inc. ("Mallard Point") tendered its application requesting the Commission to approve its proposed increase in sewer rates. In Case No. 2003-00284,¹ the Commission ordered Mallard Point to file quarterly financial reports.² The Commission finds that those quarterly financial reports should be incorporated herein by reference.

Commission Staff, having performed a limited financial review of Mallard Point's operations, has prepared the attached report containing Staff's findings and recommendations regarding the proposed rates. All parties should review the report carefully and submit any written comments on Staff's findings and recommendations or requests for a hearing or informal conference no later than October 17, 2005.

¹ Case No. 2003-00284, Application of Mallard Point Disposal Systems, Inc. for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities (Ky. PSC May 27, 2004).

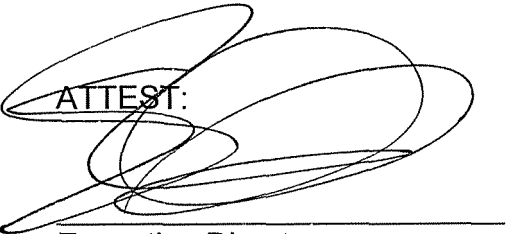
² Mallard Point's quarterly reports contain legible copies of the vendor invoices, copies of the chemical and maintenance reimbursement invoices, bank reconciliations, and the cash receipts and disbursements journal for the months in that quarter.

IT IS THEREFORE ORDERED that:

1. Mallard Point's quarterly financial reports that have been filed in Case No. 2003-00284, are hereby incorporated herein by reference.
2. All parties shall, no later than October 17, 2005, submit written comments, if any, regarding the attached Staff Report or requests for a hearing or informal conference.
3. Any party filing a request for a formal hearing is to include in said request its comments as to the particular finding of the Staff Report to which it objects and a brief summary of testimony it would present at a formal hearing.
4. If no request for a formal hearing or informal conference is received by this date, this case shall stand submitted to the Commission for a decision on all issues raised by the application.

Done at Frankfort, Kentucky, this 12th day of October, 2005.
By the Commission

ATTEST:



Executive Director

STAFF REPORT
ON
MALLARD POINT DISPOSAL SYSTEMS, INC.
CASE NO. 2005-00235

On June 20, 2005, Mallard Point Disposal Systems, Inc. ("Mallard Point") tendered its application requesting the Commission approve its proposed increase in sewer rates. The proposed sewer rates will generate annual revenues of \$247,467, \$82,023 or 49.6 percent over Mallard Point's normalized test period revenues from rates of \$165,444.³

Pursuant to a request by Mallard Point for assistance with the preparation of a rate application, Commission Staff performed a limited financial review of Mallard Point's test period operations, the calendar year ending December 31, 2004. In performing its limited financial review, Staff examined the quarterly financial reports that the Commission has incorporated into the record in this current proceeding. The scope of Staffs 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 Jessamyn Thompson of the Commission's Division of Financial Analysis performed the limited financial review of Mallard Point's test-period operations. Mr. Frost is responsible for the preparation of this Staff Report, with the exception of the

³ Application, Exhibit E, Revenue Requirement and Rate Determination.

determination of normalized operating revenue and the rate calculation, which were prepared by Ms. Thompson.

Upon completion of its limited review, Staff developed and presented to Mallard Point a draft rate application containing (1) an income statement with proposed operating expense reclassifications and (2) a pro forma income statement reflecting Staffs findings and recommendations. Mallard Point agreed with Staffs operating expense reclassifications, but disagreed with several of Staffs findings and recommendations. For this reason Mallard Point revised Staffs proposed pro forma income statement.

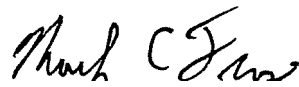
Exhibits A and B of the application, attached hereto as Appendix A, is the income statement showing Staffs reclassification of Mallard Point's test-period operating expenses. Appendix B contains the comparison of Mallard Point's actual and pro forma operations, which is contained in Exhibits C and D of the application. Based upon Staffs recommendations, Mallard Point's operating statement would appear as set forth in Appendix C.

As shown in Appendix D, Staffs recommended pro forma operations, and an 88 percent operating ratio, results in a revenue requirement from rates of \$192,662, an increase of \$22,978 or 13.54 percent over Staffs normalized revenue from rates of \$169,684. Staffs recommended revenue requirement from rates will allow Mallard Point to cover its pro forma operating expenses, meet the debt service requirements, and provide for future equity growth.

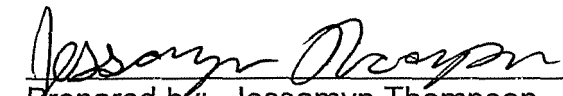
Using Mallard Point's responses to the interrogatories, Staff has established for rate-making purposes that there are 400.69 residential equivalents. To calculate the

monthly revenue requirement of \$16,055, Staff has divided the total revenue requirement from sewer rates of \$192,662 by 12 months. Dividing the monthly revenue requirement by the 400.69 residential equivalents calculates a flat residential rate of \$40.07 per month. Staff recommends the Commission direct Mallard Point to bill each residential customer the flat monthly rate and to bill the commercial customer the flat monthly rate per residential equivalent.

Signatures



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



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

APPENDIX A
STAFF REPORT CASE NO. 2005-00235
OPERATING EXPENSE
RECLASSIFICATION

Account Titles	Test Period Actual	Reclassification Adjustments	Adj. Ref.	Reclassified Operations
Operating Revenues:				
Residential	\$ 154,894	\$ 0		\$ 154,894
Commercial	7,861	0		7,861
Total Operating Revenues	<u>\$ 162,755</u>	<u>\$ 0</u>		<u>\$ 162,755</u>
Operating Expenses:				
Operation & Maint. Exp:				
Owner/Manager Fee	\$ 0	\$ 0		\$ a
Sludge Hauling	8,521	0		8,521
Utility Service:				
Electricity	7,965	0		7,965
Water	456	0		456
Office Utilities	0	0		0
Other - Labor, Materials & Exp.				
Contract Labor	33,545	(2,385)	(1)	31,160
Contract Service - Routine Maint.	12,315	(615)	(2)	11,700
Part-Time Labor	0	2,325	(3)	2,325
Fuel/transportation	2,324	0		2,324
Laboratory/fleeting	11,520	0		11,520
Chemicals	2,038	0		2,038
Maint - Treatment & Disposal Plant				
Maintenance	382	675	(4)	1,057
Miscellaneous	159	0		159
Parts	3,442	0		3,442
Repairs	4,500	0		4,500
Office Supplies				
Bank Service Charges	825	0		825
Dues & Subscriptions	160	0		160
Office Supplies	1,210	(771)	(5)	439
Penalties	117	0		117
Postage & Delivery	198	1,668	(6)	1,866
Outside Services Employed – Acc.	9,547	(897)	(7)	8,650
Insurance	1,486	0		1,486
Rent	0	0		0
Total Operation & Maint. Exp.	<u>\$ 100,710</u>	<u>\$ 0</u>		<u>\$ 100,710</u>
Depreciation	22,666	0		22,666
Amortization	7,144	0		7,144
Taxes Other than Income Tax	4,239	0		4,239
Total Operating Expenses	<u>\$ 134,759</u>	<u>\$ 0</u>		<u>\$ 134,759</u>
Net Operating Income	<u>\$ 27,996</u>	<u>\$ 0</u>		<u>\$ 27,996</u>
Other Deductions:				
Interest Long-Term Debt	\$ 51,758	\$ 0		\$ 51,758
Other Interest	2,037	0		2,037
Total Other Deductions	<u>\$ 53,795</u>	<u>\$ 0</u>		<u>\$ 53,795</u>
Net Income	<u>\$ (25,799)</u>	<u>\$ 0</u>		<u>\$ (25,799)</u>

Adj. Ref.	Account		Description	Amount
	Source:	Destination:		
(1)	Contract Labor	Part-Time Labor	Hager Laborer	\$ (1,525)
	Contract Labor	Part-Time Labor	McDaniels	(500)
	Contract Labor	Maintenance	Danny's Welding	(360)
	Net Reclassification Adjustment			<u>\$ (2,385)</u>
(2)	Contract Service - Routine Maint.	Maintenance	Vendor: Skinner Welding	\$ (40)
	Contract Service - Routine Maint.	Maintenance	Vendor: Smith, A	(475)
	Contract Service - Routine Maint.	Part-Time Labor	Vendor: Norton	(100)
	Net Reclassification Adjustment			<u>\$ (615)</u>
(3)	Contract Labor	Part-Time Labor	Hager Laborer	\$ 1,525
	Contract Labor	Part-Time Labor	McDaniels	500
	Contract Service - Routine Maint.	Part-Time Labor	Vendor: Norton	100
	Maintenance	Part-Time Labor	Hanson - Day Labor Scouring Pump Station	200
	Net Reclassification Adjustment			<u>\$ 2,325</u>
(4)	Contract Service - Routine Maint.	Maintenance	Vendor: Skinner Welding	\$ 40
	Contract Service - Routine Maint.	Maintenance	Vendor: Smith, A	475
	Contract Labor	Maintenance	Danny's Welding	360
	Maintenance	Part-Time Labor	Hanson - Day Labor Scouring Pump Station	(200)
	Net Reclassification Adjustment			<u>\$ 675</u>
(5)	Office Supplies	Postage & Delivery	Stamps	\$ (853)
	Accounting	Office Supplies	Paper	24
	Accounting	Office Supplies	Toner	30
	Accounting	Office Supplies	Envelopes	16
	Accounting	Office Supplies	Miscellaneous	12
	Net Reclassification Adjustment			<u>\$ (771)</u>
(6)	Office Supplies	Postage & Delivery	Stamps	\$ 853
	Accounting	Postage & Delivery	Stamps	815
	Net Reclassification Adjustment			<u>\$ 1,668</u>
(7)	Accounting	Office Supplies	Paper	\$ (24)
	Accounting	Office Supplies	Toner	(30)
	Accounting	Office Supplies	Envelopes	(16)
	Accounting	Office Supplies	Miscellaneous	(12)
	Accounting	Postage & Delivery	Stamps	(815)
	Net Reclassification Adjustment			<u>\$ (897)</u>

APPENDIX B
STAFF REPORT CASE NO. 2005-00235
MALLARD POINT'S
PRO FORMA INCOME STATEMENT

Account Titles	Test Period Actual	Pro Forma Adjustments	Pro Forma Operations
Operating Revenues:			
Residential	\$ 154,894	\$ 4,334	\$ 159,228
Commercial	7,861	(1,645)	6,216
Total Operating Revenues	\$ 162,755	\$ 2,689	\$ 165,444
Operating Expenses:			
Operation & Maint. Exp:			
Owner/Manager Fee	\$ 0	\$ 35,000	\$ 35,000
Sludge Hauling	8,521	100	8,621
Utility Service:			
Electricity	7,965	0	7,965
Water	456	0	456
Office Utilities	0	1,320	1,320
Other - Labor, Materials & Exp.			
Contract Labor	31,160	0	31,160
Contract Service - Routine Maint.	11,700	300	12,000
Part-Time Labor	2,325	0	2,325
Fuel/transportation	2,324	0	2,324
Laboratory/Testing	11,520	960	12,480
Chemicals	2,038	0	2,038
Maint. - Treatment & Disposal Plant			
Maintenance	1,057	0	1,057
Miscellaneous	159	0	159
Parts	3,442	0	3,442
Repairs	4,500	0	4,500
Office Supplies			
Bank Service Charges	825	(124)	701
Dues & Subscriptions	160	(160)	0
Office Supplies	439	0	439
Penalties	117	(117)	0
Postage & Delivery	1,866	0	1,866
Outside Services Employed - Acc.	8,650	2,150	10,800
Insurance	1,486	0	1,486
Rent		6,600	6,600
Total Operation & Maint. Exp.	\$ 100,710	\$ 46,029	\$ 146,739
Depreciation	22,666	1,181	23,847
Amortization	7,144	2,056	9,200
Taxes Other than Income Tax	4,239	(349)	3,890
Total Operating Expenses	\$ 134,759	\$ 48,917	\$ 183,676
Net operating Income	\$ 27,996	\$ (46,228)	\$ (18,232)
Other Deductions:			
Interest Long-Term Debt	\$ 51,758	\$ (15,051)	\$ 36,707
Other Interest	2,037		2,037
Total Other Deductions	\$ 53,795	\$ (15,051)	\$ 38,744
Net Income	\$ (25,799)	\$ (31,177)	\$ (56,976)

APPENDIX C
STAFF REPORT CASE NO. 2005-00235
STAFF'S RECOMMENDED
PRO FORMA OPERATIONS

Account Titles	Test Period Actual	Pro Forma Adjustments	Adj. Ref.	Pro Forma Operations
Operating Revenues:				
Residential	\$ 154,894	\$ 8,569	(b)	\$ 163,463
Commercial	7,861	(1,640)	(b)	6,221
Total Operating Revenues	<u>\$ 162,755</u>	<u>\$ 6,929</u>		<u>\$ 169,684</u>
Operating Expenses:				
Operation & Maint. Exp:				
Owner/Manager Fee	\$ 0	\$ 3,600	(c)	\$ 3,600
Sludge Hauling	8,521	100	(a)	8,621
Utility Service:				
Electricity	7,965	0		7,965
Water	456	0		456
Office Utilities	0	1,320	(a)	1,320
Other - Labor, Materials & Exp.				
Contract Labor	31,160	(1,530)	(d)	29,630
Contract Service - Routine Maint.	11,700	300	(a)	12,000
Part-Time Labor	2,325	0		2,325
Fuel/Transportation	2,324	0		2,324
Laboratory/Testing	11,520	960	(a)	12,480
Chemicals	2,038	0		2,038
Maint. - Treatment & Disposal Plant				
Maintenance	1,057	0		1,057
Miscellaneous	159	0		159
Parts	3,442	0		3,442
Repairs	4,500	(1,375)	(e)	3,125
Office Supplies				
Bank Service Charges	825	(124)	(a)	701
Dues & Subscriptions	160	(160)	(a)	0
Office Supplies	439	0		439
Penalties	117	(117)	(a)	0
Postage & Delivery	1,866	0		1,866
Outside Services Employed - Acc.	8,650	2,150	(a)	10,800
Insurance	1,486	0		1,486
Rent		6,600	(a)	6,600
Total Operation & Maint. Exp.	<u>\$ 100,710</u>	<u>\$ 11,724</u>		<u>\$ 112,434</u>
Depreciation	22,666	(5,671)	(f)	16,995
Amortization	7,144	(1,853)	(g)	5,456
Taxes Other than Income Tax	4,239	(1,884)	(h)	2,355
Total Operating Expenses	<u>\$ 134,759</u>	<u>\$ 2,481</u>		<u>\$ 137,240</u>
Net Operating Income	<u>\$ 27,996</u>	<u>\$ 4,448</u>		<u>\$ 32,444</u>
Other Deductions:				
Interest Long-Term Debt	\$ 51,758	\$ (15,051)	(a)	\$ 36,707
Other Interest	2,037	(2,037)	(i)	0
Total Other Deductions	<u>\$ 53,795</u>	<u>\$ (17,088)</u>		<u>\$ 36,707</u>
Net Income	<u>\$ (25,799)</u>	<u>\$ 21,536</u>		<u>\$ (4,263)</u>

a. Uncontested Adjustments. As previously mentioned, at the conclusion of the limited financial review, Staff prepared a draft application containing a pro forma income statement with its recommendations and findings. Mallard Point accepted several of Staffs adjustments and those are included in Mallard Point's requested pro forma operations. The following are brief descriptions of those uncontested adjustments.

Sludge Hauling. Staffs review of the test-period invoices revealed that Mallard Point's sludge hauling expense of \$8,521 was actually \$8,621, an understatement of \$100. To correct Mallard Point's error, test-period sludge hauling has been increased by \$100.

Office Rent/Utilities. To comply with the requirements of Administrative Regulation 807 KAR 5:006 Section 13(1)(b)(2) Mallard Point began renting an office from its owner, Mark Smith at an estimated annual cost of \$7,920.⁴ Mallard Point submitted comparative cost information to support the monthly office rent of \$550. Upon review of this comparative cost information, Staff is of the opinion that the rent and utilities estimates are reasonable and should be included in Mallard Point's pro forma operating expenses. Accordingly, operating expenses have been increased by \$7,920.

Routine Maintenance. Mallard Point is required by the Division of Water to have a licensed operator. In April 2004 Noel Norton, a licensed operator, increased the routine maintenance fee that he charges to Mallard Point from \$900 to \$1,000 per month. Staff has increased routine maintenance fee expense by \$300⁵ to reflect the current annual cost.

Laboratory/Testing. Mallard Point's KPDES permit requires weekly testing of its effluent discharge. Kenvirons charges a fee of \$240 per week or \$12,480 annually to test Mallard Point's effluent. Staff has increased laboratory/testing expense by \$960⁶ to reflect the current annual cost.

⁴ \$110 (Monthly Utilities) x 12 Months =	\$ 1,320
\$550 (Monthly Office Rent) x 12 Months =	+ 6,600
Pro Forma Office Expense	<u>\$ 7,920</u>

⁵ \$1,000 (Routine Maintenance Fee) x 12 Months = \$12,000 - \$11,700 (Test-Period Routine Maintenance Expense) = \$300.

⁶ \$240 (Monthly Testing Fee) x 12 Months = \$12,480 - \$11,520 (Test-Period Laboratory/Testing Expense) = \$960.

Dues & Subscriptions. Upon its review of the test-period invoices, Staff noted that Mallard Point recorded paying Chamber of Commerce dues of \$160. The Commission has previously found that similar community organization expenses benefit utility community relations and are a form of charitable contribution that should not be recovered through utility rates. Test-period operating expenses have been reduced by \$160 to remove Mallard Point's Chamber of Commerce dues.

Penalties. During the test period, Mallard Point reported paying penalties and bank over draft fees of \$241.⁷ The Commission has previously held that penalties are the responsibility of the owner/stockholder, and therefore, should be recovered from Mallard Point's ratepayers. To coincide with the prior Commission findings, test-period operations have been decreased by \$241 to eliminate these costs.

Accounting. Upon review of the test period invoices, Staff determined that Mallard Point was paying \$7,200⁸ in annual bookkeeping and reporting fees. In addition to these annual fees Mallard Point pays Stivers and Associates, PSC an annual fee of \$3,600 for preparing the compilation report, the annual report for the Commission, the property tax returns, and the income tax returns.⁹ Accordingly, outside services employed – accounting expense has been increased by \$2,150.¹⁰

Interest Long-Term Debt. When Mallard Point refinanced its outstanding long-term loan in March 2004, it also increased the loan amount. The new loan of \$680,000 consists of \$400,000 for the refinancing and \$280,000 to repay Mark Smith, Mallard Point's sole-owner, for prior years' operating deficits. Allowing Mallard Point to recover from its current customer base interest associated with the loan for prior deficits constitutes retro-active rate making. Therefore, 41 percent¹¹ of the interest or \$20,195¹² has been

⁷ \$124 (Bank Over Draft Fees) + \$117 (Penalties) = \$241

⁸ \$400 (Monthly Bookkeeping Fee) x 12 Months =	\$	4,800
\$150 (Quarterly Report Fee) x 4 Quarters =		600
\$300 (Bi-Monthly Fee) x 6 Months	+	1,800
Annual Bookkeeping/Reporting Fees	\$	<u>7,200</u>

⁹ Mallard Point's Responses to Commission Staffs First Information Request, Item 6.

¹⁰ \$10,800 (Pro Forma Accounting) - \$8,650 (Test-Period Level) = 2,150.

¹¹ \$280,000 (Loan Prior Deficits) ÷ \$680,000 (Total Loan) = 41.67%.

¹² \$49,045 (Long-Term Interest Expense) x 41.176% = \$20,195.

deducted from long-term interest expense. Staff has also increased long-term interest expense by \$5,144 to reflect the interest on the loan the Commission approved in Mallard Point's prior rate case. Staffs overall decrease to long-term interest expense is \$15,051.

b. Normalized Operatinn Revenues. At the end of the test period, Mallard Point was providing sewer service to 376 residential customers and 1 commercial customer. Based upon the initial information provided by Mallard Point, Staff determined that the residential equivalent number was 390.69,¹³ which when applied to the tariffed rate of \$35.29 results in normalized revenue from rates of \$165,444. Therefore, Mallard Point's application reflects increasing the revenue from sewer rates of \$162,755 by \$2,689 to its pro forma level of \$165,444.

Upon review of Mallard Point's responses to the interrogatories,¹⁴ Staff has calculated a revised residential equivalent number of 400.69¹⁵ and applied this to the current tariffed rate to arrive at a normalized level of revenue from sewer rates of \$169,684. Accordingly, Staff has increased operating revenues from sewer rates of \$162,755 by \$6,929 to its pro forma level of \$169,684.

c. Owner/Manager Fee. Mallard Point proposes to include an owner/manager fee of \$35,000 in its pro forma operating expenses. According to Mallard Point, the changes in the financial records justify its requested owner compensations.

In response to Staff interrogatories, Mallard Point provided a listing of the duties its owner/manger performed in the test-period; but, it was unable to document the

¹³ 376 (Residential) + 14.69 (Residential Equivalent for the 1 Commercial) = 390.69.

¹⁴ Responses to Commission Staffs First Information Request, Items 3 and 4.

¹⁵ 386 (Residential) + 14.69 (Residential Equivalent for the 1 Commercial) = 400.69.

number of hours Mr. Smith spent performing those duties.¹⁶ In that same response Mallard Point claims that it does not have the ability to conduct a comprehensive study of Commission proceedings to identify decisions that have allowed privately owned sewer utilities comparable to Mallard Point rate recovery of an owner/manager fee of \$35,000; however, Mallard Point did review the annual reports on file with the Commission to conclude that there is a wide range of fees being charged to their respective customers.¹⁷ Mallard Point concludes in its response, that because it has no expenditures for administrative & general salaries, internal supervision and engineering, or routine maintenance, that those services are provided by Mr. Smith.¹⁸

Staff has reviewed the previous Commission decisions for each of the sewer utilities identified by Mallard Point. The following are brief discussions for each utility:

Middletown Waste Disposal – There is no record that this utility has filed a rate application.

Knot County Water & Sewer District – This utility is a combined water and sewer district and is not comparable to Mallard Point's operations. However, in the last rate case the sewer division's allocation of the manger's salary was reduced from \$50,000 to \$16,648.¹⁹

Shadow Wood Sewer – The Commission accepted Staffs position that the duties of an owner/manger will vary from time to time but the position does not constitute full time-employment. Staff recommended and the Commission accepted that \$3,600 was appropriate compensation for

¹⁶ Mallard Point's Response to the Commission Staffs First Information Request, Item 5.

¹⁷ Id.

¹⁸ Id.

¹⁹ Case No. 2002-00292, The Application of the Knott County Water and Sewer District for A Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities, (Ky. PSC May 20, 2003).

overseeing the daily operations of a small sewer utility, and therefore, the Owner/manager fee of \$49,313 was decreased by \$45,713 to \$3,600.²⁰

Delaplain Disposal Company - Staff determined that the test-period management fee \$42,007 paid to Proctor/Davis/Ray Engineers was unreasonable and should be disallowed for rate-making purposes. The fee was reduced by \$28,405 to \$13,692 to allow routine maintenance fee and transportation.²¹

Bullitt Utilities, Inc. - This is a sanitation district that is not subject to regulation by the Commission.

Contrary to Mallard Point's claim, its routine maintenance is performed by Noel Norton for an annual fee of \$12,000;²² administrative services (i.e.: billing/collection, bookkeeping, reporting, and accounting) are provided by outside vendors at an annual cost of \$10,800; and system maintenance is performed by a full-time contractor for an annual fee of \$29,830.²³ As owner/manger Mr. Smith has certain managerial responsibilities and duties for the oversight of the outside contractors; but, Staff believes that an owner/manager fee of \$35,000 is unwarranted and excessive.

In the past the Commission has limited the owner/manager fee to \$3,600. Mallard Point has not persuaded Staff to deviate from that prior decision. In addition, Staffs recommended pro forma operations include provisions for maintenance, a licensed operator, bookkeeping, accounting, billing services and collection services,

²⁰ Case No. 2001-00423, The Application of Shadow Wood Subdivision Sewer Service, A Joint Venture of Fourth Avenue Corporation and Long Corporation D/B/A Shadow Wood Subdivision Sewer Service for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities, (Ky. PSC September 6, 2002).

²¹ Case No. 1991-00282, The Application of Delaplain Disposal Company for A Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities, (KY. PSC January 15, 1992).

²² \$1,000 (Licensed Operator Fee) x 12 Months = \$12,000.

²³ \$1,130 (Monthly Fee - Noel Norton) x 12 Months = \$29,380.

which leaves only the administrative duties to be performed by Mr. Smith in return for the owner/manager fee.

d. Contract Labor. Mallard Point reported contract labor expense of \$31,160 for the test period. Upon its review of the operating statement detail for January 1, 2004 through December 31, 2004, Staff determined that for this 12-month period Mallard Point recorded payments to Charlie Hanson of \$30,510.

Mr. Hanson charges a bi-weekly fee of \$1,130 to perform the following daily maintenance services for Mallard Point: (1) open and release air valves during all rains; (2) remove any pop up from clarifier; (3) clean weirs; (3) transfer sludge from one holding tank to another; (4) de-water sludge holding tanks; (5) clean splitter box; (6) repair all leaks in service lines; (7) wash down plant; and (8) replace belts and blower motors. Multiplying Mr. Hanson's bi-weekly fee of \$1,130 by 26 annual payments results in an expense level of \$29,380, \$1,130 below the amount reported. Contract labor expense has been decreased by \$1,130 to eliminate the extra payment to Mr. Hanson.

In its responses to Staff interrogatories, Mallard Point submitted an invoice dated January 2, 2004 from Mr. Hanson. The \$400 invoice was to repay Mr. Hanson for cost of two day laborers to clean the sludge tanks. Given that the invoice date was January 2, 2004, Staff believes the services were performed in the prior period and, therefore, has been removed from the test-period operating expenses.

Staff's recommendations for test-period contract labor expense results in an overall decrease of \$1,530.²⁴

²⁴ \$1,130 (Extra Payment) + \$400 (Prior Period Cost) = \$1,530.

e. Repairs. Mallard Point reports a test-period repair expense of \$4,500. Staff's review of the repair invoices revealed that Mallard Point had expensed the replacement of blower transformers at a cost of \$987. Staff believes that the transformer replacement is a non-recurring expenditure that should be removed from operating expense and amortized. Accordingly, repair expense has been reduced by \$987. A provision for the recovery of the capital expenditures is included in the amortization expense adjustment.

Upon further review of the invoice, Staff was unable to locate the invoice supporting the \$388 payment to the Pipe Eyes. In its responses to Staff interrogatories, Mallard Point was unable to produce the requested documentation. Accordingly, Staff has reduced Mallard Point's proposed repairs expense by an additional \$388 for a total reduction to this expense of \$1,375.

f. Depreciation. Mallard Point proposes to increase its test period depreciation expense of \$22,666 by \$1,181 for a pro forma level of \$23,847. The following table shows how Mallard Point arrived at its pro forma depreciation expense.

<u>Description</u>	<u>Investment</u>	<u>Dep. Life</u>	<u>Depreciation Expense</u>
50,000 GPD Treatment Plant	\$ 127,775	20	\$ 6,389
100,000 GPD Plant Expansion	\$ 191,028	20	9,551
Sludge Holding Tank	\$ 20,296	20	1,015
50,000 GPD Renovation (CN 2003-00284)	\$ 69,500	20	3,475
Sludge Removal (CN 2003-00284)	\$ 1,960	5	392
Electrical Panel Wiring	\$ 4,715	5	943
Myers 5 HP Grinder Pump	\$ 2,670	5	534
Depreciation Schedule (2004)	\$ 2,315	5	463
Myers 5 HP Grinder Pump/Control Panel	\$ 5,424	5	+ 1,085
<u>Mallard Point's Pro Forma Depreciation Expense</u>			<u>\$ 23,847</u>

In reviewing Mallard Point's pro forma depreciation schedule, Staff notes that the 50,000 gallon wastewater treatment facility that was installed in 1986 will be fully

depreciated at the end of calendar year 2006. Given, that the depreciation of the 1986 wastewater facility will not be an on-going expense after 2005, Staff proposes to eliminate \$6,389 from pro forma depreciation expense.

In Case No. 2005-00284, the Commission granted Mallard Point a Certificate of Public Convenience and Necessity to rehabilitate its 50,000 GPD treatment plant. In that proceeding, Mallard Point provided bids showing that the rehabilitation of the 50,000 GPD will cost approximately \$71,460. Using the estimated construction cost, the Commission calculated a pro forma depreciation expense for the 50,000 GPD plant rehabilitation of \$3,867.²⁵ Given that the renovation has yet to be completed, Staff has included the \$3,687 depreciation estimate in its pro forma depreciation expense.

In reviewing the Application and Mallard Point's responses to the Interrogatories, Staff was unable to identify the \$2,315 capital expenditure that was made in calendar year 2004. Accordingly, Staff is not including the \$463 in its pro forma depreciation expense.

Staffs proposes to decrease depreciation expense of \$22,666 by \$5,671 for a pro forma depreciation expense level of \$16,995. The following table is the calculation of Staffs pro forma depreciation expense.

<u>Description</u>	<u>Investment</u>	<u>Dep. Life</u>	<u>Depreciation Expense</u>
50,000 GPD Treatment Plant	\$ 127,775	20	\$ 0
100,000 GPD Plant Expansion	\$ 191,028	20	9,551
Sludge Holding Tank	\$ 20,296	20	1,015
50,000 GPD Renovation (CN 2003-00284)	\$ 69,500	20	3,475
Sludge Removal (CN 2003-00284)	\$ — — 1,960. —	5	392

²⁵ \$1,960 (Sludge Removal) ÷ 5 Years =	\$ 392
\$ 51,309 (Treatment Renovation) ÷ 20 Years =	2,565
\$18,191 (Sand Blasting & Paint) ÷ 20 Years =	+ 910
Pro Forma Depreciation – Plant Renovation	<u>\$ 3,867</u>

Electrical Panel Wiring	\$	4,715	5	943
Myers 5 HP Grinder Pump	\$	2,670	5	534
Depreciation Schedule (2004)	\$	2,315	5	0
Myers 5 HP Grinder Pump/Control Panel	\$	5,424	5	+ 1,085
Staff's Pro Forma Depreciation Expense				\$ 16,995

g. Amortization. Mallard Point proposes to increase its test period amortization expense of ~~\$7,144~~ by ~~\$2,056~~ for a pro forma level of \$9,200. The following table shows how Mallard Point arrived at its pro forma depreciation expense.

Description	Investment	Amt. Life	Amortization Expense
KPDES Permit	\$ 1,700	4	\$ 425
Engineering Fee – Permit	\$ 560	4	140
Rate Case – Legal (CN 2003-00284)	\$ 21,904	3	7,301
Rate Case (CN 2005-00235)	\$ 8,000	3	+ 1,334
Mallard Point's Pro Forma Amortization Expense			\$ 9,200

In Case No. 2003-00284, the Commission based its finding that Mr. Smith and the ratepayers should share equally in the legal fees incurred by Mallard Point on the position that:

[t]he 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.

A sharing of the legal fees results in a rate case amortization expense of \$3,741, \$3,560 below the amount that Mallard Point includes in its pro forma amortization expense. Staff has reduced pro forma amortization expense by \$3,560 to reflect the level the Commission found reasonable in that prior proceeding.

Mallard Point proposes to amortize the estimated cost of this rate case of \$8,000 over 3 years for an amortization expense of \$1,334. In its responses to the Commission's interrogatories, Mallard Point provided invoices from its attorney and accountant totaling \$9,113.

Because Mallard Point’s attorney includes complete descriptions of the services provided, the amount of time billed for each service, and the hourly billing rate, Staff is able to determine that the legal fees appear reasonable. However, the accountant’s invoice only gives the following description, “[v]arious meetings, work with James Mooney, communications with Mark Frost, revise PSC draft application and re-file.” Given the lack of invoice detail and the only service provided by the accountant was to revise an application that was prepared by Staff, Staff believes that the \$3,200 accounting fee has not been justified. Amortizing the legal fees incurred to date of \$5,913 over 3 years, Staff calculates rate case amortization expense of \$986, \$348 below Mallard Point’s proposed level.

Staff’s proposes to decrease amortization expense of \$7,144 by \$1,688 for a pro forma depreciation expense level of \$5,456. The following table is the calculation of Staffs pro forma amortization expense.

<u>Description</u>	<u>Investment</u>	<u>Amt. Life</u>	<u>Amortization Expense</u>
KPDES Permit	\$ 1,700	4	\$ 425
Engineering Fee – Permit	\$ 560		
Rate Case – Legal (CN 2003-00284)	\$ 11,223		3,741
Blower Transformer	\$ 987		
Rate Case (CN 2005-00235)	\$ 5,913	3	± 986
Staffs Pro Forma Amortization Expense			\$ 5,456

h. Taxes Other Than Income Taxes. Mallard Point proposes to decrease its test period taxes other than income taxes expense of \$4,239 by \$349 for a pro forma level of \$349. The proposed adjustment eliminates the late fee for property taxes of \$117 and the 2003 Public Service Commission assessment of \$232. Upon review of the quarterly financial reports, Staff was unable to locate the invoices supporting the \$500 payment to the Kentucky State Treasurer or the other taxes and licenses of \$1,277. In

its responses to Staff interrogatories, Mallard Point was unable to produce the requested documentation. Accordingly, Staff has reduced Mallard Point's proposed pro forma taxes, other than income taxes expense, by an additional \$1,777 to eliminate the undocumented tax payments.

i. Interest Short-Term Debt. In 2004 Mallard Point heeded the Commission's directive to cease the practice of commingling Mr. Smith's private funds with those of the regulated utility. At that time Mallard Point realized that its operations were not profitable and Mr. Smith began making short-term loans to cover the operating losses. The short-term loans resulted in interest expense of \$2,037.

Historically, the Commission has not allowed utilities to recover from the rate-payers interest on loans incurred to cover operating expenses, because it is the responsibility of the owner to monitor the utility's financial condition and seek rate relief in a timely manner. Nothing has been presented by Mallard Point to persuade Staff that this practice should be modified. Therefore, operating expenses have been decreased by \$2,037 to eliminate short-term interest expense.

APPENDIX D
 STAFF REPORT CASE NO. 2005-00235
 STAFF'S REVENUE
 REQUIREM

Pro Forma Operating Revenues	\$	169,684
Divided by: Pro Forma Operating Expenses	-	137,240
Operating Ratio		123.640%
Pro Forma Operating Expenses	\$	137,240
Divided by: Operating Ratio	-	88%
Subtotal	\$	155,955
Add: interest Expense		36,707
Recommended Revenue Requirement	\$	192,662
Less: Normalized Operating Revenue		169,684
Recommended Increase in Revenue from Rates	\$	22,978