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Before the Public Service Commission

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**PUBLIC SERVICE
COMMISSION**

In the Matter of:

ALTERNATIVE RATE FILING APPLICATION)
FOR MIDDLETOWN WASTE DISPOSAL, INC.) Case No. 2009-00227

ATTORNEY GENERAL'S WRITTEN COMMENTS
TO COMMISSION STAFF REPORT

WITH

NOTICE REGARDING HEARING OR INFORMAL CONFERENCE

The Attorney General, consistent with the Commission's 1 April 2010 Order which grants all parties seven days from the date of the Order to submit Written Comments, provides his Written Comments for the Commission's Staff Report on Middletown Waste Disposal, Inc. Furthermore, the Attorney General provides notice that while he reserves the right to fully participate in any informal conference or public hearing that the Commission may hold in this proceeding, he does not, under the April 1st Order, request an informal conference or public hearing.

WRITTEN COMMENTS

Adjustment (a) - Normalized Operating Revenue

The Attorney General accepts Commission Staff's Pro Forma Normalized Operating Revenue amount of \$137,150.

Adjustment (b) - Owner/Manager Fee

The Attorney General accepts Commission Staff's Pro Forma Owner/Manager Fee Operations and Maintenance ("O&M") Expense amount of \$3,600.

Adjustment (c) - Treatment System - Sludge Hauling

The Attorney General accepts Commission Staff's Pro Forma Treatment System - Sludge Hauling O&M Expense amount of \$2,159. With regard to the issue of the amortization associated with this adjustment, the Attorney General addresses the issue in his Written Comments concerning Adjustment (n). (See page 9 of this document.)

Adjustment (d) - Fuel & Power Expense

The Attorney General accepts Commission Staff's Pro Forma Fuel & Power O&M Expense amount of \$30,864.

Adjustment (e) - Miscellaneous Supplies & Expense - Treatment and Disposal

Test period amount for Miscellaneous Supplies & Expense - Treatment and Disposal is \$11,590. Staff, in establishing its Pro Forma Operations amount for this expense, increases the test year amount by \$7,280. The basis for the increase is a \$140 a

week incremental cost associated with an additional analysis required under MWD's KPDES Permit.¹ The Attorney General agrees that the adjustment meets the "known and measurable" criteria, and he accepts Commission Staff's Pro Forma Expense amount of \$18,870.

Adjustment (f) - Maintenance – Collection Sewer System

Both Middletown Waste Disposal and Commission Staff adjust the test period Maintenance – Collection Sewer System O&M Expense by \$16,848 to remove the cost of certain repairs to its collection system characterized as nonrecurring expenditures. The Attorney General agrees with the adjustment to reduce this expense amount to zero in establishing a Pro Forma Income Statement. With regard to the issue of the amortization of these repairs, the Attorney General addresses the issue in his Written Comments concerning Adjustment (n). (See page 9 of this document.)

Adjustment (g) – Maintenance – Pumping System

The test period O&M Expense amount for Maintenance – Pumping System is \$76,025. MWD proposes to reduce this amount by \$57,641 for nonrecurring repair costs associated with the lift station. Staff proposes to further reduce the expense item by \$4,035 to reflect an additional amount connected with nonrecurring expenditures for Header Repairs. The Attorney General agrees with Staff's adjustment amount of \$61,676 which results in a Pro Forma Income Statement Amount of \$14,349 for this

¹ Staff Report, Appendix C, page 5. ($\$140.00 \times 52 = \$7,280.00$)

expense. With regard to the issue of the amortization of these repairs, the Attorney General addresses the issue in his Written Comments concerning Adjustment (n). (See page 9 of this document.)

Adjustment (h) – Outside Services Employed

The test period O&M Expense amount for Outside Services Employed is \$15,921. For the three-year period preceding the test period (2005 – 2007), the average for this expense item is approximately \$12,676.² MWD and Commission Staff propose to reduce the test period amount by \$2,442 characterized as nonrecurring (thereby establishing a Pro Forma Income Statement amount of \$13,479 for this expense). The Attorney General agrees with the adjustment, and he will discuss the issue of the amortization of the \$2,442 in his Written Comments for Adjustment (n). (See page 9 of this document.)

Adjustment (i) – Insurance

The Attorney General accepts Commission Staff's Pro Forma Insurance Expense amount of \$6,466.

Adjustment (j) – Transportation

The Test Period O&M Expense associated with Transportation is \$2,605. MWD proposes to reduce this amount by \$2,100. Commission Staff recommends further reducing this amount by \$505 in order to eliminate costs associated with

² \$12,338 for 2005; \$13,072 for 2006; and \$12,618 for 2007 for an average of \$12,676. Sources – MWD Annual Reports to PSC for 2005, 2006, and 2007.

“reimbursements made to Mr. Lorenz for purchases of gasoline that were made on his Chase credit card.”³ MWD concedes that, “There is no documentation supporting a cost allocation.”⁴

Expenses, even those having a minimal effect on operating income, must be borne by shareholders unless such expenses are proven beneficial to ratepayers in furnishing reasonable utility service.⁵ The burden of proof is with Middletown Waste Disposal, Inc.⁶ It has not met its burden; accordingly, the Attorney General agrees with Staff’s recommendation to further reduce the test period amount by \$505. The Pro Forma Income Statement amount for this expense is zero.

Adjustment (k) – Miscellaneous

MWD recommends reducing the test period O&M Miscellaneous Expense amount of \$7,812 by \$6,316 to remove sales tax collections. Staff recommends acceptance of this reduction, and the Attorney General agrees that the Pro Forma Income Statement amount of Miscellaneous Expense is \$1,496.

³ Staff Report, Appendix C, page 9.

⁴ Staff Report, Appendix C, page 9.

⁵ *In the Matter of: Notice of Adjustment of Rates of Kentucky-American Water Company*, Case No. 9482, Order entered 8 July 1986, page 22; also see *In the Matter of: Adjustment of Rates of Columbia Gas of Kentucky, Inc.*, Case No. 10498, Order entered 6 October 1989, page 30.

⁶ KRS 278.190(3); also see *In the Matter of: Notice of Adjustment of the Rates of Kentucky-American Water Company*, Case No. 8836, Order entered 20 December 1983 (Burden of proof for the necessity of any change in the approved rates rests entirely with the applicant, and it is not necessary that the Commission or anyone else prove that the proposed change is inappropriate.).

Adjustment (I) – Rents

The test period O&M Expense amount for Rents is \$1,200. MWD proposes to increase this amount by \$1,200 (for a total Rents expense amount of \$2,400). Commission Staff conveys its belief that MWD has not met its burden of proof for the \$1,200 increment proposed as an adjustment. The Attorney General agrees with the Commission Staff on this point; MWD has failed to meet its burden of proof. Moreover, the Attorney General points out that the failure is not limited to the \$1,200 incremental increase proposal.

As Staff notes, current rental payments are consequent to “a less-than-arm’s-length transaction.”⁷ Further, per Staff, “It is the utility’s responsibility to justify the reasonableness of its expenses, especially when they are the result of a less-than-arm’s length transaction between affiliated parties.”⁸ Given the Staff’s observation that, “the Office location on Mr. Lorenz’s farm does not provide a benefit to the utility, which is located in Middletown, Kentucky (emphasis added),”⁹ MWD fails to establish the propriety of the expense amount for the test period. According, the Attorney General disagrees with Staff’s Pro Forma Income Statement amount of \$1,200 for this expense category and submits that it should be zero.¹⁰

⁷ Staff Report, Appendix C, page 10.

⁸ Staff Report, Appendix C, page 10.

⁹ Staff Report, Appendix C, page 11.

¹⁰ KRS 278.190(3); see also Case No. 9482, Order entered 8 July 1986, page 22 (expenses must be proven beneficial to the ratepayers).

Other Test Period O&M Expense Amounts

Several O&M Expense amounts from the test period were not adjusted by Commission Staff in establishing its Pro Forma Income Statement. With regard to Chemicals (\$1,142), Routine Maintenance Fee (\$7,980), Internal Supervision & Engineering (\$0), Maintenance – Treatment & Disposal (\$1,005), Maintenance – Other Plant (\$3,525), Administrative & General (\$0), and Office Supplies (\$776), the Attorney General agrees with Staff's use of the test period amounts for establishing a Pro Forma Income Statement for MWD.

Summary for Operation and Maintenance Expense

Incorporating by reference the preceding Written Comments, the Attorney General disagrees with the Commission Staff's recommended Pro Forma Income Statement amount of \$106,911 and submits that the amount should be \$105,711.

Adjustment (m) – Depreciation

The test period Depreciation Expense amount is \$18,478. MWD proposes to remove the entire amount from the test period based upon its position that, Commission policy is to disallow depreciation expense on plant funded by Contributions in Aid of Construction (CIAC), and Middletown's historical records suggest that 99% of the plant was funded in this manner."¹¹ Staff, relying upon the 2008 Annual Report, contests MWD's decision not to seek an amount for depreciation

¹¹ Application, Attachment A, Note "L."

expense. Staff establishes a Pro Form Depreciation Expense amount of \$2,087. The Commission should reject Staff's recalculation; the amount should be zero.

First, MWD indicates that it has reviewed its historic records and concludes that 99% of its plant is funded by Contributions In Aid of Construction. This concession alone calls into question the reliability of using the information regarding CIAC in the 2008 Annual Report. Otherwise stated: MWD itself does not believe that there is sufficiently reliable evidence for proposing a depreciation expense; therefore, the applicant itself calls into question the reliability of the information in the 2008 Annual Report, the basis for Staff's position.

Second, while the Commission is not required to prove that a proposed change is inappropriate (the Commission never has the burden of proof), it does not follow that Staff, when proposing an unrequested increase over the amount in the application in an Alternative Rate Filing proceeding, need not provide a sufficiently reliable evidentiary basis for an adjustment serving to increase rates. In this instance, Staff does not rely upon an examination of the historic records of MWD to propose an accurate, going-forward amount of plant eligible for depreciation and the corresponding depreciation expense amount. Staff does not examine the accuracy of the information it uses for this adjustment. In a circumstance in which the utility represents that 99% of the utility plant is not eligible for depreciation, reliance upon an Annual Report, with nothing else, is simply not an adequate evidentiary basis to develop an unrequested expense amount.

Adjustment (n) – Amortization

Middletown Waste Disposal proposes to increase the test year Amortization Expense amount (of zero) by \$28,825.¹² As an initial matter, the Attorney General questions whether the 2008 capital expenditures of \$8,390 (for the Air Diffuser and Sludge Pump) are items that qualify as plant eligible for depreciation; therefore, the Attorney General questions whether the rate-making treatment for the items is through amortization (rather than depreciation). As a practical matter, whether characterized as depreciation or amortization, the core issue remains, is the amount of expenditures appropriate for recovery through rates. Accordingly, the Attorney General will discuss the items as issues pertaining to amortization.

Comparing Table 3 with Table 4 of the Staff Report,¹³ Staff does not contest the costs associated with the Lift Station (\$49,251), Collection Lines (\$16,848), Sludge Pump (\$5,030), or Air Diffuser (\$3,360) proposed by MWD. The Attorney General accepts these cost amounts as well. Staff, nonetheless, does not use the same amortization periods as MWD for these items (increasing the periods for the first three and decreasing the period for the last item, the Air Diffuser). The basis for Staff's amortization periods is an average service life schedule issued by the Commission, and the Attorney General agrees with Staff's amortization periods.

¹² Application, Attachment A, Note "M."

¹³ Staff Report, Appendix C, pages 11, 12, and 14.

Further, in terms of Tables 3 and 4, MWD's application contains amortization expense elements for its KPDES Permit (\$1,000), Legal Fees (\$2,442), and Rate Case Costs (\$3,330). Staff increases the KPDES Permit cost by \$360, and the increase is not discussed in the Staff Report. To this extent, the Attorney General does not accept the \$360 increase by Staff. The Attorney General does accept the five-year amortization period for this item. The Attorney General does not accept the amortization of \$2,442 in Legal Fees. These items are nonrecurring expenses, and there is simply no demonstration that the items warrant amortization. Staff increases Rate Case Cost from \$3,330 to \$9,404. While a rate case expense amount of this size is troublesome, the Attorney General will accept the \$9,404 amount and the corresponding three-year amortization period. Finally, the Attorney General accepts Staff's inclusion of \$4,035 for Header Repairs and the three-year amortization period for this item.

Consistent with the foregoing discussion, the Attorney General does not agree with Staff's recommended Amortization Expense amount of \$17,573 but instead submits that the amount should be \$16,687.¹⁴

Adjustment (o) – Income Tax (and Taxes Other than Income Tax)

The Attorney General accepts Commission Staff's Pro Forma Income Tax Adjustment and recommends a Pro Forma Income Statement amount of zero for this

¹⁴ \$17,573 minus \$814 associated with Legal Fees and \$72 associated with the KPDES Permit.

expense amount. With regard to Taxes Other than Income Tax, the Attorney General does not object to the test period amount of \$3,395.

Adjustment (p) – Interest – Long-Term Debt

The test period amount for Interest – Long-Term Debt is \$9,095. Staff recommends eliminating \$4,290 of this amount which is associated with interest on loans to cover operating expenses. The Attorney General agrees with this adjustment.

Summary Regarding Net Income

The Attorney General submits that the Pro Forma Income Statement Operating Revenue amount should be \$137,150; the Total O&M Expense amount should be \$105,711; Total Operating Expenses should be \$125,793,¹⁵ Pro Forma Net Operating Income, therefore, is \$11,357 and (subtracting out Interest – Long-Term Debt in the amount of \$4,769) Net Income is \$6,588.

With regard to the Revenue Requirement Determination, $\$125,793 / .88$ yields a sub-total of \$142,947. Adding in Interest Expense of \$4,769, the Attorney General's recommended Revenue Requirement is \$147,716. Subtracting from \$147,716 an Operating Revenue amount of \$137,150 results in an increase in revenue from rates amount of \$10,566 (rather than \$15,308 per the Staff Report).¹⁶

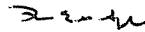
¹⁵ $\$105,711 + \$16,687$ (Amortization) + \$3,395 (Taxes Other than Income Taxes) = \$125,793.

¹⁶ Staff Report, page 4, Table 1.

WHEREFORE, the Attorney General submits his Written Comments to Commission Staff Report with Notice Regarding Hearing or Informal Conference.

Respectfully submitted,

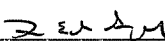
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Counsel certifies that an original and ten photocopies of this document were served and filed by hand delivery to Jeff Derouen, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; furthermore, it was served by mailing a true and correct of the same, first class postage prepaid, Richard A. Greenberg, Smith, Greenberg & Leightty, PLLC, 2321 Lime Kiln Lane, Suite C, Louisville, Kentucky 40222 (Counsel for Middletown Waste Disposal, Inc.), all on this 7th day of April, 2010.



Assistant Attorney General