

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF RIDGELEA INVESTMENTS, INC.) CASE NO.
FOR ALTERNATIVE RATE ADJUSTMENT) 2009-00500

ORDER

On December 14, 2009, Ridgelea Investments, Inc. ("Ridgelea") applied to the Commission for authority to establish a surcharge pursuant to 807 KAR 5:076, the alternative rate filing procedure for small utilities. Because of filing deficiencies, the Commission did not accept the application for filing until January 8, 2010. Ridgelea amended its application on June 15, 2010 to use the calendar year 2009 as the test period. In its July 14, 2010 Order, the Commission suspended Ridgelea's proposed rates revisions for five months, from July 15, 2010 up to and including December 14, 2010.

Commission Staff, having performed a limited financial review of Ridgelea's operations, has prepared the attached report containing its findings and recommendations regarding the proposed rates. The August 25, 2010 amended procedural schedule requires the Staff Report to be issued on or after November 27, 2010 and it requires the Parties to submit any written comments with the Commission by December 1, 2010. The Commission believes that the amended procedural schedule does not provide the parties with sufficient time to review the Staff Report and to submit their comments. Accordingly, the Commission finds that all parties should review the report carefully and submit any written comments about Staff's

findings and recommendations or requests for a hearing or an informal conference no later than 14 days from the date of this Order.

IT IS THEREFORE ORDERED that:

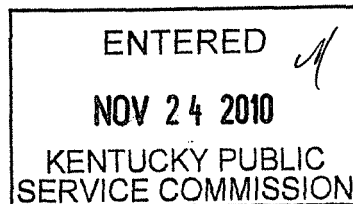
1. All parties shall have 14 days from the date of this Order to submit to the Commission written comments, if any, regarding the attached Staff Report and to request a hearing or an informal conference in this matter.

2. Any party requesting a hearing in this matter shall state in its request its objections to the findings set forth in the Staff Report and provide a brief summary of testimony that it would present at hearing.

3. A party's failure to object to a finding or recommendation contained in the Staff Report within 14 days of this Order shall be deemed as agreement with that finding or recommendation.

4. If no request for a hearing or an informal conference is received within 14 days of the date of this Order, this case shall stand submitted to the Commission for decision based upon the existing record.

By the Commission



ATTEST:

Executive Director

Case No. 2009-00500

STAFF REPORT
ON
RIDGELEA INVESTMENTS, INC.
CASE NO. 2009-00500

Ridgelea Investments, Inc. ("Ridgelea") applied to the Commission for authority to adjust its sewer rates pursuant to 807 KAR 5:076. To evaluate the requested increase, Commission Staff performed a limited financial review of Ridgelea's test period operations, the calendar year ending December 31, 2009. The scope of Staff's 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 Sam Reid of the Commission's Division of Financial Analysis performed the limited review. This report summarizes their review and recommendations. Mr. Reid is responsible for the pro forma revenue adjustment and the rate determination. Mr. Frost is responsible for all pro forma expense adjustments, the revenue requirement determination, and the recommended surcharge.

The comparison of Ridgelea's actual and pro forma operations shown is in Appendix A. Staff's proposal for Ridgelea's pro forma operating statement is set forth in Appendix B. The explanation of Staff's proposed pro forma adjustments is found at Appendix C.

The Commission has historically used an operating ratio approach¹ to determine revenue requirements for small, privately owned utilities.² This approach is used because no basis for rate-of-return determination exists or the cost of the utility has fully or largely been recovered through the receipt of contributions. For these reasons, Staff finds that this method should be used to determine Ridgelea's revenue requirement. Staff further finds that an operating ratio of 88 percent will allow Ridgelea sufficient revenues to cover its reasonable operating expenses and to provide for reasonable equity growth.

Using an 88-percent operating ratio, Ridgelea determined that its requested pro forma operations support a revenue requirement from base sewer rates of \$126,457. However, Ridgelea is only requesting base sewer rates that will produce annual revenues of \$114,624, which is an increase of \$42,984, or 60 percent, above the normalized revenue from base sewer rates of \$71,640. Ridgelea's proposed rates will increase the residential bill from \$30 to \$48, an increase of \$18, or 60 percent.

As shown in Table 1, Staff's recommended pro forma operations, and an 88 percent operating ratio, results in a revenue requirement from base sewer rates of \$76,135, an increase of \$4,495, or 6.27 percent, over normalized revenue from rates of \$71,640.

¹ Operating Ratio is defined as the ratio of expenses, including depreciation and taxes, to gross revenues.

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes} + \text{Other Than Income Taxes}}{\text{Gross Revenues}}$$

² See, e.g., McKnight Utilities Co., Case No. 7553 (Ky. PSC Nov. 13, 1979).

Table 1		
Operating Expenses	\$	66,999
Divided by: Operating Ratio	÷	88%
Requested Revenue Requirement	\$	76,135
Less: Normalized Operating Revenue	-	71,640
Recommended Increase in Revenue from Rates	\$	4,495

Because Ridgelea’s proposed base sewer rate will produce revenues greater than the revenue requirement determined reasonable herein, Staff recommends that the Commission deny it. Using the revenue requirement it determined reasonable and the current number of ratepayers that Ridgelea serves in Franklin County, Staff calculates a residential rate of \$32 per month, as shown in Table 2. Staff recommends that the Commission approve the residential rate set forth in Appendix C, as it will produce the recommended revenue requirement from rates of \$76,135.

Table 2		
Total Requested/Recommended Revenue Requirement	\$	76,135
Divided by: 12-Months	÷	12
Monthly Revenue Requirement	\$	6,344.58
Divided by: Current Customer Level	÷	199
Monthly Rate – Rounded to Nearest Dollar Amount	\$	32.00
% Increase		6.667%

Ridgelea entered into an Agreed Order with the Energy and Environment Cabinet (“EEC”) that was signed by Ridgelea on August 1, 2009. The Order requires Ridgelea to initiate an Infiltration and Inflow study (“I&I Study”) from Leak Eliminators, LLC or any other experienced person or entity approved by the Division of Water. Ridgelea obtained a \$26,000 quote from Hall Environmental for the I&I Study. Ridgelea requests

the Commission approve a monthly surcharge of \$7.26³ per ratepayer to fund the I&I Study. The proposed surcharge would be in effect for 18 months.

In addition to Hall Environmental, Ridgelea contacted Leak Eliminators which provided a quote of \$65,000 to perform the I&I Study. Given the requirement in the Agreed Order, Staff believes that Ridgelea's proposed I&I Study is necessary and that \$26,000 is a reasonable estimate of the cost of the study.

If Ridgelea is allowed to recover the amortization of the I&I Study in its base rates, there will not be a monitoring mechanism in place to ensure that Ridgelea actually performs the study. If Ridgelea fails to complete its I&I Study in a timely manner, Staff believes that the delay could adversely affect the quality of its service. To fund the I&I Study in a timely manner and to ensure that the study is completed, Staff recommends that Ridgelea be authorized to assess a monthly surcharge of \$5.45 for a 24-month period or until \$26,000 has been collected. Staff arrived at its projected monthly surcharge collection of \$1,084.55 by multiplying the recommended monthly surcharge of \$5.45 by the test-period customer level of 199.

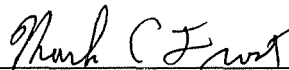
Staff further recommends the following conditions be placed upon Ridgelea's assessment and collection of the proposed surcharge: (1) surcharge collections should be placed in a separate interest-bearing account; (2) the monthly transfers to the surcharge account should equal the monthly surcharge calculated herein and should be transferred from Ridgelea's gross revenues prior to those revenues being dispersed for another purpose; (3) Ridgelea should submit quarterly activity reports that include the monthly surcharge billings and collections; the monthly surcharge bank statement; a

³ \$26,000 (Cost of I&I Study) ÷ 18 Months = \$7.26.

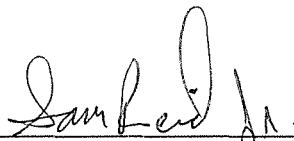
detailed listing of payments from the account; and invoices supporting the payments; and (4) Ridgelea's failure to comply with all conditions would result in the revocation of the surcharge and the refund of all collected surcharge proceeds, plus interest.

The surcharge collections constitute contributions and, therefore, should be accounted for in the manner prescribed by the Uniform System of Accounts for Class C Sewer Utilities. The monthly billing should be debited to customer accounts receivable and credited to the contribution account. When the surcharge is actually collected from the customer, special funds would be debited and the customer account credited.

Signatures



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



Prepared by: Sam Reid
Manager, Communications, Water and
Sewer Rate Design Branch
Division of Financial Analysis

APPENDIX A
 STAFF REPORT CASE NO. 2009-00500
 RIDGELEA'S REQUESTED
 PRO FORMA INCOME STATEMENT

Account Titles	Actual Operations	Pro Forma Adjustments	Pro Forma Operations
Operating Revenue	\$ 71,640	\$ 0	\$ 71,640
Operating Expenses:			
Operation & Maint. Exp:			
Owner/Manager Fee	\$ 3,900	\$ 5,155	\$ 9,055
Treatment System - Sludge Hauling	5,055	0	5,055
Utility Service Water	792	0	792
Fuel & Power Expense	5,674	418	6,092
Routine Maintenance Fee	0	0	0
Maintenance - Treatment & Disposal	35,050	8,757	43,807
Maintenance - Other Plant	1,550	0	1,550
Agency Collection Fees	10,746	6,448	17,194
Outside Services Employed	14,901	(11,108)	3,793
Miscellaneous	0	1,200	1,200
Total Operation & Maint. Exp.	\$ 77,668	\$ 10,870	\$ 88,538
Depreciation	446	0	446
Amortization	815	19,973	20,788
Taxes Other than Income Tax	4,760	(3,250)	1,510
Income Taxes - Utility Operations	0	0	0
Total Operating Expenses	\$ 83,689	\$ 27,593	\$ 111,282
Net Operating Income	\$ (12,049)	\$ (27,593)	\$ (39,642)
Other Income:			
Interest Income	0	0	0
Other Deductions:			
Interest - Long-Term Debt	630	(630)	0
Net Income	\$ (12,679)	\$ (26,963)	\$ (39,642)

APPENDIX B
STAFF REPORT CASE NO. 2009-00500
STAFF'S RECOMMENDED
PRO FORMA INCOME STATEMENT

Account Titles	Actual Operations	Pro Forma Adjustments	Ref	Pro Forma Operations
Operating Revenue	\$ 71,640	\$ 0		\$ 71,640
Operating Expenses:				
Operation & Maint. Exp:				
Owner/Manager Fee	\$ 3,900	\$ (3,900)	a	\$ 0
Treatment System - Sludge Hauling	5,055	0		5,055
Utility Service Water	792	(79)	b	713
Affluent Testing	0	11,900	c	11,900
Fuel & Power Expense	5,674	462	d	6,136
Routine Maintenance Fee	0	7,200	e	7,200
Maintenance - Treatment & Disposal	35,050	(25,573)	f	9,477
Maintenance - Other Plant	1,550	0		1,550
Agency Collection Fees	10,746	0	g	10,746
Outside Services Employed	14,901	(11,108)	h	3,793
Miscellaneous	0	0	i	0
Total Operation & Maint. Exp.	\$ 77,668	\$ (21,098)		\$ 56,570
Depreciation	446	882	j	1,328
Amortization	815	6,776	k	7,591
Taxes Other than Income Tax	4,760	(3,250)	l	1,510
Income Taxes - Utility Operations	0	0		0
Total Operating Expenses	\$ 83,689	\$ (16,690)		\$ 66,999
Net Operating Income	\$ (12,049)	\$ 16,690		\$ 4,641
Other Deductions:				
Interest - Long-Term Debt	630	0		630
Net Income	\$ (12,679)	\$ 16,690		\$ 4,011

APPENDIX C
STAFF REPORT CASE NO. 2009-00500
STAFF'S PRO FORMA ADJUSTMENTS

a. Owner/Manager Fee. Ridgelea proposes to increase its test-period owner/manager fee expense of \$3,900 by \$5,155 to a pro forma level of \$9,055. According to Ridgelea, its proposed adjustment reflects an owner/manger fee of \$9,055 that the Commission authorized in Case No. 2008-00364.¹ In that proceeding, the Commission found that “[b]y all accounts Ridgelea’s owner is heavily involved and spends significant time in operational matters for these aged and failing plants.”² A Kentucky Division of Water employee related to Commission Staff that “the owner often responds in person to frequent emergency situations associated with the Franklin County sewers despite his location in Cincinnati, Ohio.”³

Since that proceeding, Ridgelea has entered into an Agreed Order with the EEC wherein Charles G. Hungler, Jr., Ridgelea’s President, agreed to surrender his wastewater treatment plant certification. Since Mr. Hungler acquired the Franklin County treatment plants in 2003,⁴ Ridgelea has received approximately 90 separate Notices of Violations (“NOV”) from the EEC.⁵ Mr. Hungler states that he visits the

¹ Case No. 2008-00364, Application for Rate Adjustment of Ridgelea Investments, Inc. Pursuant to the Alternative Rate Adjustment Procedure for Small Utilities (Ky. PSC Dec. 8, 2008).

² Id. Staff Report released October 14, 2008, Attachment A, Explanatory Note B. Owner/Manager Fee.

³ Id.

⁴ Case No.. 2003-00184, Application of Ridgelea Investments, Inc. for Purchase of Sewage Treatment Facilities of Mulberry Enterprises, Inc. (Ky. PSC Sep. 12, 2003).

⁵ Ridgelea's Response to the Commission Staff's Fourth Information Request, Item 3(a).

Franklin County plants twice per week and spends approximately five hours per trip performing routine and non-routine maintenance.⁶ However, Mr. Hungler does not maintain documentation to track the hours he spends at the Franklin County plants, nor does he maintain a mileage log to verify the number of trips that are made each week.⁷

Ridgelea stated that, during the calendar years 2008 and 2009, it did not maintain a general ledger or a cash disbursements journal.⁸ According to Ridgelea, its financial record keeping consisted of a checkbook, expense invoices, and a year-end compilation completed by its CPA.⁹ Ridgelea admitted that past recordkeeping practices have been inadequate and resulted in Ridgelea's inability to locate key documents.¹⁰

The Commission's has historically permitted utilities of Ridgelea's size to recover through rates an owner/manager fee of \$3,600 upon good showing that owner/manager's duties and responsibilities warrant that level of compensation. In a proceeding before the Commission, it is the owner/manager's responsibility to provide detailed responses to all interrogatories. The 90 cited NOV's and the actions taken in the Agreed Order demonstrate that Mr. Hungler has neglected his owner/manger duties by not providing adequate supervision of the daily operations of the Franklin County

⁶ Ridgelea's Response to Commission Staff's First Information Request, Items 1 and 2.

⁷ Id.

⁸ Id., Items 4-5.

⁹ Id., Item 5.

¹⁰ Ridgelea's Responses to Commission Staff's Second Information Request at 1.

treatment plants. Further evidence of this neglect is Ridgelea's admitted poor financial record-keeping and Ridgelea's inability to respond to the Staff's information requests in a timely manner. To date, Ridgelea has taken approximately 69 additional days in submitting its responses to Staff's first three information requests.¹¹

In past proceedings where an owner of a utility has been found to neglect his duties, the Commission has not included an allowance for an owner/manager fee in the pro forma operating expenses.¹² For the aforementioned reasons, Staff recommends that no provision for an owner/manager fee be included and has decreased pro forma operating expenses by \$3,900 to eliminate the test-period owner/manager fee expense.

b. Utility Service - Water. Ridgelea reports a test-period level of water expense of \$792. In reviewing the general ledger and invoices, Staff determined that the actual test-period water expense is actually \$713, which is \$79 less than the amount reported. Accordingly, Staff recommends that Ridgelea's test-period water expense be reduced by \$79.

c. Effluent Testing. Ridgelea proposes to increase its operating expenses by \$9,120 to reflect the EEC requirement for it to use an outside testing

¹¹ First Information Request: Responses due March 18, 2010; Ridgelea submitted its response to Item 16 on April 22, 2010, approximately 35 days from the original due date. Second Information Request: Responses due May 27, 2010; Ridgelea was granted an extension of time until June 17, 2010, approximately 21 days from the due date. Third Information Request: responses due August 6, 2010; Ridgelea submitted its responses on August 19, 2010, approximately 13 days from the due date.

¹² See Case No. 2003-00494, Application of Airview Estates, Inc. for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities, Staff Report released Mar. 11, 1993 at 4. See 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, Staff Report released Nov. 21, 2003, at 3-4.

vendor rather than Perfectawaste.¹³ The Agreed Order with EEC requires Ridgelea to use one of the following designated laboratories to test the effluent from its Franklin County facilities: McCoy & McCoy Laboratories, Inc.; Appalachian States Analytical, LLC; or Fouser Environmental. Currently, Ridgelea is using the testing services of Fouser Environmental and is charged a fee of \$175 per test.

Staff finds that an adjustment to reflect the testing requirements of the Agreed Order and the current \$175 testing fee meets the rate-making criteria of known and measurable. Using the testing requirements set forth in Ridgelea’s KPDES permit and the current of fee of \$175 per test, Staff calculates a pro forma effluent testing expense of \$11,900 as shown in Table 3. Accordingly, Staff recommends that the Commission increase Ridgelea’s operating expenses by that amount.

Table 3				
Plant	Testing Frequency	Annual Tests	Cost per Test	Staff
Edgewood	Weekly	52	\$ 175	\$ 9,100
Farmgate	Monthly	12	\$ 175	2,100
Meadowbrook	Quarterly	4	\$ 175	+ 700
Pro Forma Adjustment				\$ 11,900

d. Fuel and Power Expense. Ridgelea proposes to increase its test-period fuel and power expense from \$5,674 to \$6,092, which is an increase of \$418. Ridgelea’s adjustment reflects a 6 percent increase in the electricity rates of Blue Grass Energy Cooperative Corporation (“Blue Grass Energy”) that became effective on April 1, 2009 and an anticipated 5.27 percent increase in BlueGrass Energy’s rates.

¹³ Ridgelea’s Responses to the Commission Staff Third Information Request, Item 4, Adjustment D, Management of Treatment and Disposal Plant. \$13,200 (Pro Forma Testing Cost) - \$4,080 (Test-Period Cost) = \$9,120.

Staff finds that an adjustment to reflect the Blue Grass Energy rates that became effective on April 1, 2009 meets the rate-making criteria of known and measurable.¹⁴ However, since the Commission has yet to issue a decision in Case No. 2010-00169,¹⁵ an adjustment to reflect those proposed rates does not meet that criteria.

Based upon its review of the Order in Case No. 2008-00411, Staff has determined that Blue Grass Energy's rates were increased 6.9 percent. Applying a 6.9 percent increase to the electricity that Ridgelea purchased prior to April 1, 2009 results in an increase of \$462 as shown in Table 4. Accordingly, Staff recommends that fuel and power expense be increased by that amount.

Service		Totals	% Increase	Pro Forma
From	To			
12/01/08	01/01/09	\$ 561.62	106.90%	\$ 600
01/01/09	02/01/09	509.30	106.90%	544
02/01/09	03/01/09	338.99	106.90%	362
03/01/09	04/01/09	381.84	100.00%	382
04/01/09	05/01/09	349.68	100.00%	350
05/01/09	06/01/09	524.56	100.00%	525
06/01/09	07/01/09	511.74	100.00%	512
07/01/09	08/01/09	607.14	100.00%	607
08/01/09	09/01/09	717.25	100.00%	717
09/01/09	10/01/09	536.71	100.00%	537
10/01/09	11/01/09	494.09	100.00%	494
11/01/09	12/01/09	505.59	100.00%	506
12-Month Totals		<u>\$ 6,038.51</u>		<u>\$ 6,136</u>
Less: Test-Period Fuel and Power expense				<u>5,674</u>
Pro Forma Adjustment				\$ 462

¹⁴ Case No. 2008-00411, Application of Blue Grass Energy Cooperative Corporation to Pass-Through an Increase of Its Wholesale Power Supplier Pursuant to KRS 278.455(2) (Ky. PSC Mar. 31, 2009).

¹⁵ Case No. 2010-00169, Application of Blue Grass Energy Cooperative Corporation for Pass-Through of East Kentucky Power Cooperative, Inc. Wholesale Rate Adjustment.

e. Routine Maintenance. Ridgelea reports paying \$6,900 during the test period to three outside contractors to operate its Franklin County plants. Ridgelea is paying Greg Mayeux, its current licensed operator, a fee of \$600 per month to perform routine maintenance services. It requests a routine maintenance expense of \$7,200 to reflect the current annual cost for this service.

The Agreed Order with ECC requires that Ridgelea use an independent certified operator at the three treatment plants located in Franklin County. Staff finds that an adjustment to reflect the requirements of the agreed Order meets the rate-making criteria of known and measurable and should be reflected in Ridgelea's test period operations. Accordingly, Staff recommends that operating expenses be increased by \$7,200 to reflect the current routine maintenance fee.

f. Maintenance – Treatment and Disposal. Ridgelea reports a test-period maintenance – treatment and disposal expense of \$35,050. In reviewing the expense schedules and test-period invoices, Staff determined that Ridgelea incorrectly recorded its test-period effluent testing expense of \$6,588¹⁶ and routine maintenance expense of \$15,000¹⁷ in the maintenance – treatment and disposal account. To correct for this error, Staff is recommending that the Commission reduce Ridgelea's maintenance – treatment and disposal expense by \$21,588.

Upon further review of the test-period invoices, Staff discovered that \$3,985 of capital expenditures was incorrectly recorded by Ridgelea as an expense. To eliminate

¹⁶ \$1,163 (McCoy & McCoy) + \$1,200 (Fouser Environmental) + \$4,225 (Perfectawaste) = \$6,588.

¹⁷ \$8,100 (Perfectawaste) + \$2,400 (Jim Thacker) + \$2,500 (Ron Mangeot) + \$2,000 (Greg Mayeux) = \$15,000.

the capital expenditures that are listed in Table 5, Staff proposes a further reduction to maintenance – treatment and disposal expense of \$3,985.

Table 5	
Sullivan Electric Company - 2hp Pump	\$ 454
Vitech - Bar Screen	552
Perfectawaste - Coal Tar	837
Perfectawaste - Coal Tar	992
Chuck Hungler - Repair tank	1,150
Pro Forma Adjustment	<u>\$ 3,985</u>

g. Agency Collection Fee. Ridgelea proposes to increase its test-period agency collection fee expense of \$10,746 by \$6,448. Applying the requested revenue requirement of \$42,984 to the 15 percent billing and collection fee charged by the Farmdale Water District results in Ridgelea’s pro forma expense of \$17,194.

In Case No. 2007-00436,¹⁸ the Commission made the following finding’s regarding the billing and collection fees being charged by the Farmdale Water District:

The Commission finds that, given the high level of expense and the questionable nature of Farmdale District’s termination practices, the current arrangement does not appear reasonable. Based upon the rates that Farmdale proposes in its application, it will pay \$7.93 per month to Farmdale District for each bill collected. With each additional increase in the monthly sewer rate, an additional 15 percent of that increase must be added to customer bills and paid to Farmdale District, though no new service is provided. Such an arrangement is unreasonable on its face.¹⁹

In that proceeding the Commission denied Farmdale Development Corporation’s adjustment to the agency collection fee expense to reflect the effect of the requested

¹⁸ Case No. 2007-00436, Application of Farmdale Development Corporation for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities (Ky. PSC July 30, 2008).

¹⁹ Id. at 12.

revenue requirement and limited Farmdale Development Corporation's recovery of the agency collection fee expenses to the test period expense level of \$8,091.²⁰ The Commission also placed the Farmdale Development Corporation on notice that in any future rate proceeding it will be required to demonstrate the reasonableness of its agency collection fee expense and to show that it has undertaken reasonable efforts to develop an alternative to its present collection methods, including the conducting of its own billing and collection.²¹

Staff believes that Ridgelea has been unable to show that its proposed agency collection expense is reasonable and that it has undertaken all reasonable efforts to develop an alternative. For these reasons, Staff recommends that the Commission deny Ridgelea's proposed adjustment and allow only the recovery of the agency collection fee expense of \$10,764 incurred during the test period. Staff further recommends that the Commission require Ridgelea to make the same evidentiary showings regarding agency collection fees that it currently requires of Farmdale Development Corporation.

h. Outside Services. Ridgelea proposes to decrease its test-period outside-services expense of \$14,901 by \$11,108 to remove legal fees of \$14,108, and the addition of the bookkeeping/accounting fee of \$3,000. Ridgelea is removing the legal fees incurred to negotiate the Agreed Order with the ECC and in the ECC proceeding to revoke the operator certification of Mr. Hungler. To improve its recordkeeping, Ridgelea

²⁰ Id. at 15.

²¹ Id.

hired the consultant who prepared this rate case in May 2010. Ridgelea is requesting that it be allowed to recover the legal fees over a five-year amortization period.

Staff agrees with Ridgelea that the legal fees are a nonrecurring cost that should be amortized rather than expensed. However, the legal fees incurred in ECC's action to revoke Mr. Hungler's operator certification are solely Mr. Hungler's responsibility and, therefore, should not have been recorded by Ridgelea as an operating expense. Further, Staff agrees that Ridgelea needs to improve its financial recordkeeping and that the \$3,000 annual cost for this service appears reasonable. Staff recommends that the Commission accept Ridgelea's adjustment to reduce outside service expense by \$11,108. The recovery of the legal fees incurred to negotiate the Agreed Order will be addressed in the section discussing the amortization adjustment.

i. Office Rent. Ridgelea proposes to increase operating expenses by \$1,200 to reflect an allocation of rent and other office expenses. According to Ridgelea, its Franklin County operations have never been charged for the use of an office, a telephone, a cellular telephone, or standard office equipment.

Ridgelea is currently sharing an office with Perfectawaste, which is owned by Perfecto Properties, an affiliated company. Perfecto Properties is currently charging Perfectawaste \$700 per month for office rent. The payment of office rent to Perfecto Properties is considered a less-than-arm's-length transaction. A utility bears the responsibility of justifying the reasonableness of its expenses, especially those that result of a less-than-arm's length transaction between affiliated parties. Ridgelea failed to comply with Staff requests for detailed documentation on shared office costs.²² Staff

²² Ridgelea's Response to Commission Staff's Fourth Information Request, Item 5.

believes that Ridgelea has failed to meet its burden of proof and recommends the Commission reject Ridgelea's proposed adjustment to increase operating expenses to include office rent of \$1,200.

j. Depreciation. Ridgelea reports a test-period level of depreciation expense of \$446. The equipment being depreciated has a depreciation life of seven years and it was installed on June 11, 2003. Given that the equipment will be fully depreciated in 2010, Staff recommends that the associated depreciation expense be eliminated from Ridgelea's pro forma operations. Accordingly, pro forma operating expense has been decreased by \$446. As shown in Table 6, Staff calculates a depreciation expense of \$1,328 to reflect depreciating the capital items removed from operating expenses over their estimated useful lives. Combining Staff's recommended adjustments to depreciation expense results in a net increase to depreciation expense of \$882.

	Amount	Depreciation	
		Years	Expense
Sullivan Electric Company - 2hp Pump	\$ 454	3	\$ 151
Vitech - Bar Screen	\$ 552	3	184
Perfectawaste – Coal Tar	\$ 837	3	279
Perfectawaste – Coal Tar	\$ 992	3	331
Chuck Hungler - Repair tank	\$ 1,150	3	383
Depreciation			\$ 1,328

k. Amortization. Ridgelea is proposing to increase its test-period amortization expense of \$815 by \$19,973. In Case No. 9059,²³ the Commission determined that, "The burden of proof is upon the utility to justify its investment at the price in excess of the net original cost based on economic and quality of service criteria." Ridgelea has not produced any evidence to meet its burden of proof, but

²³ Case No. 9059, An Adjustment of Rates of Delta Natural Gas Company, Inc. (Ky. PSC Sep. 11, 1985) at 3.

rather relied on the fact that the recovery of the amount paid in excess of the book value was allowed in Case No. 2008-00364.²⁴ Upon its review of the record in Case No. 2008-00364, Staff did not locate any evidence to support inclusion of the amortization. Also, the quality of service currently being provided by Ridgelea is questionable when its has been cited by the ECC for 90 NOV's. Staff believes that Ridgelea has not met its burden of proof regarding the recovery of the amortization of the amount paid in excess of the book value.

Staff calculates an amortization expense of \$7,591 as shown in Table 7 below. A pro forma amortization expense of \$7,591 results in an increase of \$6,776 to test-period amortization expense of \$815.

	Amount	Amortization	
		Years	Expense
Current Rate Case Cost	\$ 2,200	3	\$ 733
Agreed Order - Legal Fees	\$ 9,400	5	1,880
Prior Rate Case Amortizations:			
KPDES Permit	\$ 3,400	5	680
Legal Fees	\$ 13,656	5	2,731
Agreed Order – DOW	\$ 9,400	6	1,567
Pro Forma Adjustment			\$ 7,591

i. Taxes Other Than Income Tax. Ridgelea proposed to reduce taxes other than income tax expense of \$4,760 by \$3,250 to eliminate misclassified consulting fees of \$750 and fines of \$2,500 paid to the ECC and agreed that these costs should be deducted from the pro forma operating expenses. Accordingly, Staff recommends the Commission accept Ridgelea's proposed adjustment to reduce taxes other than income tax expense by \$3,250.

²⁴ Case No. 2008-00364, Application for Rate Adjustment of Ridgelea Investments, Inc. Pursuant to the Alternative Rate Adjustment Procedure for Small Utilities (Ky. PSC Dec. 8, 2008).

APPENDIX D
STAFF REPORT CASE NO. 2009-00500
RECOMMENDED RATES AND CHARGES

RATES AND CHARGES

Residential Monthly Flat Rate \$ 32.00 per Month

MONTHLY SURCHARGE

\$5.45 per customer for a period of 24 months or until \$26,000 has been collected

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