

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF RIDGELEA INVESTMENTS,)
INC. FOR AN ADJUSTMENT OF RATES) CASE NO.
PURSUANT TO THE ALTERNATIVE RATE) 2008-00364
FILING PROCEDURE FOR SMALL UTILITIES)

O R D E R


On October 6, 2008, Ridgelea Investments, Inc. ("Ridgelea") filed its application for Commission approval of its proposed sewer rates. 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. All parties should review the report carefully and submit any written comments on Staff's findings and recommendations or requests for a hearing or an informal conference within 10 days of the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have 10 days from the date of this Order to submit written comments regarding the attached Staff Report or to request a hearing or an informal conference in this matter. If no request for a hearing or an informal conference is received by that date, this case shall stand submitted to the Commission for decision.

Done at Frankfort, Kentucky, this 14th day of October, 2008.

ATTEST:

By the Commission


Executive Director *for Stephen Stumbo*
in commission

STAFF REPORT
RIDGELEA INVESTMENTS, INC.
CASE NO. 2008-00364

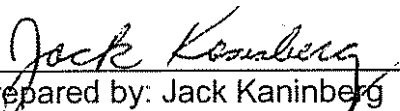
Pursuant to a request by Ridgelea Investments, Inc. ("Ridgelea") for rate case assistance, Commission Staff ("Staff") performed a limited review of the utility's test year operations for the calendar year ended December 31, 2007. The scope of Staff's review was limited to obtaining information as to 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.


Upon completion of the review, Staff assisted Ridgelea in the development and preparation of a rate application for its operations in Franklin County, where it provides sewer service to 199 customers from three sewage treatment plants. The application included an adjusted pro forma operating income statement wherein adjustments were made to test year operating revenues and expenses that were known and measurable and deemed to be reasonable, as shown in Attachment A. The rates proposed by Ridgelea were based on the pro forma income statement as shown in the application. The application also includes the calculation of Ridgelea's revenue requirement for its Franklin County operations using an 88% operating ratio, which is frequently used by the Commission to determine revenue requirements for small sewer utilities. To generate the revenue requirement of \$71,640 for Franklin County operations, Ridgelea is proposing to increase its annual revenues from sewer rates by \$18,865, an increase of 35.75 percent over normalized sewer revenues of \$52,775.

On August 29, 2008, the Commission received the rate application from Ridgelea. This application was deemed deficient because the customer notice failed to list the proposed percentage increase, and on October 6, 2008, Ridgelea cured this deficiency by filing the proper customer notice. Ridgelea's current rate for its Franklin County operations is a flat monthly fee of \$22.10, which it proposes to increase by 35.75 percent to \$30.00. Based on its review, Staff finds that Ridgelea's statement of adjusted test period operations is reasonable and reflective of normal operations and should be used to determine the revenue requirement. Staff further finds that the method that Ridgelea used to determine its revenue requirement is correct and reasonable. Accordingly, Staff recommends approval of Ridgelea's requested rates.

Jason Green is responsible for all revenue adjustments and the calculation of the proposed rates. Jack Kaninberg is responsible for the determination of the revenue requirement. Based on the recommendations herein, Staff is of the opinion that the rate as shown in Attachment B of this report is reasonable and should be approved by this Commission.

Signatures


Prepared by: Jack Kaninberg
Financial Analyst, Water and Sewer
Revenue Requirements Branch
Division of Financial Analysis


Prepared by: Jason Green
Rate Analyst
Water and Sewer Rate Design Branch
Division of Financial Analysis

ATTACHMENT A
STAFF REPORT CASE NO. 2008-00364

Ridgelea 2008 Pro Forma Attachment A	2007 PSC Report	Grantland reported	Franklin reported	Franklin Adjustments	Ref.	Franklin Adjusted
Revenues	\$102,059	\$50,324	\$51,735	\$1,040	A	\$52,775
Owner/Manager Fee	\$1,900	\$350	\$1,550	\$7,505	B	\$9,055
Sludge Hauling	\$3,250	0	\$3,250	\$11,725	C	\$14,975
Misc.-Trtmt./Disp.	\$59,088	\$10,756	\$48,332	(\$31,007)	D	\$17,325
Fuel/Power-Pumping	\$12,970	\$6,484	\$6,486	0		\$6,486
Agency Collection Fee	\$11,900	\$3,984	\$7,916	0	E	\$7,916
Outside Services Employed	\$25,493	\$500	\$1,500	0	F	\$1,500
		0	\$23,493	(\$23,493)		0
<i>Total Sewer O&M</i>	\$114,601	\$22,074	\$92,527	(\$34,725)		\$57,802
Depreciation Expense	\$2,841	\$2,446	\$395	0		\$395
Amortization Expense	\$815	0	\$815	\$3,411	G	\$4,226
Taxes Other Than Income	\$17,387	\$2,157	\$15,230	(\$14,065)	H	\$1,165
Total Operating Expenses	\$135,644	\$26,677	\$108,967	(\$45,924)		\$63,043
Income Taxes	\$684	\$684	0	0	I	0
Total Sewage Op. Exp.	\$136,328	\$27,361	\$108,967	(\$45,924)		\$63,043
NOI	(\$34,269)	\$22,963	(\$57,232)	\$46,964		(\$10,268)
Interest Income	\$21	\$21	0	0	J	0
Other Interest Expense	(\$319)	0	(\$319)	\$319	K	0
Net Income	(\$34,567)	\$22,984	(\$57,551)	\$47,283		(\$10,268)

\$ 63,043 – Pro Forma Operating Expenses for Franklin County Operations
88% - Divide by 88% Operating Ratio

\$ 71,640 – Revenue Requirement for Franklin County Operations

\$ 52,775 – Normalized Revenues for Franklin County Operations

\$ 18,865 – Increase Requested for Franklin County Operations

$\$71,640 / 12 = \$5,970 / 199 \text{ customers} = \$30.00 \text{ monthly rate}$

Explanatory Notes:

A. Normalized Revenues for the three Franklin County plants serving 199 customers, based on Commission Staff's billing analysis.

B. Owner/Manager Fee was adjusted to include an owner/manager fee of \$9,055 for the three Franklin County plants. In 2007, Ridgelea reported management fees of \$350 for Grantland and \$1,550 for all three Franklin County plants combined. Ridgelea's owner has never filed a rate case in Kentucky, and is generally unfamiliar with PSC rate-making practices, including the allowance of an owner/manager fee. The Commission frequently allows an owner/manager fee of \$3,600 for the owner/operator of a single sewage treatment plant, and in this case the owner operates four separate plants in two noncontiguous counties. By all accounts Ridgelea's owner is heavily involved and spends significant time in operational matters for these aged and failing plants. Staff's discussions with an employee of the Kentucky Division of Water indicated that the owner often responds in person to frequent emergency situations associated with the Franklin County sewers despite his location in Cincinnati, Ohio.

In addition, in preparing this application Staff has made significant adjustments to Ridgelea's reported 2007 expenses for its Franklin County operations, as detailed below. Because Ridgelea is generally unfamiliar with PSC practices, its documentation for various expenses was less than desirable, which is exacerbated by the fact that most of Ridgelea's maintenance and repair work is performed by Ridgelea's owner or his affiliated service company Perfect-A-Waste. Under these circumstances, Staff has removed the undocumented expenses reported by Ridgelea, but has included an owner/manager fee of \$9,055 for the three Franklin County plants, an average of \$3,018 per plant.

C. Sludge Hauling Expense was adjusted to include pro forma expenses of \$11,725 for sludge hauling and \$3,250 for sludge dumping fees charged by the City of Frankfort. PSC Staff noted that Ridgelea's sludge hauling is done by Perfect-A-Waste Sewage, an unregulated sewer services company owned by Ridgelea's owner. Staff also noted that an unusually heavy volume of sludge hauling costing \$7,000 was done in May 2007, and questioned whether this occurs annually. According to Ridgelea's owner, such heavy volumes are hauled annually to comply with environmental requirements, and such work has been done in the past by nonaffiliated companies at a significantly higher price than the \$7,000 paid in 2007. Therefore, this expense has been included in pro forma operations.

D. Miscellaneous Treatment & Disposal Expense was adjusted to remove expenses totaling \$31,007 from Franklin County operations. Ridgelea reported a total expense for 2007 of \$59,088 - consisting of \$10,756 at Grantland and \$48,332 in Franklin County - and this total included \$20,325 of undocumented accounts payable. Of the remaining \$38,763, checks were written to Ridgelea's owner totaling \$15,448, but no invoices exist to detail the work performed, at which Franklin County plant, or the time spent. According to Ridgelea's owner, he generally visits the plants on a weekly basis, performs various maintenance duties, and does the grass cutting.

Another \$20,656 in checks were written to the owner's Perfect-A-Waste service company, some of which were not supported by invoices. The invoices that do exist show Perfect-A-Waste billed monthly charges of \$650 for combined routine maintenance at the three Franklin County plants, and also billed other charges for effluent samples, chlorine, cleanings, and miscellaneous items.

In preparing this application, PSC Staff has removed a significant portion of these expenses due to inadequate documentation, detailed as follows:

	2007 PSC Report	Grantland Reported	Franklin reported	Franklin Adjustments	Franklin Adjusted	Notes
Accounts payable EOY	\$20,325	\$6,500	\$13,825	(\$13,825)	0	Remove -not documented
Checks Written						
Outside Vendors	\$2,350	\$500	\$1,850	0	\$1,850	
Charles Hungler (Owner)	\$15,448	???	\$9,834	(\$9,834)	0	No invoices
Perfect-A-Waste	\$20,656	\$1,092	\$19,564	(\$4,089)	\$15,475	5 invoices missing
Unaccted for	\$309	\$309	0	0	0	Disregard
Subtotal			\$31,248	(\$13,923)	\$17,325	
Paid from LOC	???	???	???	???	0	Disregard
Checks Total	\$38,763	\$4,256	\$34,507	???	\$17,325	
Totals	\$59,088	\$10,756	\$48,332	(\$27,748) ?-(\$3,259)	\$17,325	\$3,259 unexplained. remove

E. Agency Collection Fees of \$7,916 for the Franklin County plants were not adjusted. However, Staff notes that, unless Ridgelea aggressively pursues alternatives to its current billing and collection arrangement in Franklin County, this expense will increase if any rate increase is granted. The Farmdale

Water District currently bills for Ridgelea and charges 15% of all revenues collected. The PSC has previously expressed its longstanding concerns with this arrangement in other cases, and in this case Staff has not included any increase in this expense.

F. Outside Services Employed Expense was adjusted to remove expenses totaling \$23,493 from Franklin County operations. Ridgelea reported a total expense of \$25,493, consisting of \$2,000 in accounting fees and \$23,493 in legal fees. The accounting fees were allocated \$500 to Grantland and \$1,500 to Franklin County, and Staff made no adjustment. Of the \$23,493 in total legal fees, \$4,300 were accounts payable for which Ridgelea did not provide documentation; \$5,537 were legal fees associated with Indiana (non-jurisdictional) operations which Franklin County customers should not be expected to bear; and \$13,656 were fees associated with Franklin County legal matters which should not reasonably recur on an ongoing basis. Staff has removed all of these fees from pro forma operations, although it has included amortization of the Kentucky legal fees in Amortization Expense.

G. Amortization Expense was adjusted to include three items totaling \$4,226: the amortization of the acquisition adjustment of \$815; a \$2,731 amortization over five years of the Kentucky legal fees of \$13,656 that were removed from Outside Services Employed Expense; and a \$680 amortization over five years of the five-year discharge permits costing \$3,400 at the three Franklin County plants (removed below from Taxes Other Than Income Expense).

H. Taxes Other Than Income Expense was adjusted by \$14,065 to remove expenses associated with Franklin County operations. Ridgelea reported \$17,387 in total expense, of which \$2,157 was related to Grantland and \$15,230 was related to the Franklin County plants. The details of Staff's adjustment to this account are as follows:

Category	2007 PSC Report	Grant	Franklin reported	Franklin Adjustments	Franklin Adjusted	Notes
-Fines	\$10,675	\$0	\$10,675	(\$10,675)	0	
-5 year Permits	\$3,200	\$1,200	\$2,000	(\$2,000)	0	Remove and amortize
-Other Licenses & Permits	\$1,944	0	\$1,944	(\$1,400)	\$544	Remove & amortize Edgewood 5-yr. permit.
-Taxes	\$1,568	\$957	\$611	\$10	\$621	Allows \$606 property tax and \$15 filing fee.
-Total	\$17,387	\$2,157	\$15,230	(\$14,065)	\$1,165	

I. Income Taxes Expense was removed for rate-making purposes because Ridgelea is a Subchapter S Corporation.

J. Interest Income of \$21 was removed for rate-making purposes because it is immaterial and because Ridgelea is not generating sufficient revenues to accrue cash.

K. Other Interest Expense of \$319 was removed for rate-making purposes, under the assumption that Ridgelea is using the proceeds of a one-year note to help pay current and past-due operating expenses.

ATTACHMENT B
STAFF REPORT CASE NO. 2008-00364
STAFF'S RECOMMENDED RATE

Monthly Sewer Rate

Flat Rate

\$30.00 per month