

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF MAYO VILLAGE )  
WATER COMPANY, INC., FOR AN )  
ADJUSTMENT OF ITS RATES PURSUANT ) CASE NO. 8992  
TO THE ALTERNATIVE RATE ADJUSTMENT )  
PROCEDURE FOR SMALL UTILITIES )

O R D E R

On February 24, 1984, Mayo Village Water Company, Inc., ("Mayo Village") filed its application with this Commission to increase its rates pursuant to 807 KAR 5:076, Alternative Rate Adjustment procedure for Small Utilities ("ARF"). Mayo Village stated that the proposed rates would produce additional revenue of \$19,065, an increase of 50 percent. However, due to actual charges being greater than authorized, based on normalized test year revenue including the higher unauthorized rates, the actual increase requested would be \$16,132, an increase of 40 percent. Based upon the determination herein, Mayo Village has been granted an increase in revenue of \$1,443 annually, an increase of 3.5 percent.

On April 20, 1984, the Commission concluded from the record in this matter that there was a high probability of significant commingling of Mayo Village's expense items that were attributable to personal affairs and/or the cable TV franchise. Therefore,

Mayo Village was notified that an expansion of the scope of the proceeding was necessary to adequately evaluate the issues of the case.

On August 20, 1984, a hearing was conducted in this matter at the Commission's offices in Frankfort, Kentucky. The Consumer Protection Division of the Office of the Attorney General ("AG") was the only party to intervene in this proceeding.

#### COMMENTARY

Mayo Village is a privately-owned water company organized and existing under the laws of the Commonwealth of Kentucky ("Commonwealth") and serving approximately 118 customers with its principal office in Pikeville, Kentucky.

As found and documented herein, the operations and record keeping functions of Mayo Village are highly commingled with those of a jointly-owned and managed cable TV franchise and with personal affairs of the owners, Mr. and Mrs. Ireland Chaney. The only full-time permanent office employee, Mrs. Chaney, performs financial record keeping functions for both businesses in a single office located in the Chaney's home. There is a common billing process for 91 common customers of both businesses; consequently cash receipts for the 91 common customers are also processed jointly. From this combined office, billing, receipts and disbursements are processed by this owner-employee for the remainder of the 135 cable TV franchise customers and the remainder of the 118 water company customers. Records of both businesses are located in this office and a single telephone is used for both personal and business purposes. Analogous

circumstances exist for other routine operational functions such as repairs, maintenance, inspection, disconnects and reconnects, where another owner-employee, Mr. Chaney, performs duties for both businesses while in the common billing area and may use equipment for personal affairs. Thus the concern arises about the true cost of service to water customers.

#### TEST PERIOD

The Commission has adopted the 12-month period ending December 31, 1983, as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test period, the Commission has given full consideration to known and measurable changes found reasonable.

#### REVENUES AND EXPENSES

Mayo Village proposed several adjustments to revenues and expenses in its application. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

##### Commingled Expenses

Mr. Ireland Chaney, owner, president and principal laborer of Mayo Village, stated that he uses Mayo Village's truck for cable TV franchise operations.<sup>1</sup> Mr. Chaney also stated that Mayo Village's office labor and office furnishings, etc., were used for the cable TV franchise operations.<sup>2</sup> Furthermore, it was discovered that proportionately large sums of personal

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<sup>1</sup> Transcript of Evidence ("T.E."), August 20, 1984, pp. 48-49.

<sup>2</sup> T.E., pp. 55, 57, 59, 61.

expenses were commingled<sup>3</sup> with Mayo Village's expenses. The 1983 Annual Report lists 118 water customers for Mayo Village. The response to Item No. 5 of the Commission's information request dated July 12, 1984, states that there are 135 cable TV customers. Common customers which receive both cable TV and water services total 91. The Commission, in consideration of the aforementioned facts as determined herein, concludes that the expenses of Mayo Village are commingled with personal expenses and the expenses of the cable TV franchise.

From these facts, the question naturally arises as to how these commingled expenses can be separated to discern the true cost of service to water customers. Numerous attempts to obtain mileage records, work-time records, etc., understandably failed since Mayo Village is a very small company and to maintain such records would be burdensome. However, it should in no manner be inferred and the Commission in no way intends to imply that the lack of such record keeping lessens Mayo Village's burden of proof for any issue in this proceeding.

Initially the Commission was concerned with the commingling of business operations. However, subsequent to a thorough investigation of this one aspect of joint operations, the Commission has concluded that only \$1,630 of the total operation and maintenance expenses are attributable to the operation of the

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<sup>3</sup> Response to Commission's Order dated June 4, 1984, Item Nos. 6-7.

cable TV business. The \$1,630 consists of \$699 of administrative labor, \$200 of rent, \$402 of office supplies, \$282 of transportation expense, and \$47 in depreciation. During the test period, the cable TV business paid Mayo Village \$2,400 for performing the billing and collecting services for it. Therefore, the Commission finds that it is in the best interests of those concerned to allow the economics of joint operations to continue. The Commission nonetheless admonishes Mayo Village that, if it cannot prove in future proceedings that it has been totally compensated by the cable TV business for providing operation and maintenance services, this Commission may deem the arrangement to be imprudent and may disallow excessive costs for rate-making purposes.

It is apparent from the relatively large sums expended for personal costs and included as test-period office supplies expenses of the water company, the high level of transportation costs (classified as meter reading expense) relative to the 2-1/2 miles of water lines and the expensing of personal insurance costs to Mayo Village's operating statement, that the diversion of water company assets for personal use is pervasive in this instance. Therefore, the Commission has made allocations of some test-year expenses based on specific identification and reasonable assumptions given the inadequacy of Mayo Village's record keeping.

#### Normalized Revenues

Mayo Village's 1983 Annual Report shows revenues from water sales of \$37,868. The billing analysis shows that revenues of \$40,800 should have been generated by the rates charged during the

test period, a difference of \$2,932. Information filed in response to requests made at the hearing shows that Mayo Village had uncollectible accounts of \$1,090 which were not reflected in the billing analysis. In addition, Mr. John Tackett, Accountant for Mayo Village, stated in the response filed June 15, 1984, and in his testimony at the hearing<sup>4</sup> that the remaining revenue difference is due to adjustments for water leaks on the customers' side of the meter. The Commission has, therefore, determined that the test-period normalized revenue from water sales is \$40,800 based on the rates currently being charged by Mayo Village. This is a net increase of \$2,932 to reported test period revenues.

#### Wages and Salaries

Reported test-period wages and salaries were \$8,736.<sup>5</sup> Mayo Village proposed adjustments totaling \$7,449 annually to increase wages and salaries,<sup>6</sup> for a proposed level of \$16,185. The intent of the proposed increase is to raise the salaries of Mr. and Mrs. Chaney to \$7,200 each. Mr. Chaney received \$3,460 in salary during the test period and received no salary during 1982. Mrs. Chaney received approximately \$3,491 in salary during the test period and received no salary during 1982.<sup>7</sup> The proposed increase

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4 T.E., pp. 26-27.

5 Response to Commission's Order dated June 4, 1984, Item No. 1.

6 Application of Mayo Village filed February 24, 1984, p. 29.

7 Ibid., p. 3.

in salaries was not based on increases in job responsibilities and was intended solely to provide fair compensation for the Chaney's.<sup>8</sup>

It is clear from the pattern of extreme fluctuation in the level of salaries that the amount withdrawn represents a residual claim to Mayo Village's assets and is not a salary based on services received and, as such, is essentially based on the availability of funds in excess of other operating cash. It is the intent of this Commission to allow for rate-making purposes fair and reasonable compensation for all factors of production, including labor. Moreover, the Commission is required by law to provide a reasonable return on invested capital. In this instance the Chaney's are the principal constituents of both of these costs. The Commission is of the opinion that the salaries (as represented by the test period level of \$6,951 and the after-corporate tax net income of \$4,935 as determined herein) are fair and reasonable levels of compensation for the owners-operators of a utility such as this. Therefore, the Commission has denied the adjustment to increase wages and salaries for rate-making purposes herein.

Office Supplies

Reported test-year office supplies expense was \$4,938. Of this total amount, \$2,468 was expended for various personal expenses of the Chaney's.<sup>9</sup> Also charged to this account were

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<sup>8</sup> Response to Commission's Order dated June 4, 1984, Item No. 2.

<sup>9</sup> Ibid., Item No. 7.

contributions to charitable organizations in the amount of \$310.<sup>10</sup> In determining the amount of personal expenses included in this account, Mayo Village failed to allocate a portion of the telephone base rate to the cable TV business. Assuming 1/3 of the base telephone bill should be allocated to the cable TV business, personal expenditures would be reduced by \$50 and result in total personal expenditure and donations in the total amount of \$2,728. The Commission is of the opinion that personal expenses and charitable contributions which do not benefit the utility's customers are not legitimate expenses for rate-making purposes and consequently, has reduced test-period reported office supplies expense by \$2,728 to an annual amount of \$2,210.

#### Property Insurance

Mayo Village reported test-period property insurance expense of \$2,763. A breakdown of this amount reflected that \$161 was for flood insurance on a building and its contents; \$200 was for the service truck liability insurance; and \$1,519 was for multi-peril coverage on the building exclusively.<sup>11</sup>

The record reflects that the building is not an asset of Mayo Village; however, tools, parts and supplies used in the water operations are stored in the building. Consequently, the Commission finds it reasonable to allocate the flood insurance premium on the basis of the amount attributable to coverage of the

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<sup>10</sup> Response to AG Data Request dated March 26, 1984, Item No. 8.

<sup>11</sup> Ibid., Item No. 10.



building's contents and finds a reduction to this premium of \$110 is fair and reasonable.

The allocation of the truck insurance policy premium should be based on the personal expense allocation factor which is the same method used herein to allocate meter reading transportation expense. Thus, the Commission has reduced this premium by \$100.

Since the building is not Mayo Village's asset and coverage is exclusively on the building, the Commission concludes that the exclusion of the total premium of \$1,519 is appropriate.

#### Rents

The 1983 reported rent expense was \$300 which was for the use of a room in the Chaney's home for an office. Mayo Village proposed an annual \$300 increase for an adjusted annual expense of \$600. The Commission is of the opinion that \$600 annual rental for an office is not unreasonable; however, in this instance the office is regularly used for personal purposes which is evidenced by the payments of personal expenses and personal use of the telephone and for the cable TV business, neither of which benefit the customers of Mayo Village. Therefore, the Commission has reduced the annual rental expense by \$200, 1/3 of the annual charge for personal use of the office, and finds an annual rental charge of \$400 to be fair and reasonable.

#### Interest Expense

Mayo Village's actual test-period interest expense was \$1,307. The total interest expense expected to be incurred

through the next 5 years is \$303,<sup>12</sup> which results in an average expense of \$61. Therefore, the Commission has reduced test-period interest expense by \$1,246.

#### Meter Reading

The test-year reported meter reading expense of \$5,638 was comprised of gas, oil and repairs to Mayo Village's service truck. The Commission is of the opinion that \$5,638 for transportation expense is excessive when considering the number of customers of Mayo Village and that it has only 2-1/2 total miles of water lines. Mayo Village has offered no valid evidence in this proceeding that this is a reasonable level of transportation expense. Moreover, it is very clear to the Commission that personal use should account for some of this expense. Therefore, in fairness to Mayo Village, the Commission finds that \$2,819 annually, or 1/2 of the actual test-year reported cost, is a fair and reasonable amount for this expense. In future proceedings, the Commission must have complete documentation of all transportation costs for utility purposes before they can be included.

#### Depreciation Expense

Mayo Village had actual test-year depreciation expense of \$5,589. This represents a depreciation rate approaching 10 percent on undepreciated assets.<sup>13</sup> Of the total depreciation, \$931 was attributable to the service truck with a cost basis of \$4,655,

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<sup>12</sup> Response to Commission's Order dated June 6, 1984, Item No. 4.

<sup>13</sup> Ibid., Item No. 5.

which is approximately a 20 percent rate and is not unreasonable. Of the remaining gross assets of \$86,075, \$26,698 is for water treatment equipment, \$57,640 is for mains and \$1,737 is for meters. Depreciating these amounts by 2.5 percent, 2 percent and 10 percent, respectively, and allocating the service truck depreciation expense on the same basis as meter reading expense, results in a fair and reasonable level of depreciation expense of \$2,460. Therefore, the Commission has reduced reported test-year depreciation expense by \$3,129.

Taxes Other Than Income Taxes

Mayo Village reported test-period taxes (other than income taxes) expense of \$2,481. Page 22 of the Annual Report states in its detailed breakdown of this expense that \$1,041 of the total amount was for sales taxes. Part of Mayo Village's duty as a corporate citizen of the Commonwealth is to act as the Commonwealth's agent in the collection of sales taxes. Mayo Village is obliged to calculate, bill, and collect sales taxes from its appropriate customers and remit the sales tax to the Commonwealth. Thus, Mayo Village is an agent of the Commonwealth and it has no claim to the sales tax; in fact, it establishes a liability to the Commonwealth as it collects the tax. Consequently, all receipts of sales taxes should be recognized and recorded as a liability to the Commonwealth in an equal amount.

Instead of recording the sales tax liability at the time of collection, some businesses prefer to credit sales with the entire amount collected, including the sales tax, and to make an adjustment at the end of each period to reflect sales tax payable.

Under this method, if certain sales are not subject to the tax, it is necessary to keep a record of taxable and non-taxable sales. Also under this method, any discrepancy between the tax due and the amount actually collected from customers would be automatically absorbed in the sales figure.

The Commission is not aware of any generally accepted accounting principle which treats the remittance of sales taxes to the taxing governmental authority by the collecting agent as an expense. Moreover, the Uniform System of Accounts for Class C Water Utilities anticipates the use of one of the above methods. Therefore, the Commission concludes that sales taxes are not a legitimate expense for rate-making purposes and, accordingly, the Commission has reduced the test-period level of taxes other than income taxes by \$1,041.

The Commission finds that Mayo Village's adjusted test period operations are as follows:

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenue	\$37,868	\$ 2,932	\$40,800
Operating Expenses	45,559	<6,999>	38,560
Operating Income	<u>\$&lt;7,691&gt;</u>	<u>\$ 9,931</u>	<u>\$ 2,240</u>
Other Income	2,400	-0-	2,400
Interest Expense	1,307	<1,246>	61
Net Income	<u><u>\$&lt;6,598&gt;</u></u>	<u><u>\$11,177</u></u>	<u><u>\$ 4,579</u></u>

#### REVENUE REQUIREMENTS

The Commission finds that an operating ratio of 88 percent modified for state and federal taxes and an allowance for uncollectible accounts is fair and reasonable. The Commission has

determined Mayo Village's increased revenue requirements as follows:

Total Operating Expenses	\$ 38,560
Interest Expense	61
Other Income	<2,400>
Uncollectible Accounts	<1,090>
	<u>\$ 35,131</u>
Modified Operation Ratio	85.445%
	<u>\$ 41,115</u>
Uncollectible Retention Factor	97.33%
Gross Revenue Requirements	<u>\$ 42,243</u>
Test-Period Operating Revenues	<40,800>
Increase in Revenues	<u><u>\$ 1,443</u></u>

#### UNAUTHORIZED RATES

On August 5, 1981, the Commission entered an Order in Case No. 8136 (Notice of Mayo Village Water Company, Inc., to Publish an Effective Tariff which Increases Water Rates) establishing rates to be charged by Mayo Village; however, the application filed in the instant case shows the actual rates charged during the test period were 20 cents higher per 1,000 gallons of water than those allowed in Case No. 8136.

In response to the Commission's information request of June 4, 1984, Mayo Village filed a comparison, based on test year sales, of revenues which should have been produced from the authorized rates and from actual rates charged. This showed a difference of approximately \$3,164. No explanation was given for the charging of unauthorized rates, but Mr. Chaney testified that he was not aware the rates charged were different from those granted.<sup>14</sup>

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<sup>14</sup> T.E., pp. 53-54.

As detailed elsewhere in this Order, the evidence shows that the revenues collected by Mayo Village during the test year are not sufficient and, accordingly, an increase has been granted herein. Moreover, the Commission is of the opinion that requirement of a refund of the overcharges would affect the financial viability of Mayo Village and ultimately be detrimental to both Mayo Village and its customers. However, the Commission cautions Mayo Village that in the future only those rates specifically authorized by the Commission may be charged.

#### OTHER CHARGES

Mayo Village's approved connection fee which is on file with the Commission is \$10. However, Mr. Chaney's testimony<sup>15</sup> and the response filed June 15, 1984, indicate that Mayo Village began charging a \$20 connection fee at the same time the current rates were placed into effect. This connection fee is applicable when residents change and it is necessary to disconnect service for one customer and reconnect for another at the same premises, as well as when service is connected for a new customer. The Commission is of the opinion that \$20 is a reasonable charge which will enable Mayo Village to recoup its costs from those for whom the cost is incurred. The Commission cautions Mayo Village, however, that no rate or charge may be changed without prior approval of the Commission.

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<sup>15</sup> T.E., pp. 50-51.

### SUMMARY

The Commission, having considered the evidence of record and being advised, is of the opinion and finds that:

1. The rates in Appendix A are the fair, just and reasonable rates for Mayo Village and will produce gross annual revenue sufficient to pay its operating expenses, service its debt, and provide a reasonable surplus for equity growth.

2. The rates proposed by Mayo Village would produce revenue in excess of that found to be reasonable herein and therefore should be denied upon application of KRS 278.030.

3. Mayo Village is currently charging rates which are in excess of those authorized by the Commission. No refunds should be required at this time, but Mayo Village should be advised that only those rates and charges approved by the Commission may be made and that refunds may be required and penalties imposed should further violations occur.

4. Pursuant to 807 KAR 5:066, Section 13(1)(b), customers are responsible for maintenance and repair of service lines from the meter to the premises served. Therefore, Mayo Village should not make adjustments for water leaks which occur in the customer's service line since such adjustments are ultimately reflected in higher rates to other customers.

5. The \$20 connection fee currently charged by Mayo Village is fair, just and reasonable and should be approved.

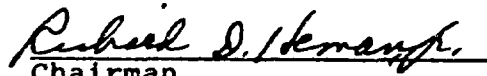
IT IS THEREFORE ORDERED that the rates and charges in Appendix A be and they hereby are approved for services rendered on and after the date of this Order.

IT IS FURTHER ORDERED that the rates proposed by Mayo Village be and they hereby are denied.

IT IS FURTHER ORDERED that within 30 days of the date of this Order, Mayo Village shall file with the Commission its revised tariff sheets setting out the rates and charges approved herein and shall file tariff sheets setting out all rules and regulations governing the provision of service.

Done at Frankfort, Kentucky, this 21st day of December, 1984.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

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Secretary



APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 8992 DATED DECEMBER 21, 1984.

The following rates are prescribed for the customers of Mayo Village Water Company, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

5/8-Inch Meters

<u>Usage Blocks</u>		<u>Rates</u>
First	2,000 gallons	\$8.70 Minimum
Next	3,000 gallons	3.10 per 1,000 gallons
Next	15,000 gallons	2.60 per 1,000 gallons
Next	30,000 gallons	2.00 per 1,000 gallons
Over	50,000 gallons	1.65 per 1,000 gallons

1-Inch Meters

<u>Usage Blocks</u>		<u>Rates</u>
First	2,000 gallons	\$11.30 Minimum
Next	3,000 gallons	3.10 per 1,000 gallons
Next	15,000 gallons	2.60 per 1,000 gallons
Next	30,000 gallons	2.00 per 1,000 gallons
Over	50,000 gallons	1.65 per 1,000 gallons

Connection Fee \$20.00