

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC INVESTIGATION OF THE)	
IMPACT OF THE TAX CUTS AND JOB ACT ON)	CASE NO.
THE RATES OF KENTUCKY-AMERICAN)	2018-00042
WATER COMPANY)	

ORDER

This proceeding arises from a Commission-initiated investigation of the effect of the Tax Cuts and Jobs Act (TCJA) on the rates of Kentucky-American Water Company (Kentucky-American) and four other investor-owned utilities. The Attorney General of the Commonwealth of Kentucky by and through the Office of Rate Intervention (Attorney General) requested and was granted intervention. On January 26, 2018, Kentucky-American filed¹ the Direct Testimony of John Wilde (Wilde Testimony), which included proposed rates and charges that reflect the reduction of its tax expense due to the lowering of the corporate federal income tax (FIT) rate from 35 percent to 21 percent under TCJA.

Pursuant to the Commission’s procedural schedule, discovery was conducted and Kentucky-American requested that this case be submitted based on the record, while the Attorney General requested the scheduling of an informal conference and an evidentiary

¹ Kentucky-American filed the testimony in Case No. 2017-00481, *Electronic Investigation of the Impact of the Tax Cuts and Job Act on the Rates of Atmos Energy Corporation, Delta Natural Gas Company, Inc., Columbia Gas of Kentucky, Inc., Kentucky-American Water Company, and Water Service Corporation of Kentucky* (filed Jan. 26, 2018). Case No. 2017-00481 was subsequently separated into this and other utility-specific investigations, and the record from Case No. 2017-00481 was incorporated into this proceeding by the Commission’s January 30, 2018, initiating Order.

hearing. An informal conference (IC) was held at the Commission's offices on July 9, 2018. At the IC, Kentucky-American explained that it currently lacks the information necessary to calculate the amount of excess Accumulated Deferred Income Taxes (ADIT) to be returned to the ratepayers. Kentucky-American also described the procedures to be used for gathering the information necessary to calculate its excess ADIT and stated the anticipated time frame for completing those procedures. On August 16, 2018, the Attorney General filed a motion requesting that his previously filed request for a hearing be held in abeyance, stating that it would be premature for the Commission to hold a hearing before the necessary information regarding the excess ADIT is available.² The Attorney General's motion also requests the Commission to now implement Kentucky-American's proposed interim rates reflecting the savings from the reduced FIT expense.

On August 20, 2018, Kentucky-American filed a revised schedule of rates reflecting the amounts recorded as a deferred liability for the lower tax expense under the TCJA for the period of January 1, 2018, through July 31, 2018, and an estimated August 2018 reserve. Kentucky-American proposes that the reduction in its revenue requirements attributable to the lower tax expense under the TCJA be returned to customers via a reduction in rates. The proposed rate reduction is based upon only the FIT rate reduction, while the rate impact of the TCJA on Kentucky-American's ADIT will continue to accrue as a deferred liability and will be addressed later in this proceeding, or in Kentucky-American's next base rate case. The proposed rate reduction returns to customers over the next ten months the deferred FIT liability for the eight months of

² Attorney General's Motion to Hold Request for Hearing in Abeyance and to implement the Proposed Interim Rate Relief filed August 16, 2018.

January through August 2018, along with an additional ten months' worth of annual FIT savings over that same period based on authorized revenues from the last rate case.³

FIT Reduction

In Wilde's Testimony, Kentucky-American proposed to use the twelve months ending August 31, 2017, as the test year to calculate the effects the TCJA would have on the FIT portion of its revenue requirement. Kentucky-American chose this 12-month period because it is the same test year that was used to establish its current base water rates in Case No. 2015-00418.⁴ For the sewer rates, Kentucky-American's proposed calculations are based on the 12-month period ending December 31, 2013, the base period from Case No. 2014-00390.⁵ Kentucky-American calculated a difference in its FIT between the 35 percent tax rate and the 21 percent tax rate to be \$3,974,550 for the water division and \$10,515 for the sewer division.⁶ Applying the gross revenue conversion factor (GRCF) for the 21 percent FIT rate of 1.35983 for water and 1.34662 for sewer, Kentucky-American arrived at its revenue requirement reduction of \$5,404,718 for water customers and \$14,160 for sewer customers.⁷

In its December 27, 2016 Order initiating this investigation in Case No. 2017-00481, the Commission ordered Kentucky-American to begin recording the deferred

³ Case No. 2015-00418, *Application of Kentucky-American Water Company for an Adjustment of Rates* (Ky. PSC Aug. 23, 2016).

⁴ Wilde Testimony at 7.

⁵ *Id.* and Case No. 2014-00390, *Application of Kentucky-American Water Company for an Adjustment of its Wastewater Rates pursuant to 807 KAR 5:076* (Ky. PSC July 2, 2015).

⁶ Wilde Testimony, Exhibit A, Federal Income Tax Calculation – Estimated Savings.

⁷ *Id.*

liability on its books as of January 1, 2018, to reflect the reduction in the federal corporate tax rate to 21 percent and the associated savings in excess deferred taxes. On August 20, 2018, Kentucky-American stated that it had closed its books for the first seven months of 2018 and as of July 31, 2018, the deferred FIT expense liability was \$2,909,033 for water customers and \$3,416 for sewer customers.⁸ Kentucky-American calculated an estimated reserve of \$15,000 for August 2018, which results in a total reserve deferred FIT expense liability of \$3,404,966 for water customers and \$3,985 for sewer customers.⁹

Kentucky-American updated its annual FIT reduction for water and sewer operations to reflect the January through August 2018 deferred FIT expense, called the Stub Revenue Deferral, of \$3,408,951, and to reflect a reduction for the additional ten months of September 2018 through June 2019 of \$4,375,751. The total revenue proposed to be refunded to Kentucky-American customers over ten months is \$7,784,702.¹⁰

ADIT Reduction

The reduction in the FIT rate on regulated utilities from 35 percent to 21 percent results in excess ADIT balances that must be returned to the ratepayers. The TCJA separates the excess ADIT into two categories, protected and unprotected. The TCJA normalization rules only apply to protected ADIT which is defined as public utility property subject to accelerated depreciation under 26 U.S.C.A §§ 167 and 168.¹¹

⁸ Kentucky-American's Updated Notice of Amount of Deferred Liability filed August 20, 2018, at 1.

⁹ *Id.*

¹⁰ *Id.*, Exhibit A.

¹¹ Tax News Update, *Power and Utility concerns under the TCJA*, January 25, 2018, 2018-0186 <https://taxnews.ey.com/news/2018-0186-power-and-utility-concerns-under-the-tcja>.

The TCJA normalization rules require utilities to use the Average Rate Assumption Method (ARAM) or the Reverse South Georgia Method (RSGM) if the utility does not have sufficient financial records to comply with the requirements of ARAM.¹² Kentucky-American's parent corporation, American Water Works Inc. (American Water), owns the software that will enable Kentucky-American to determine which method the TCJA would require Kentucky-American to use, ARAM or RSGM.¹³ Kentucky-American estimates that it will take until the first or second quarter of 2019 to populate the data from Kentucky-American's existing records into American Water's software.¹⁴ Because Kentucky-American is unable to determine with any certainty which amortization method the TCJA will require it to use until 2019, using an estimate based on RSGM now could result in a normalization rule violation.¹⁵

Rate Design

Kentucky-American is proposing a base rate reduction rather than a rider for the FIT tax expense reductions, asserting that a rate reduction is more direct and efficient than implementing a rider. Under Kentucky-American's current billing system, the coding of a rider would take 60–90 days to create and implement.¹⁶ Calculations are based on the 12-month period ending August 31, 2017, plus the deferred liability results from the first eight months of 2018.¹⁷ The rates are designed to return the deferred liability incurred

¹² *Id.*

¹³ Responses to Staff's Second Request, Item 1.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ Wilde Testimony at 7.

in the first eight months of 2018 to customers and provide an additional ten months' of annual tax savings to customers for a total of \$7,784,702 to be refunded to water and sewer customers over the next ten months.¹⁸ These rates would be effective until new base rates are established in Kentucky-American's next general rate case or until the Commission approves revised rates in this case to be effective after the ten-month period ending June 30, 2019.¹⁹

In determining the rates for the water customers, Kentucky-American estimated the tax savings, determined the proportional amount of savings for each customer class based on each class's test year revenue and then calculated the rate, per hundred gallons, that would produce the revenues authorized in rate Case No. 2015-00418 less the tax savings. For the residential water customer with a 5/8 inch meter using 4,000 gallons, the base rate portion of an average bill will decline from \$36.57 per month to \$32.73 per month, a decrease of \$3.84, or about 10.5 percent. For the sewer customers, Kentucky-American calculated the FIT reduction in authorized revenues, which was 3.9 percent, and applied this percentage reduction to the rates for Rockwell Village, Owenton, and Ridgewood sewer customers.²⁰

Summary

The Commission has investigated and analyzed the methodology proposed by Kentucky-American to reduce its rates to reflect the tax expense impact of the TCJA.

¹⁷ Kentucky-American adjusted the 12-month difference to 11 months as the proposed rates will be effective for 11 months.

¹⁸ Kentucky-American Notice of Amount of Deferred Liability filed July 23, 2018, Exhibit A

¹⁹ Kentucky-American Notice of Amount of Deferred Liability filed July 23, 2018, at 2.

²⁰ Wilde Testimony at 8. Kentucky-American did not include a reduction in Millersburg sewer rates as the City of Millersburg sewer rates were adopted after the last rate case.

Based on its review of the case record, including the testimony and data request responses, the Commission finds that Kentucky-American's proposed methodology to reflect the FIT expense reduction is reasonable and in the public interest. Further, the Commission finds that the rates and charges which are set forth in Exhibit B Schedule 2 attached to Kentucky-American's August 20, 2018 filing, and in the Appendix to this Order, are reasonable and should be approved. This investigation is ongoing and the record needs to be further developed before a determination can be made as to the reduction in rates necessary to reflect the impact of the TCJA on Kentucky-American's excess ADIT. Finally, once Kentucky-American has filed its 2017 Federal Income Tax return or has determined if it can use ARAM or RSGM, Kentucky-American must file an estimate of the excess deferred accumulated taxes and its plan on how those amounts will flow back to its customers.

IT IS THEREFORE ORDERED that:

1. The rates and charges set forth in the Appendix, attached hereto, reflect the FIT expense reduction under the TCJA and are fair, just, and reasonable for Kentucky-American to charge for service rendered on and after September 1, 2018.

2. Kentucky-American shall file a plan with the Commission, within 30 days of the earlier of the filing of its 2017 Federal Income Tax Return or its determination of whether ARAM or RSGM can be used to calculate ADIT, to refund to customers the excess ADIT since January 1, 2018, resulting from the TCJA.

3. This case shall remain open on the Commission's docket to further investigate the refunds due to customers for the excess ADIT since January 1, 2018.

4. Within 20 days of the date of this Order, Kentucky-American shall file with the Commission, using the Commission's electronic Tariff Filing System, its revised tariffs as set forth in this Order reflecting that they were approved pursuant to this Order.

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By the Commission



ATTEST:


Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2018-00042 DATED **AUG 30 2018**

The following rates and charges are prescribed for the customers in the area served by Kentucky-American Water Company. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under the authority of this Commission prior to the effective date of this Order.

Water Consumption Rates

Residential	\$0.5059 per 100 Gallons
Commercial	\$0.4412 per 100 Gallons
Industrial	\$0.3834 per 100 Gallons
Municipal & Other Public Authorities	\$0.4053 per 100 Gallons
Sales for Resale	\$0.3837 per 100 Gallons
Bulk Sales Rate	\$0.1674 per 50 Gallons

Municipal or Private Fire Protection Service

2-inch	\$8.11 per month
4-inch	\$32.67 per month
6-inch	\$73.49 per month
8-inch	\$130.64 per month
10-inch	\$204.18 per month
12-inch	\$294.43 per month
14-inch	\$423.96 per month
16-inch	\$522.81 per month
Private Hydrant	\$70.90 per month
Public Hydrant	\$39.90 per month

Sewer Rates

Rockwell Village	
First 12,000 Gallons	\$32.67
Over 12,000 Gallons	\$0.272 per 100 Gallons
Owenton	
First 2,000 Gallons	\$27.19
Next 1,000 Gallons	\$1.235 per 100 Gallons

Next 2,000 Gallons	\$0.972	per 100 Gallons
Next 5,000 Gallons	\$0.880	per 100 Gallons
Next 10,000 Gallons	\$0.787	per 100 Gallons
Next 20,000 Gallons	\$0.694	per 100 Gallons
All over 40,000 Gallons	\$0.662	per 100 Gallons

Ridgewood \$35.14

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