

**KENTUCKY-AMERICAN WATER COMPANY**  
**CASE NO. 2008-00427**  
**ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION**

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**Witness: Michael A. Miller/Sheila Miller**

24. With regard to AFUDC, please provide the following information:
- a. Which of the Company's witnesses is testifying to the subject of AFUDC in this case and where is this included in his/her testimony?
  - b. Please provide a detailed description of the following: (a) current AFUDC accrual policies; (b) changes made in the AFUDC accrual policy and rate determination in the last 10 years; (b) current AFUDC accrual rate and the method used to calculate this rate; if applicable, explain whether the Company is using a tax-grossed up AFUDC rate.
  - c. W/P 1-5, page 18 shows that the proposed AFUDC amount of \$3,094,804 consists of the equity portion of AFUDC of \$1,819,124 and the equity gross-up amount of \$1,231,179. Please explain what exactly these two AFUDC components represent, and how they were derived.
  - d. Work paper and description of how the pro forma AFUDC amount of \$3,094,804 was calculated. Show the total forecasted period average AFUDC-bearing CWIP balance and describe and quantify what projects make up this total AFUDC-bearing CWIP balance. Show the total forecasted period average non-AFUDC bearing CWIP balance and describe and quantify what projects make up this total non-AFUDC bearing CWIP balance. Show that the AFUDC rate, when multiplied by the total forecasted period average AFUDC-bearing CWIP balance produces the proposed AFUDC amount of \$3,094,804.
  - e. What is the impact of the AFUDC amount of \$3,094,804 on the Company's net after-tax operating income? Please show calculations.

**Response:**

- a. Michael A. Miller and/or Sheila Miller  
Mr. Miller's testimony discusses the AFUDC in regard to the KRS II project on pages 32 and 36 of his testimony.
- b. a. The Company's policy for AFUDC was provided in response to KAW\_R\_PSCDR1#2 (filed under confidential protection).  
b. There has been no material change in the policy in the last 10 years. The AFUDC rate is based on the currently authorized WACC.  
c. The current AFUDC rate is 8.03% and it is determined by the weighted cost of capital (return on rate base). The Company's current AFUDC is based on the weighted cost of capital of 8.03% and the equity portion is grossed-up for taxes in accordance with FAS 109 guidelines.
- c. The total AFUDC included in the company's going level revenue is \$3,094,804. That number is comprised of both the debt cost portion of AFUDC and the gross-up

equity portion of \$1,819,124 as shown on WP 1-5, page 18. The equity gross-up amount is not double counted in the AFUDC brought above the line to determine going-level revenues. Instead, while it is shown on the schedule, it is only used in the deferred tax calculation and amortized in accordance with FAS 109 which has been accepted by this commission in past cases. See the calculation below.

	Weighted Cost of Capital As Proposed	
Calc of Equity Factor		
Weighted Cost of LTD	3.12%	
Weighted Cost of STD	0.40%	
Weighted Cost of Pref	0.15%	
Weighted Cost of Com	4.87%	
Effective Tax Rate	40.36%	
Total of Equity	5.02%	
Total Capital	8.54%	
 Equity Factor	 58.78%	
 Total AFUDC from June 2009 thru May 2010		 3,094,804
Equity portion		
Weighted Cost of Preferred	0.15%	
Weighted Cost of Common	4.87%	
Total Equity	<u>5.02%</u>	
Total Capital	8.54%	
Equity Ratio	58.78%	
 Equity Portion = Total AFUDC x Equity Ratio		 1,819,124
 AFUDC Equity Gross up		
Equity Portion		1,819,124
One minus effective tax rate		<u>59.64%</u>
Equity portion divided by 59.64%		3,050,302
Less Equity Portion		<u>1,819,124</u>
Equity gross up		1,231,178

- d. The AFUDC calculation is detailed in working paper KAW\_R\_PSCDR1#1a\_WP1-5\_111408 pages 2 thru 36 beginning with the month of June 2009. The CWIP that the AFUDC calculation is based upon is detailed in working paper KAW\_R\_PSCDR1#1a\_WP1-4\_111408 pages 52 thru 65.

e. \$1,890,925

AFUDC	\$3,094,804
SIT	185,688

FIT            1,018,191  
                  \$1,890,925

For the electronic version, refer to KAW\_R\_AGDR1#24\_122308.pdf.

**SUPPLEMENTAL RESPONSE:**

- e. The Company's original response to this question was not correct. The Commission Staff asked a related question in PSCDR3#15, for which the Company did a more in-depth analysis regarding the AFUDC included in the case. At the time, the Company did not realize that the response to PSCDR3#15 created a conflict with the original response. Recently, the AG brought this conflict to the Company's attention and the Company agreed to supply a supplemental response to this question.

The utility operating income impact of the AFUDC included in the case is \$3,097,255. In the original response, the Company had incorrectly indicated that UOI associated with the \$3.095 million of AFUDC was impacted by the income tax effect. Due to the impact of deferred income taxes on the AFUDC the elimination of AFUDC essentially falls out dollar for dollar to the UOI line. As indicated on the attached schedules, that greater UOI deficiency related to eliminating the AFUDC must then be increased by the revenue conversion factor to gross-up the UOI deficiency for taxes in arriving at the revenue requirement deficiency consistent with the response to PSCDR3#15.

For the electronic version, refer to KAW\_SR\_AGDR1#24\_021309.pdf.

Kentucky American Water Company  
AGDR1#24e Supplemental

Line No.	Description	Original filing Forecasted Return at Current Rates	PSCDR3#15 Forecasted Return at Current Rates	Variance
1				
2	Operating Revenues	<u>62,245,274</u>	<u>59,150,470</u>	<u>3,094,804</u> AFUDC
3	Operating Expenses			
4	Operation and Maintenance	31,760,768	31,760,768	
5	Depreciation and Amortization	8,398,250	8,398,250	
6	Taxes Other Than Income	3,752,543	3,752,543	
7	State Income Taxes	512,472	512,850	
8	Federal Income Taxes	<u>2,923,048</u>	<u>2,925,121</u>	
9	Total Operating Expenses	<u>47,347,081</u>	<u>47,349,532</u>	
10	Utility Operating Income	<u>14,898,193</u>	<u>11,800,938</u>	<u>3,097,255</u>
11	Rate Base	<u>305,544,471</u>	<u>305,365,471</u>	
12	Rate of Return	<u>4.88%</u>	<u>3.86%</u>	
13	revenue conversion factor			<u>1.6519988</u>
14	Revenue Increase (cash)*			<u>5,116,662</u>

\*Note: The revenue increase generated above using the revenue conversion factor is slightly different than generated through the Company's detailed revenue requirement model due to changes in DFIT (AFUDC) and rate base.

KENTUCKY-AMERICAN WATER COMPANY

CASE NO: 2008-00427

OVERALL FINANCIAL SUMMARY

FOR THE TWELVE MONTHS ENDED: MAY 31, 2010

SCHEDULE C-1, PAGE 1 OF 1  
Witness Responsible: M.A. Miller/S. A. Miller

DATA: \_\_\_ BASE PERIOD \_X\_ FORECASTED PERIOD  
TYPE OF FILING: \_X\_ ORIGINAL \_\_\_ UPDATED \_\_\_ REVISED  
WORKPAPER REFERENCE NO(S): SCH C-2 (TOTAL COMPANY)

Line No.	Description	Forecasted Return at Current Rates	Proposed Increase	Forecasted Return at Proposed Rates
2	Operating Revenues	\$62,245,274	\$18,494,631	\$80,739,905
3	Operating Expenses			
4	Operation and Maintenance	31,760,768	141,176	31,901,944
5	Depreciation and Amortization	8,398,250	0	8,398,250
6	Taxes Other Than Income	3,752,543	30,535	3,783,078
7	State Income Taxes	512,472	1,099,376	1,611,848
8	Federal Income Taxes	2,923,048	6,028,241	8,951,289
9	Total Operating Expenses	47,347,081	7,299,328	54,646,409
10	Utility Operating Income	\$14,898,193	\$11,195,303	\$26,093,496
11	Rate Base	\$ 305,544,471		\$305,544,471
12	Rate of Return	4.88%		8.54%

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SCHEDULE C-1, PAGE 1 OF 1  
Witness Responsible: M.A. Miller/S. A. Miller

DATA: \_\_\_ BASE PERIOD \_\_\_ X FORECASTED PERIOD  
TYPE OF FILING: \_\_\_ X ORIGINAL \_\_\_ UPDATED \_\_\_ REVISED  
WORKPAPER REFERENCE NO(S): SCH C-2 (TOTAL COMPANY)

Line No.	Description	Forecasted Return at Current Rates	Proposed Increase	Forecasted Return at Proposed Rates	original filing	Variance
2	Operating Revenues	\$59,150,470	\$23,586,039	\$82,736,509	80,739,905	1,996,604
3	Operating Expenses	original revenue requirement	18,494,631			
4		adjustment to revenue requirement	5,091,408			
5						
6	Operation and Maintenance	31,760,768	180,040	31,940,808	31,901,944	38,864
7						
8	Depreciation and Amortization	8,398,250	0	8,398,250	8,398,250	0
9						
10	Taxes Other Than Income	3,752,543	38,941	3,791,484	3,783,078	8,406
11						
12	State Income Taxes	512,850	1,402,024	1,914,874	1,611,848	303,026
13						
14	Federal Income Taxes	2,925,121	7,687,762	10,612,883	8,951,289	1,661,594
15						
16	Total Operating Expenses	47,349,532	9,308,767	56,658,299	54,646,409	2,011,890
17						
18	Utility Operating Income	\$11,800,938	\$14,277,272	\$26,078,210	\$26,093,496	-15,286
19						
20						
21	Rate Base	\$ 305,365,471		\$305,365,471	305,544,471	-179,000
22						
23						
24						
25	Rate of Return	3.86%		8.54%	8.54%	8.54%
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