

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

In the Matter of:

AN 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 ) CASE NO. 2017-00481  
OF KENTUCKY, INC., KENTUCKY-AMERICAN )  
WATER COMPANY, AND WATER SERVICE )  
CORPORATION OF KENTUCKY )

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**DIRECT TESTIMONY OF STEVEN M. LUBERTOZZI**

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1 **Q. Please state your name, present position and business address.**

2 A. My name is Steven Lubertozi. I am the President of Water Service Corporation of  
3 Kentucky (“WSCK” or “Company”). My business address is 2335 Sanders Road,  
4 Northbrook, IL 60062.

5 **Q. What are the duties of your current position?**

6 A. As President of WSCK, I am responsible for all aspects of the Company’s business,  
7 culminating in the ongoing provision of safe drinking water and environmentally  
8 responsible wastewater service to all of our customers.

9 **Q. Please describe your professional background.**

10 A. I graduated from Indiana University in 1990, and I am a Certified Public Accountant. I  
11 earned my Master of Business Administration from Northwestern University’s Kellogg  
12 School of Management. I am a member of the American Institute of Certified Public  
13 Accountants. I have been employed by Utilities, Inc. since June of 2001.

14 **Q. Have you testified previously before the Public Service Commission of Kentucky?**

15 A. Yes. I have provided written and oral testimony before public utilities commissions  
16 throughout the United States, including the Public Service Commission of Kentucky  
17 (“Commission”), on topics ranging from cost of equity, capital structure, cost of debt,  
18 acquisition adjustments, divestment strategies, appropriate levels of operations and  
19 maintenance expense, parent company allocations, affiliate transactions, income taxes  
20 and most every aspect of utility operations. The other state commissions where I have  
21 presented testimony include Florida, Illinois, Indiana, Maryland, Nevada, New Jersey,  
22 New Mexico, North Carolina and South Carolina.

23 **Q. What is the purpose of your testimony in this proceeding?**

1 A. My testimony is to respond to the Commission's order to investigate the impact of the  
2 recently enacted Tax Cuts and Jobs Acts.

3 **Q. Please summarize Tax Cuts and Jobs Act?**

4 A. On December 22, 2017, President Donald Trump signed into law the Tax Cuts and Jobs  
5 Act of 2017 ("Tax Act"). The Tax Act can impact the Company, customers and  
6 developers in at least three ways. First, the Tax Act reduces the corporate income tax  
7 rates from 35% to 21%. Second, Contributions in Aid of Construction ("CIAC") are now  
8 included in taxable income for tax purposes, and third, bonus depreciation was  
9 eliminated.

10 **Q. What are requirements from the Commission's December 27, 2017 order?**

11 A. My interpretation is that there are three requirements in the Commission's December 27,  
12 2017 order, which are:

13 1) For WSCK to commence recording deferred liabilities on its books to reflect the  
14 reduction in the federal corporate tax and to the associated savings in excess deferred  
15 taxes,

16 2) For WSCK to show the impact of the reduction in federal corporate tax rates on the  
17 Company's financials reflecting the deferred liabilities, and

18 3) For WSCK to prepare a schedule of proposed rates to reflect the tax rate reduction.

19 **Q. Is WSCK in the process of recording deferred tax liabilities on its books to reflect  
20 the reduction in the federal corporate income tax rate?**

21 A. WSCK, through its shared service organization, Water Service Corp. ("WSC"), is  
22 currently working with tax and accounting professionals to prepare the necessary journal  
23 entries if any such journal entries are required. However, since our financial audit for the

1 2017 calendar year is ongoing WSCK will not be in a position to set up a deferred tax  
2 liability, if one is even required, by the time contemplated by the Commission's  
3 December 27, 2017 order. Therefore, WSCK would not be able to respond to the first two  
4 items listed in the Commission's order.

5 **Q. How does the Company respond to the Commission request that WSCK prepare a**  
6 **schedule of rates to reflect the tax rate reduction?**

7 A. First WSCK must have the ability to generate the level of revenues contemplated in its  
8 most recent rate case. In Case No. 2015-00382 the Commission authorized WSCK adjust  
9 its rates to permit WSCK to recover \$2,462,154 in annual revenues.

10 **Q. Has the Company achieved the annual revenue requirement contemplated in Case**  
11 **No. 2015-00382?**

12 A. No, it has not. For the calendar year 2017, WSCK's preliminary financials, show that  
13 WSCK generated \$2,414,588, which is \$47,565 below the expected revenue requirement  
14 contained in the Commission order in Case No. 2015-00382.

15 **Q. Why is earning below the revenue requirement authorized in the Company's last**  
16 **case relevant?**

17 A. WSCK must have the opportunity to generate revenue to cover all of its operating  
18 expenses, and if revenues had decreases since 2015 it can be presumed that WSCK is not  
19 covering all of its costs.

20 **Q. In Case No 2015-00382 did WSCK use the 35% corporate income tax rate to**  
21 **determine its requested revenue?**

22 A. Yes, in Case No. 2015-00382 WSCK used the higher corporate income tax rate.

1 **Q. If WSCK would have used the 21% corporate income tax rate to determine its**  
2 **revenue request what would have been the resulting revenue request?**

3 A. Assuming all other items, capital and expenses, where unchanged, WSCK would have  
4 requested an increase in revenue of \$442,921, as compared to the additional annual  
5 revenue request of \$516,969. Ultimately, WSCK and the AG were able to reach a  
6 settlement agreement, which was approved by this Commission.

7 **Q. What amount of revenue did parties include in the settlement agreement that was**  
8 **approved by the Commission?**

9 A. The settlement agreement allowed WSCK to increase its revenue by \$361,892 or 70% of  
10 \$516,969 the original additional annual revenue request in Case No. 2015-00382.  
11 Assuming all other things being equal, the Company assumed a hypothetical settlement  
12 agreement would have resulted in a rate increase of 70% of the \$442,921 or \$310,045.

13 **Q. Assuming this hypothetical revenue request and hypothetical revenue settlement,**  
14 **what would have been WSCK's resulting overall revenue requirement?**

15 A. Assuming the parties would have settled on 70% of the reduced revenue request of  
16 \$442,921, which only accounts for the 14% reduction in the federal corporate income tax  
17 rate and which was not known at the time and could not have been known at the time,  
18 and further assuming the Commission would have approved such settlement, WSCK  
19 would have been authorized to recover \$2,410,307 in annual revenue. Below is a table  
20 (Table 1) which illustrates the hypothetical revenue.

**Table 1: Hypothetical Revenue**

**Using the 21% corporate income tax rate in Case No. 2015-00382**

<u>Description</u>	<u>Amount</u>
Authorized revenue from Case No. 2015-00382	\$ 2,462,154
Less approved increase from Case No. 2015-00382	(361,892)
Sub total	2,100,262
Plus hypothetical increase (70% of reduced revenue request)	310,045
Hypothetical revenue from Case No. 2015-00382	2,410,307
2017 annual revenue	2,414,588
<b>Difference</b>	<b>\$ (4,281)</b>

1

2 **Q. Using this analysis, is it the Company’s opinion that WSCK’s customers are due a**  
3 **reduction in rates due to the reduction in the corporate income tax rate from 35%**  
4 **to 21%?**

5 A. No. Table 1 shows that the resulting variance is only \$4,281, which is de minimus.  
6 Ultimately, the cost of drafting this testimony and engaging the AG and Commission  
7 would likely cost more than the variance shown in Table 1.

8 **Q. Did WSCK use an Operating Ratio or Rate Base Rate of Return to request rates in**  
9 **Case No. 2015-00382?**

10 A. Consistent with past practice and the Commission and Attorney General’s (“AG”)  
11 expectation, WSCK used an Operating Ratio (“OR”) methodology to request rates, which  
12 was contemplated in Case No. 2008-00563.

13 **Q. In WSCK’s most recent rate case, did the Commission make a determination of**  
14 **deferred taxes assets or liabilities?**

15 A. No deferred tax assets or liabilities have ever been authorized or ordered by the  
16 Commission for WSCK, as WSCK’s rates have been set using an operating ratio.

1 **Q. How is an operating ratio rate case different from a rate base rate of return rate**  
2 **case?**

3 A. An OR case allows a utility to recover its costs plus a return or margin on certain  
4 expenses. A rate base rate of return rate case allows a utility to earn a return on and of its  
5 investment, and this investment includes a reduction (liability) from Accumulated  
6 Deferred Income Taxes. Absent this liability, it may not be appropriate to WSCK to  
7 create the regulatory liability for the excess deferred income taxes contemplated in the  
8 Commission's December 27, 2017 order.

9 **Q. Are there other issues related to the Tax Act that were not contemplated in the**  
10 **Commission's December 27, 2017 order?**

11 A. Yes, there are at least two other issues that need to be addressed. First, the taxability of  
12 CIAC, and second the elimination of bonus depreciation.

13 **Q. Please explain how the taxability of CIAC will impact WSCK.**

14 A. The Tax Act now makes any contribution in aid of construction ("CIAC"), plant or cash,  
15 taxable and therefore, WSCK will now need to immediately start collecting gross up on  
16 all CIAC. Below is Table 2 which shows WSCK's gross up methodology.

**Table 2: CIAC Gross Up Calculation  
2017 Tax Act making CIAC taxable**

**TAX IMPACT =  $R / 1.0 - R \times (F + P)$**

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(1) R = Applicable marginal rate of Federal and State Corporate Income Tax.

(2) R shall be determined as follows:

$$R = ST + FT (1 - ST)$$

ST = Applicable marginal rate of State Corporate Income Tax

FT = Applicable marginal rate of Federal Income Tax

(3) F = Dollar Amount of charges paid or contributions to a utility as contributions in aid of construction which must be included in taxable income of the utility.

(4) P = Dollar amount of property or monies conveyed to utility which must be included in taxable income of the utility.

1

2 **Q. Please summarize the Company's position as it relates to the Tax Act?**

3 A. WSCK acknowledges that the federal corporate tax rate is decreasing from 35% to 21%,  
4 but there are multiple reasons why there should be no rate reduction for WSCK's  
5 customers. First, it is too early to determine the full impact of the Tax Act on WSCK or  
6 its customers. Secondly, WSCK is not achieving the revenue requirement authorized by  
7 this Commission, which was based on a June 30, 2015 test year, and thirdly, assuming  
8 the hypothetical revenue determination shown in Table 1 WSCK would only be  
9 collecting an additional \$4,281 of annual revenue, which is de minimus.

10 **Q. Do you believe that the Commission should engage in single-issue ratemaking?**

11 A. It is my understanding that the Commission has a history of rejecting single-issue  
12 ratemaking, unless otherwise specifically authorized by regulation. An adjustment to  
13 rates based explicitly and solely on the Tax Act would violate the single-issue ratemaking  
14 principle. Furthermore, many other items (e.g., expense and capital) have changed since  
15 WSCK's last rate case, which was a based on a June 30, 2015 test year, and therefore it



1 would be imprudent and inappropriate to adjust customer's rates outside of a base rate  
2 case.

3 **Q. Does the Company plan on filing a base rate case in 2018?**

4 A. Yes, WSCK is forecasting that it will file a base rate case using an OR and a future test  
5 year within 2018. This anticipated case will address all of the issues contemplated within  
6 the Tax Act and any and all changes to capital investment and operating expenses.

7 **Q. Please summarize the Company's position as it relates to the Tax Act?**

8 A. WSCK acknowledges that the federal corporate tax rate is decreasing from 35% to 21%,  
9 but there are multiple reasons why there should be no rate reduction for WSCK's  
10 customers. First, it is too early to determine the full impact of the Tax Act on WSCK or  
11 its customers. Secondly, WSCK is not achieving the revenue requirement authorized by  
12 this Commission, which was based on a June 30, 2015 test year, and thirdly, assuming  
13 the hypothetical revenue determination shown in Table 1 WSCK would only be  
14 collecting an additional \$4,281 of annual revenue, which is de minimus.

15 **Q. Does this conclude your prepared direct testimony?**

16 A. Yes, it does.

**AFFIDAVIT**

The undersigned, Steven M. Lubertozi, being duly sworn, deposes and says that he is the President of Water Service Corporation of Kentucky and is authorized to submit this testimony on behalf of Water Service Corporation of Kentucky, and that the information contained in the testimony is true and accurate to the best of his knowledge, information and belief, after reasonable inquiry, and as to those matters that are based on information provided to him, he believes to be true and correct.



Steven M. Lubertozi, Affiant

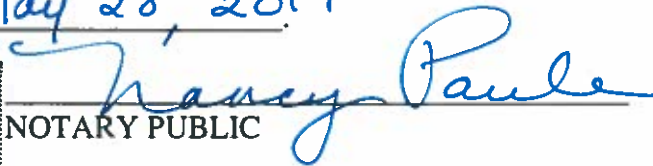
**NOTARY CERTIFICATE**

**STATE OF ILLINOIS**

**COUNTY OF COOK**

Subscribed, acknowledged and sworn to before me by Steven M. Lubertozi on this 25th day of January, 2018.

My commission expires: May 28, 2019



NOTARY PUBLIC