KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2018-00042
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Linda C. Bridwell

1. Refer to the Direct Testimony of John R. Wilde, page 9, wherein Mr. Wilde states, "KAWC believes that the most efficient way to address the amount of tax expense benefits to customers since January 1, 2018, is to create a deferred liability within 30 days of the effective date of changes that the Commission may authorize, to be included in the next rate case."

a. Provide the expected date KAW intends to file a notice for its next general base rate case.

b. Provide the effective date of new rates KAW anticipates in its next general base rate case.

Response:

a. Kentucky American continually evaluates the appropriate time to file a petition for an adjustment to rates, balancing the financial requirements of the business with the cost implications for customers. While Kentucky American is not actively preparing a rate case at this time, it expects to file a notice for its next general base rate case within the next 12 months.

b. Please refer to the response to part a of this same discovery request.

Witness: John R. Wilde

2. Refer to the Direct Testimony of John R. Wilde, page 6, wherein Mr. Wilde states, "KAWC proposes to establish a regulatory liability once the remeasurement of the ADIT is completed and notify the Commission of the initial amount of the regulatory liability established."

a. When does KAW expect it will be able to provide an estimate regarding the level of ADITs?

b. Does KAW have an estimate of excess ADITs, subject to re-measurement? If so, provide the estimate, separated by protected and unprotected excess ADITs.

Response:

a. KAW, solely for financial reporting purposes under ASC 740, computed a re-measurement of its ADIT. This estimate was subject to the provisions contained in SEC Staff Accounting Bulletin 118. In SAB 118, SEC staff acknowledges that any amount booked is an estimate subject to change, and as such gives companies a one-year measurement period to make changes. The estimate provided here can and will change within the next year primarily driven by the company's filing of its income tax returns.

b. KAW was included in American Water Works, Inc.'s ("AWW") annual 10K. As part of that filing, KAW, for financial purposes, subject to guidance in SAB 118, re-measured its ADIT. Substantially all of the amount of the re-measurement was recorded in a regulatory liability account reflecting KAW's belief the amounts will be refunded to customers through normalization of the amounts in the future. KAW does not have the ability to break out the difference between protected and unprotected, however, it can break out the amounts between plant and non-plant. See response to Item 4 for further details.

The AWW 10K shows that KAW recorded a regulatory liability (exclusive of the gross-up) of approximately $32.8 million dollars. Of that amount, $30,163,661 was related to plant and $2,618,551 related to non plant.

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Witness: John R. Wilde

3. Provide Mr. Wilde's exhibits and any accompanying workpapers in native excel format.

Response:

Please refer to the attachment to Item 20 of the Commission's First Request for Information in this case.

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Witness: **John R. Wilde**

4. Refer to the Direct Testimony of John R. Wilde, page 4, wherein Mr. Wilde states, "[t]he calculation of the effect on ADIT balances that need to be normalized into future rates and implementing a method to normalize the resulting excess is a complex and involved process."

a. Provide KAW's understand of which deferred taxes are considered protected under the Tax Cuts and Jobs Act.

b. Explain whether KAW will be able to use the average rate assumption method for the amortization of protected excess ADITs or whether KAW will be forced to use the "alternative method" as described in the Tax Cuts and Jobs Act.

Response:

a. Under Internal Revenue Code ("IRC") section 168(1)(9), a "taxpayer must, in computing its tax expense for purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, use a method of depreciation with respect to such property that is the same as, and a depreciation period for such property that is no shorter than, the method and period used to compute its depreciation expense for such purposes".

Therefore, in general, what people commonly refer to as "protected" ADIT, is the ADIT that results from the difference between tax depreciation, and depreciation re-computed on tax basis using the same method and same life as depreciation used for ratemaking purposes. This is commonly referred to as the "method / life" difference.

In addition, on a utility by utility basis, the ADIT that results from repairs differences may or may not be a "protected" difference. The reason for this is that when the repairs accounting method change was made, depending on the facts and circumstances surrounding the procedural issues of obtaining IRS consent, a taxpayer may have been required to agree to use a normalization method of accounting related to repair property. Specifically, American Water Works and each of its subsidiary companies, including KAW, were required to agree to use normalization related to its repairs, and therefore substantially all of KAW's plant related differences are protected differences, subject to normalization provisions of the tax code.

b. KAW has not been able to make a determination with any certainty as to whether or not it qualifies for the alternative method. KAW and its affiliates have access to and license to use software that would enable usage of ARAM, after its estimate is completed and in filing the tax return for 2017. This may be enough to disqualify KAW from usage of the alternative method. If this is the case, KAW will need time to implement ARAM.

Witness: **John R. Wilde/Linda C. Bridwell**

5. Refer to the Direct Testimony of John R. Wilde, page 4, wherein Mr. Wilde states, "utilities will not be able to claim bonus depreciation on property placed in service after September 27, 2017 unless construction had begun before that date, or the property was acquired pursuant to a contract in place prior to that date."

a. Has KAW calculated the effect the loss of bonus depreciation will have on its borrowing needs? If so, provide all such calculations.

b. Has KAW calculated the effect of the loss of deduction for "some employee fringe benefits" as described on p. 5 of Mr. Wilde's testimony? If so, provide all such calculations.

c. Has KAW calculated the effect the 100% taxability on CIAC and CAC will have on the Company?

Response:

a. The analysis has not been done. Regarding bonus depreciation, the Company understands the loss of bonus depreciation will affect cash flow and borrowing needs but no detailed analysis has been done for KAW.

b. The analysis has not been done.

c. KAW has estimated the impact of the 100% taxability on CIAC and Customer Advances to be $1.5 million. While KAW is still working through all of the accounting, it expects to begin collecting a gross-up in Customer Advances and Contributions in early 2018. A gross-up on tap fees will require Commission authorization.

Witness: Linda C. Bridwell

6. Explain, in complete detail, why the use of a 12-month period ending August 31, 2017 for water rate calculations and a 12-month period ending December 31, 2013 for sewer rate calculations is reasonable.

Response:

The current rates for water were established in Case No. 2015-00418 based on the forecasted test period of 12-months ending August 31, 2017. The current rates for sewer were established in Case No. 2014-00390 based on the historical test period of the 12 months ending December 31, 2013. Given that these forecasted and historic periods were used to set the Company's current utility rates, and given that the investigation "is initiated to review the impact of the reduction of the federal corporate tax rate from 35 percent to 21 percent on the utility rates," these periods are the most logical periods to use for any adjustment to current rates.

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Witness: John R. Wilde

7. Provide the Return on Equity and Rate of Return used to calculate the amounts presented in Exhibit A to Mr. Wilde's testimony.

Response:

On Exhibit A, lines A through C for Water, the proposed return on equity and rate of return were 10.75% and 8.06%, respectively. On exhibit A, lines D through E, no separate return on equity or rate of return are calculated, but rather income tax is assumed to be the same fraction of the authorized black box revenue requirement as it was of the proposed rates.