

COMMONWEALTH OF KENTUCKY
BEFORE THE KENTUCKY PUBLIC SERVICE COMMISSION

In the Matter of:

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

KENTUCKY-AMERICAN WATER
COMPANY’S ORDERING PARAGRAPH 2 REPORT

Kentucky-American Water Company (“KAW”), by counsel, hereby reports its plan for providing to customers any excess Accumulated Deferred Income Taxes (“ADIT”) since January 1, 2018. The Commission’s August 30, 2018 Order in this matter approved the reduction in water and sewer rates as a result of the reduction in the corporate federal income tax (“FIT”) rate from 35 percent to 21 percent as part of the Tax Cuts and Jobs Act (“TCJA”). Those reduced rates have been in place since September 1, 2018.

As for the return of any excess ADIT to customers, the Commission recognized that KAW needs to determine whether the Average Rate Assumption Method (“ARAM”) or the Reverse South Georgia Method (“RSGM”) should be used to calculate excess ADIT.¹ The Commission also recognized KAW’s estimate 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” in furtherance of calculating excess ADIT.² Further, in Ordering Paragraph 2 of the Commission’s Order, the Commission directed KAW to 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

¹ August 30, 2018 Order, p. 5.

² *Id.*

whether ARAM or RSGM can be used to calculate ADIT, to refund to customers the excess ADIT.”³ The federal tax return was filed on October 12, 2018. Therefore, in accordance with Ordering Paragraph 2, KAW hereby provides the following status of its efforts regarding the ARAM or RSGM determination and its plan for providing customers any excess ADIT.

KAW now believes that it cannot use RSGM and instead must use ARAM because KAW has the data and software to establish and maintain the ARAM calculation. KAW believes this is true even though KAW is required to use a composite rate for book depreciation. The use of ARAM is a fair and economical calculation for both customers and KAW because the excess ADIT accumulated over the life of the assets, and, therefore, should be amortized to customers over the remaining life of those assets.

Progress towards populating the PowerPlant/PowerTax software the Commission referred to in its Order has been good. Prior to the enactment of TCJA, KAW began the process of engaging a consultant to assist with upgrading the PowerPlant/PowerTax software itself. Work began early in 2018 with an assessment of the current state of the software and what improvements were needed. The update project included the implementation of the Deferred Tax module which is necessary for calculating excess ADIT. Because the PowerTax portion of the software interfaces with PowerPlant, PowerPlant had to be properly reconfigured and re-implemented first. That process is near completion and PowerPlant is now in the first testing phase.

Work towards properly aligning data at a consistent level of detail and setting up the interfacing at that level of detail between the PowerPlant and PowerTax modules has also started. KAW is now in the phase of aligning the data between source systems that feed PowerPlant and PowerTax at a common and consistent level of detail, so that the required data is

³ *Id.*, p. 7.

available to be interfaced into the Deferred Tax module of PowerTax where the ARAM calculation takes place. Part of the data alignment entails making sure the data is in the correct format for interfacing and that basis adjustments are not co-mingled with method/life differences, which is currently the case for KAW's tax repair method change adjustments.

In addition, setting up the book depreciation alignment to the tax records is also progressing. An alignment is necessary because book depreciation is based on a composite rate while the tax depreciation is based on a vintage detail level. PowerPlant is capable of producing a vintage book depreciation calculation in sync with the unvintaged book depreciation calculation; KAW just needs to populate the respective PowerTax tables with that vintage calculation and align the respected tax basis record to that calculation. This alignment is important for the ARAM calculation and the analysis needed to quantify what is protected versus unprotected. It is important to note that data alignment does not mean changing any prior depreciation methods or numbers; it is just to ensure proper configuration of the software so ARAM can be calculated and maintained. KAW remains on track to be finished with this entire process by the first or second quarter of 2019 at which time it will be able to calculate excess ADIT and use ARAM for the amortization.

On October 26, 2018, KAW notified the Commission of its intent to file a general base rate case requesting an increase in its water rates. The application for that rate case will be filed within the next few weeks. Although the excess ADIT amounts will not be known with certainty at the time the rate case is filed, KAW plans to address the excess ADIT issue in its direct testimony and is working diligently towards providing exact excess ADIT amounts in the rate case at the earliest possible moment so that the issue can be addressed as the rate case progresses. However, if such exact amounts cannot be made in time to be properly considered as part of the

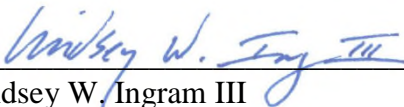
rate case, then the Commission can use this tax investigation case (which remains open pursuant to Ordering Paragraph 3 of the Commission's August 30, 2018 Order) to consider the excess ADIT issue and resulting return to customers.⁴

Date: November 9, 2018

Respectfully submitted,

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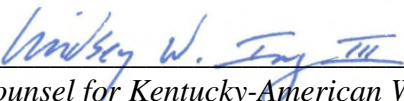
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CERTIFICATE OF COMPLIANCE

In accordance with 807 KAR 5:001, Section 8(7), this is to certify that KAW's November 9, 2018 electronic filing is a true and accurate copy of the documents being filed in paper medium; that the electronic filing has been transmitted to the Commission on November 9, 2018; that there are currently no parties that the Commission has excused from participation by electronic means in this proceeding; and that an original and six (6) copies of the filing are being hand delivered to the Commission within two (2) business days.



Counsel for Kentucky-American Water Company

⁴ In fact, to the extent there is any excess ADIT related to KAW's sewer operations, this tax investigation case would be the appropriate vehicle to address it.