



Steven L. Beshear
Governor

Leonard K. Peters
Secretary
Energy and Environment Cabinet

Commonwealth of Kentucky
Public Service Commission
211 Sower Blvd.
P.O. Box 615
Frankfort, Kentucky 40602-0615
Telephone: (502) 564-3940
Fax: (502) 564-3460
psc.ky.gov

David L. Armstrong
Chairman

James W. Gardner
Vice Chairman

Linda Breathitt
Commissioner

June 12, 2013

Lindsey W. Ingram III, Esq.
Monica Braun, Esq.
Stoll Keenon Ogden PLLC
Suite 2100
300 West Vine Street
Lexington, Kentucky 40507-1801

Re: Case No. 2012-00520
Kentucky-American Water Company

Dear Ms. Braun and Mr. Ingram:

Pursuant to the Commission's Order of June 3, 2013, in the above-referenced case, enclosed are Commission Staff's written questions to Dr. James H. Vander Weide and Mr. Carl Meyers.

Sincerely,

A handwritten signature in black ink, appearing to read "Gerald E. Wuetcher".

Gerald E. Wuetcher
Executive Advisor/Attorney

cc: Parties of Record
Enclosures

WRITTEN QUESTIONS FOR DR. JAMES H. VANDER WEIDE

1. At Schedule 3 of your rebuttal testimony, you provide an updated Discounted Cash Flow Analysis for your proxy group of water utilities at February 2013. Have you performed a more recent update based on the April 19, 2013 edition of Value Line and other more current information? If you have done so, please provide a copy of the update.

2. At pages 21 and 22 of your rebuttal testimony, you discuss “more recent research” regarding the accuracy of analysts’ forecasts.

a. Are the articles listed in Table 3 on page 22 the more recent research to which you refer?

b. Are you aware of any articles published since 2006 that address whether analysts’ forecasts are biased toward optimism?

c. If you are aware of any articles published since 2006 that address whether analysts’ forecasts are biased toward optimism, please list those articles and briefly summarize them.

3. a. Confirm that it is your position that analysts are not optimistic or self-serving in their growth forecasts, but intentionally exclude information that would tend to cause actual earnings results to be lower in comparison.

b. In your opinion, are investors aware of the items that affect actual earnings, accounting write-offs and special charges that affect actual earnings, and that analysts exclude such from their forecasts?

4. Table 3 of your rebuttal testimony indicates that one of the articles concludes that analysts’ forecasts show evidence of declining optimism and another concludes that analysts’ forecasts are pessimistic. At page 21 of your rebuttal testimony, you state that the forecasts were pessimistic for the last four years. To what do the articles attribute the analysts’ declining optimism and pessimism?

5. In your direct and rebuttal testimony, you indicate that the Capital Asset Pricing Model (CAPM) underestimates required returns for securities or portfolios with betas less than 1.0. At page 28 of your Rebuttal Testimony, you refer to two Fama and French studies which indicate that actual portfolio returns are higher for portfolios with betas less than 1.0 than what the CAPM predicted. Of what research findings, if any, are you aware that support the continued relevance of beta in determining investors’ expected return?

6. What alternate methods of performing CAPM analysis exist that provide results that you would consider more reasonable in estimating investors' required return on equity?

7. In your direct testimony, you provide CAPM estimates of 9.6 and 10.1 percent.

a. Do you believe these results to be so low as to be unreasonable?

b. Are these results inconsistent with the most recent Return on Equity awards shown in Kentucky-American Water Company's Response to Item 23 of Commission Staff's Second Request for Information? Why?

8. At page 42 of your rebuttal testimony, you discuss economists' projections that future interest rates will be higher than current interest rates.

a. How far in the future are economists projecting that interest rates will begin to rise?

b. Are economists projecting significant increases in interest rates?

c. What is the current yield to maturity on A-rated utility bonds?

9. On or about May 24, 2013, Standard & Poor's reported that it had upgraded the corporate credit rating on American Water Works Company and certain of its subsidiaries from BBB+ to A- with a stable outlook. Does this report affect your analysis and testimony in this case? If yes, what effect does it have on your analysis and testimony?

WRITTEN QUESTIONS FOR CARL MEYERS

1. Is it correct that the FIN 48 reserve is a reclassification of the deferred tax liability for expenditures deducted for tax purposes for which Kentucky-American Water Company and American Water Works Company are of the opinion that is less likely than not to be accepted by the Internal Revenue Service?
2.
 - a. What decreases to forecasted test-period expenses have occurred as a result of the aggressive tax position taken by Kentucky-American Water Company and American Water Works Company?
 - b. What reductions to rate base accounts have occurred as a result of the aggressive tax position taken by Kentucky-American Water Company and American Water Works Company?
 - c. If specific benefits cannot be identified or quantified, how do Kentucky-American Water Company ratepayers benefit from the aggressive tax accounting treatment?
3.
 - a. If Kentucky-American Water Company and American Water Works Company took a less aggressive tax accounting approach for the expenditures in question, how would Kentucky-American Water Company and American Water Works Company account for these expenditures?
 - b. Would the expenditures be capitalized and depreciated at an accelerated rate for tax purposes and result in deferred tax liability?
 - c. Can you provide a calculation of the deferred tax liability that would have resulted in the capitalization of all expenditures that have created the current FIN 48 reserve and the effects of this deferred tax liability on the requested revenue requirement? If yes, please provide.