Exhibit No.:	
Issues:	*Accumulated Deferred Income Tax Balance and Income Tax Expense*
Witness:	*Stephen M. Rackers*
Sponsoring Party:	*MOPSC*
Type of Exhibit:	*Surrebuttal Testimony*
Case No.:	*ER-2007-0002*
Date Testimony Prepared:	*February 27, 2007*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

STEPHEN M. RACKERS

UNION ELECTRIC COMPANY
d/b/a AMERENUE

CASE NO. ER-2007-0002

Jefferson City, Missouri
February 2007

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Union Electric Company d/b/a AmerenUE for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area.	))))	Case No. ER-2007-0002

AFFIDAVIT OF STEPHEN M. RACKERS

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Stephen M. Rackers, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 7 pages to be presented in the above case; that the answers in the foregoing Surrebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Stephen M. Rackers

Stephen M. Rackers

Subscribed and sworn to before me this 27th day of February, 2007

Toni M. Charlton

TONI M. CHARLTON NOTARY SEAL NOTARY PUBLIC STATE OF MISSOURI

TONI M. CHARLTON
Notary Public - State of Missouri
My Commission Expires December 28, 2008
Cole County
Commission #04474301

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STEPHEN M. RACKERS

UNION ELECTRIC COMPANY
d/b/a AMERENUE

CASE NO. ER-2007-0002

Q. Please state your name and business address.

A. Stephen M. Rackers, 9900 Page Avenue, Suite 103, Overland, Missouri 63132.

Q. By whom are you employed and in what capacity?

A. I am employed by the Missouri Public Service Commission (Commission) as a Utility Regulatory Auditor V.

Q. Are you the same Stephen M. Rackers who previously filed direct testimony in this case?

A. Yes, I am.

EXECUTIVE SUMMARY

Q. What is the purpose of your surrebuttal testimony?

A. My surrebuttal testimony will address the rebuttal testimony of AmerenUE (AmerenUE or Company) witness Charles A. Mannix regarding the balance of accumulated deferred income taxes that is appropriately included in rate base. The Staff has made adjustments to the accumulated deferred income tax balance to eliminate items which are not appropriate for ratemaking.

My surrebuttal testimony will also discuss the Staff's correction of its calculation of income tax expense to reflect the proper ratemaking treatment of salvage and cost of removal.

<u>ACCUMULATED DEFERRED INCOME TAXES</u>

Q. Please briefly discuss the items that remain at issue regarding the accumulated deferred income taxes (ADIT) that should be included as a reduction to rate base.

A. Witnesses from the Company, the Staff and the Attorney General's Office have met on several occasions to discuss this issue. As a result of these discussions and the examination of updated information through December 31, 2006, there is agreement among the parties that have participated in these discussions regarding most of the items that should be reflected in the ADIT balance that is included in rate base. However, there are two items which have not been resolved. These two items are Mixed Service Costs and Indirect Overheads. These items relate to capital costs which are treated differently for financial reporting and income tax purposes.

Q. What is the Staff's position regarding these two items?

A. The Staff believes the Mixed Service Costs and the Indirect Overheads should be reflected in rate base at the levels that exist in the ADIT balance at the end of the true-up period, January 1, 2007.

Q. Why does the Staff believe this is the appropriate treatment for Mixed Service Costs?

A. First, the parties to this case agreed to and the Commission ordered a true-up of rate base through January 1, 2007. One of the rate base items specifically mentioned in the Jointly Proposed Procedural Schedule And Request For Other Procedural Items, filed August 29, 2006, as an "anticipated true-up item" is "deferred taxes". The amount of Mixed Service Costs included in the balance of ADIT at January 1, 2007 is zero.

Second, as Mr. Mannix discusses in his rebuttal testimony, the Mixed Service Costs item is a tax receivable and not a component of the accumulated deferred income tax balance.

The Staff does not believe the true-up process should be used to redefine the components of the rate base. This is what the Company is attempting to do by proposing to include tax receivables in rate base, a component which has not been previously included. For these reasons, Mixed Service Costs should not be included in the ADIT balance.

Q. How do you respond to Mr. Mannix's characterization of Staff's position as "form over substance".

A. The Commission's true-up process is a mechanism which allows for the updating of costs that were previously recognized in the determination of rate base. This process allows the parties to know in advance, how items will be addressed. Including new components in rate base circumvents this process.

Q. Is the Staff proposing to include the Inventory Overheads item in rate base?

A. Yes. There is an amount of Inventory Overheads that exists as part of the ADIT balance at January 1, 2007. The Staff believes that this January 1, 2007 level of Inventory Overheads is the appropriate amount to include in rate base. This Staff treatment of Inventory Overheads is consistent with its treatment of Mixed Service Costs.

Q. Is this treatment of Mixed Service Costs and Indirect Overheads consistent with the Staff's evaluation and treatment of other items in the ADIT balance?

A. Yes. The Staff evaluated all the items that existed in the ADIT balance at January 1, 2007. However it did not seek to include or exclude items that were not part of the January 1, 2007 ADIT balance, as the Company is attempting to do by including Mixed Service Costs. This item does not exist in the ADIT balance at January 1, 2007.

Q. Based on the Staff's treatment of Mixed Service Costs and Inventory Overheads, what is the appropriate rate base balance for ADIT?

A. On page 6, line 13 of his rebuttal testimony, Mr. Mannix recommends a balance of $1,108,439,383, as calculated on his schedule CAM-1-1. This balance should be increased by $62,721,230, to eliminate the amount of Mixed Service Costs multiplied by the Missouri Jurisdictional allocation factor, from CAM-1-1 ($63,488,938 X 98.7908%). This increase results in a balance of $1,171,160,613 ($1,108,439,383 + $62,721,230). The Staff recommends this amount of ADIT for inclusion in rate base.

INCOME TAX EXPENSE

Q. Please explain the correction the Staff is making to its calculation of income tax expense.

A. In its original calculation of income tax expense, the Staff added back the amount of accrued net salvage (salvage received less cost of removal) included in its annual amount of depreciation expense and deducted the amount of net salvage experienced as a result of actual plant retirements. This resulted in "flow through" treatment for the timing difference associated with net salvage. A timing difference exists because the amount of net salvage included in depreciation expense will be recognized in the future and significantly exceeds the actual amount of net salvage experienced for current plant retirements. As a result of the correction to reflect normalization, as well as making other changes, the cumulative affect on revenue requirement from the Staff's initial filing is approximately $35 million.

Q. How should net salvage be treated in the calculation of income taxes?

A. The Staff should have also recognized a negative amount of deferred income tax expense to "normalize" net salvage. This treatment eliminates the $35 million overstatement of revenue requirement.

Q. Please explain the difference between flow-through and normalization.

A. Flowing-through a tax timing difference means that the period used for recognizing an expense in calculating the income taxes reported to federal and state taxing authorities is also used in calculating income tax expense for ratemaking purposes. Normalizing a tax timing difference means that the period used to recognize an expense for financial reporting is also used for recognizing the expense in calculating income taxes for ratemaking.

The revenue requirement impact of flow-through and normalization is calculated below:

		Flow-Through	Normalization
Add Back: Book Depreciation (Including accrued net salvage)	+	$272,000,000	$272,000,000
Straight Line Depreciation (Book depreciation less accrued net salvage)	-	$176,000,000	$176,000,000
Accrued Net Salvage		$ 96,000,000	$ 96,000,000
Actual Net Salvage Incurred	-	$ 25,000,000	$ 25,000,000
Additional Taxable Income (Timing difference)		$ 71,000,000	$ 71,000,000
Current Income Tax Expense at 38%		$ 26,980,000	$ 26,980,000
Deferred Income Tax Expense			$<26,980,000>
Total Income Tax Expense		$ 26,980,000	$ 0
Tax Conversion Factor		x 1.62	
Revenue Requirement		$ 43,707,600	

As shown above, isolating only the effect of normalization for the tax timing difference associated with net salvage results in a reduction to the revenue requirement currently recovered from ratepayers by approximately $44 million. However, as a result of the correction to reflect normalization, as well as making other changes, the cumulative affect on revenue requirement from the Staff's initial filing is approximately $35 million.

Q. Will the deferred income tax expense resulting from normalization be recognized in the ratemaking process?

A. Yes. The deferred income tax expense will be accumulated and included in rate base in future rate cases.

Q. Have the rates established by the Commission in recent rate cases reflected normalization for net salvage?

A. Yes. Normalization of net salvage was reflected in the rates recently ordered by the Commission in the rate cases for Kansas City Power & Light Company, The Empire District Electric Company and Atmos Energy, Inc. There is no reason why AmerenUE should receive preferential treatment for this item.

Q. Does AmerenUE's filed case reflect normalization treatment for the increase in the level of accrued net salvage that results from the Company's proposed depreciation rates?

A. Yes. The Company's proposed depreciation rates significantly increase the amount of accrued net salvage included in depreciation expense. This significant increase in accrued net salvage was normalized by the Company.

Q. Are there additional reasons why normalization is appropriate for net salvage?

A. Yes, based on the Staff's proposed depreciation rates, customers will supply approximately $96 million for net salvage, however, only approximately $25 million is actually being incurred on a normal ongoing basis by the Company. This results in approximately $71 million of cash being supplied by ratepayers for net salvage expenditures that will not occur until sometime in the future. This is a significant advance payment by ratepayers. If ratepayers are expected to provide this advance payment, they should at least receive credit for it in the calculation of income taxes for the determination of rates. This is accomplished by normalization treatment.

In addition, the difference between the net salvage being accrued in the Company's current depreciation rates and the amount of actual net salvage incurred in 2006 was minimal. Based on any of the depreciation rate proposals in this case, this differential will increase significantly. The effect on rates of this transition will only be exacerbated if customers are required to supply the additional revenue requirement associated with the flow-through of the timing difference for net salvage. Normalization will appropriately facilitate the transition to including higher levels of accrued net salvage in depreciation expense.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.