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MISSOURI PUBLIC SERVICE COMMISSION

FILE NO. ER-2014-0258

REBUTTAL TESTIMONY

OF

JAMES I. WARREN
MILLER & CHEVALIER CHARTERED

Submitted on Behalf

Of

UNION ELECTRIC COMPANY
d/b/a Ameren Missouri

JANUARY 2015

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<u>Introduction</u>

Q. Please state your name and business address.

A. My name is James I. Warren. My business address is 655 Fifteenth Street, N.W., Washington, D.C. 20005.

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

A. I am a member of the law firm of Miller & Chevalier Chartered (M&C).

Q. Please describe your current responsibilities at M&C.

A. I am engaged in the general practice of tax law. I specialize in the taxation of and the tax issues relating to regulated public utilities. Included in this area of specialization is the treatment of taxes in regulation.

Q. On whose behalf are you submitting this testimony?

A. I am submitting this testimony on behalf of Union Electric Company d/b/a Ameren Missouri (Ameren Missouri or the Company).

Q. Please describe your professional background.

A. For more than 25 years, I have been involved in the provision of tax services almost exclusively to companies in various segments of the utility industry. I joined Miller in February of 2012. For the prior three years, I was a partner in the law firm Winston & Strawn LLP. Five years prior to that, I was a partner in the law firm of Thelen Reid Brown Raysman & Steiner LLP. Before that, I was affiliated with the international accounting firms of Deloitte LLP (October 2000 – September 2003), PricewaterhouseCoopers LLP (January 1998 – September 2000) and Coopers & Lybrand (March 1979 – June 1991) and the law firm Reid & Priest LLP (July 1991 – December 1997). At each of these professional services firms, I provided tax services primarily to electric, gas, telephone and water industry clients. My practice has included tax planning for the acquisition and transfer of business assets, operational tax planning and the representation of clients in tax controversies with the Internal Revenue Service (IRS) at the audit and appeals levels. I have often been involved in procuring private letter rulings or technical advice from the IRS National Office. On several occasions, I have represented one or more segments of the utility industry before the IRS and/or the Department of Treasury regarding certain tax positions adopted by the federal government. I have testified before Congressional committees and subcommittees and at Department of Treasury hearings regarding legislative and administrative tax issues of significance to the utility industry. I am a member of the New York, New Jersey and District of Columbia Bars and am also licensed as a Certified Public Accountant in New York and New Jersey. I am a member of the American Bar Association, Section of Taxation where I am a past chair of the Committee on Regulated Public Utilities.

Q. Have you previously testified in any regulatory proceedings?

A. Yes I have. I have testified regarding tax, tax accounting and regulatory tax matters before a number of regulatory bodies including the Federal Energy Regulatory Commission and the utility commissions in Florida, Arkansas, Louisiana, Nevada, Delaware, West Virginia, Virginia, Arizona, New Jersey, New York, Connecticut, Ohio, California, Maryland, Pennsylvania, Missouri, Illinois, Kentucky, Vermont, Tennessee, Indiana, Texas, the District of Columbia and the City of New Orleans.

Q. Please describe your educational background.

A. I earned a Bachelor of Arts (B.A.) in Political Science from Stanford University, a Juris Doctor (J.D.) from New York University School of Law, a Master of Laws (LL.M.) in Taxation from New York University School of Law and a Master of Science (M.S.) in Accounting from New York University Graduate School of Business Administration.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to respond to the eight proposed income tax-related adjustments included in the direct testimony that Michael L. Brosch filed on behalf of the Missouri Industrial Energy Consumers (MIEC). These proposals are listed in the summary schedule on page 4 of his testimony.

Q. How is your testimony organized?

A. I have divided my testimony into two major parts. The first part will briefly address the four proposals of Mr. Brosch with which I concur. The second part, which is the bulk of my testimony, will address the four remaining proposals with which I take issue. With respect to the latter four, I will not follow Mr. Brosch's ordering but will address the proposals in a progression that, hopefully, allows for the discussion of the first few issues to promote an understanding of the issues that follow.

Q. Are you sponsoring any schedules with your testimony?

A. No, I am not.

Q. Do you have any general comments regarding the tax-related information that the Company filed in this proceeding?

A. Yes, I have two.

Q. What is your first general comment?

A. The Company prepared and filed its tax-related data in this proceeding well before it had final 2014 tax data and, in fact, prior to the time it had filed its income tax returns for 2013. It used the most current data it had at that time knowing that it would necessarily "true-up" all numbers and calculations later on in the proceeding.

Q. What is your second general comment?

A. "Bonus" depreciation allows a taxpayer to claim as a tax deduction in the year it places an asset in service half of its cost in addition to claiming "regular" depreciation on the remaining non-deducted portion of its cost. "Bonus" depreciation was available through the end of 2013 but, by the terms of the tax code then in effect, expired at that time. However, the Company was aware that some in Congress were proposing to extend the existing "bonus" depreciation provision through 2014 – and perhaps further. Nevertheless, as of the time the Company prepared and filed its tax-related data and responded to the various tax-related data requests propounded upon it by MIEC (upon which much of Mr. Brosch's direct testimony is based), it presumed that "bonus" depreciation would not be available in 2014. Consequently, the Company's projected 2014 taxable income was significantly greater than it would have been had "bonus" depreciation been available in that year. As it turns out, on December 19, 2014, the President signed into law an extension of "bonus" depreciation through the end of 2014.[1] Therefore, when the Company's 2014 taxable income is re-projected, it will most assuredly be significantly lower than originally estimated, and perhaps even be a net operating loss. This re-projection should have a significant impact on Mr. Brosch's proposals which are premised on the expectation that the Company will generate sufficient taxable income in 2014 to enable it to absorb various tax attributes (*i.e.*, net operating loss carryovers (NOLCs), business credit carryovers, etc.). As I discuss each of his proposals, I will indicate where this should cause an impact.

THE FOUR PROPOSALS WITH WHICH I AGREE

The Tax Effect Of Equity Issuance Costs - Brosch Schedule MLB-1

Q. Please describe this proposed adjustment.

A. Mr. Brosch proposes to decrease Ameren Missouri's income tax expense element of cost of service by approximately $1 million on account of the Company's tax treatment of its equity issuance costs.

Q. Please describe the tax treatment of equity issuance costs and its regulatory implications.

A. Under the tax law, equity issuance costs are permanently non-deductible. Consequently, when such costs are included in rates, there is no associated income tax

[1] Public Law 113-295.

benefit that can be given to customers. In this regard, equity issuance costs are like non-deductible meal and entertainment costs. The revenue requirement impact of this situation is that customers must be charged approximately $1.55 (a “grossed-up” amount) in order to fund $1 of equity issuance costs (*i.e.*, after the Company pays income tax on the $1.55 of revenue, it will retain $1 – the amount it expended in connection with the equity issuance).

Q. With what aspect of Ameren Missouri’s treatment of these costs does Mr. Brosch take issue?

A. Mr. Brosch does not take issue with the tax treatment that the Company has applied to its equity issuance costs. What he is really asserting is that if the Commission changes the amount of its equity issuance cost amortization, there should be a corresponding change to the Company’s tax expense. Thus, Mr. Brosch’s first proposed adjustment is, in reality, simply a correlative adjustment.

Q. Do you agree?

A. Yes, I do.

<u>Research Tax Credits – Brosch Schedule MLB-2</u>

Q. Please describe this proposed adjustment.

A. Mr. Brosch proposes to decrease Ameren Missouri’s tax expense element of cost of service by approximately $300,000 to reflect additional research tax credits claimed by the Company in 2013.

Q. What are research tax credits?

A. Research tax credits are credits available to taxpayers who increase their qualified research activities over a designated base amount. Once earned, these credits are applied against the taxpayer's federal income tax liability.

Q. Is there a dispute regarding the treatment and amount of the Company's research credits?

A. No, there is not. The Company prepared the tax data for this proceeding well before its 2013 federal income tax return was filed (which occurred in September of 2014). Therefore, it did not yet know the quantity of research tax credits it would claim on that return. Consequently, in preparing its filing in this case, the Company used the quantity of research credits claimed on its 2012 federal income tax return with the intent of updating the number during the proceeding.

Q. So do you agree with Mr. Brosch that the research credits in this proceeding should be updated to reflect the quantity of such credits claimed on the Company's filed 2013 federal income tax return?

A. Yes, I do.

<u>Energy Efficiency Regulatory Asset – Brosch Schedule MLB-5</u>

Q. Please describe this proposed adjustment.

A. The general practice is to reflect in a rate base calculation the accumulated deferred income tax (ADIT) consequences of those items that are reflected in rate base. One of the items included in Ameren Missouri's rate base calculation is its Energy Efficiency Deferrals. Mr. Brosch proposes to increase Ameren Missouri's ADIT credit balance (and therefore to reduce the Company's rate base) by approximately $10.4 million on account of its Energy Efficiency Deferrals.

Q. Is Mr. Brosch's proposed adjustment a "technical" adjustment or merely a "procedural" one?

A. The latter. Mr. Brosch's proposed adjustment is intended to align the ADIT associated with the Company's Energy Efficiency Deferrals with the quantity of such deferrals that ultimately is included in the setting of the Company's rates.

Q. Do you concur with Mr. Brosch on this point?

A. Yes, I do. In the data it filed in this proceeding, the Company "synchronized" its ADIT with the Energy Efficiency Deferral regulatory asset that was reflected on its accounting records as of the end of 2013. The Company agrees that its ADIT balance should be "synchronized" with the amount of the Energy Efficiency Deferral regulatory asset that is ultimately used for setting its rates in this proceeding.

<u>Treatment Of ADIT In Account #281 – Brosch Schedule MLB-6</u>

Q. Please describe this proposed adjustment.

A. Mr. Brosch proposes to increase Ameren Missouri's ADIT credit balance (and therefore to reduce its rate base) by approximately $78.8 million by including in his computation the ADIT balance reflected in FERC Account #281 – a balance which the Company has not included in its ADIT computation.

Q. What is in Account #281?

A. Mr. Brosch properly describes the contents of this account. Account #281 contains the ADIT associated with those of the Company's pollution control facilities that are afforded especially favorable treatment under the applicable tax law (*i.e.*, rapid amortization of a portion of their cost).

Q. Why has the Company excluded its Account #281 balance in its calculation of the ADIT amount by which rate base is reduced?

A. In preparing its tax-related schedules in this proceeding, the Company used the conventions, including its convention to exclude Account #281 from its rate base calculation, it has used in its prior filings. It did not specifically analyze the propriety of its prior practice with regard to that account balance.

Q. Have you considered the propriety of the Company's treatment of this item?

A. Yes, I have. I agree with Mr. Brosch that the balance in this ADIT account should be included in the calculation of the ADIT by which the Company's rate base is reduced.

<u>THE FOUR PROPOSALS WITH WHICH I DISAGREE</u>

<u>Net Operating Loss Carryforward-Related ADIT – Brosch Schedule MLB-8</u>

Q. Please describe this proposed adjustment.

A. In the Company's filing, it reflected as the impact of its NOLC an ADIT asset (a deferred tax asset or DTA) of approximately $57.6 million.[2] This had the effect of increasing rate base by that amount (by decreasing the ADIT balance which reduces rate

[2] The Company also reflected a DTA of approximately $8.4 million as the impact of tax credit carryforwards. While this portion of my testimony will discuss NOLCs in detail, similar principles, both economic and ratemaking, are relevant to the tax credit carryforwards.

base). Mr. Brosch proposes to eliminate consideration of this entire balance, thereby decreasing the Company's rate base by $57.6 million.[3]

Q. Will you summarize the issue in dispute with respect to this proposed adjustment?

A. Yes, I will. Ameren Missouri reduces its rate base by its net ADIT credit balance (its deferred tax liability or DTL). As I will explain, a DTL is used to reduce rate base because it represents a source of cost-free capital; that is, it represents an amount of cash the Company has received as a consequence of claiming certain favorable tax deductions. An NOLC has an impact on the amount of cost-free capital a company possesses. The Company has reflected in its rate base computation the actual impact its NOLC has on the quantity of cost-free capital it possesses. Mr. Brosch proposes an alternative to reflecting the actual quantity of cost-free capital. He proposes that this Commission impute for this purpose the hypothetical quantity of cost-free capital that the Company would have possessed if it had always filed a separate federal income tax return instead of filing, as it actually does, as a member of the Ameren consolidated tax group.

Q. Please summarize why you disagree with Mr. Brosch's proposal.

A. Mr. Brosch proposes to impute, for purposes of this proceeding, $57.6 million of cost-free capital that the Company does not actually have. Ameren Missouri's hypothetical "stand alone" tax posture is just that – hypothetical. The Company files as part of a consolidated group. Over all, that filing posture benefits the group. However, it is the nature of a consolidated filing that any given member may be better off in some years as a result of consolidated filing and worse off in other years. So it has been with

[3] His proposed adjustment including tax credit carryforwards is $66 million.

Ameren Missouri. Mr. Brosch has identified and selected a single point in time when the Company is worse off as a result of consolidated filing to perform his hypothetical assessment of available cost-free capital. In doing so, he ignores the other very recent points in time when the Company and its customers have significantly benefitted from consolidated filing. In short, his proposal is opportunistic and, more importantly, unfair. It has neither economics nor principle to recommend it.

Q. As a threshold matter, what produces deferred taxes?

A. Deferred taxes are produced when an item of income or expense is recognized for financial reporting purposes in a period that is different from the period in which it is recognized for tax purposes. In the context of utility regulation, this treatment is often referred to as normalization and it is necessary to the maintenance of inter-generational equity – that is, all customers receive the tax benefits commensurate with the expenses they fund.

Q. What is the source of most utility deferred taxes?

A. Accelerated (including bonus) depreciation.

Q. Can you provide an example of how deferred taxes work?

A. Yes. A $1 million electric distribution line is a good asset to illustrate the principle. Assume the line is placed in service in 2011 and is assigned a 40-year life for regulatory purposes. Its book (or regulated) depreciation rate would, therefore, be 2.5% and rates would be set to allow the utility the opportunity to collect $25,000 ($1 million multiplied by 2.5%) in depreciation from its customers each year for 40 years. For tax purposes, however, assume the line is eligible for 100% "bonus" depreciation and, consequently, its cost is fully deductible in 2011. Thus, considering only depreciation on the line, in 2011 the utility would take in $25,000 of taxable revenue and claim a tax deduction of $1 million. Thus, it would produce a net tax deduction of $975,000 ($1 million minus $25,000) which, if offset by the utility's other taxable income (and assuming a 35% tax rate), would produce incremental cash (*i.e.*, a reduction in the amount of tax otherwise payable) of $341,250 ($975,000 multiplied by 35%).

Q. What is the nature of this cash?

A. This cash represents funds presently available to the utility. However, these funds will have to be paid back to the government over time. In effect, the liberalized tax depreciation gave rise to a loan from the government.

Q. To continue the analogy, how is the "loan" repaid?

A. In each of the next 39 years, the utility will collect $25,000 from its customers to fund the depreciation on the line. This will all be taxable income. However, because the utility claimed 100% depreciation on the distribution line in the first year, it will be entitled to no further depreciation tax deductions. Thus, in each of the 39 years, the utility will include on its tax return $25,000 of taxable income upon which it will pay $8,750 ($25,000 multiplied by 35%) of tax. Over the 39 years, it will pay a total of $341,250 ($8,750 multiplied by 39) – an amount precisely equal to the cash benefit it enjoyed in 2011.

Q. So the repayment is effected by filing future tax returns?

A. Exactly.

Q. What are the consequences of the "loan" being repaid in this way?

A. Because the loan is repaid by the filing of future tax returns, there is no interest associated with it. That is why it represents cost-free capital.

Q. How does this relate to deferred taxes?

A. The outstanding loan balance is reflected as a DTL. In the distribution line example, the DTL is at its maximum in 2011 and then diminishes each year for the next 39 years as the loan is repaid.

Q. How is this DTL treated for regulatory purposes?

A. Because the utility has in hand incremental capital in the amount of its DTL for which it does not incur a carrying cost, this DTL, that is the balance of the governmental loan, is properly reflected as a reduction to rate base. In this way, ratepayers receive the entire benefit of the interest-free feature of the loan.

Q. What is a tax net operating loss (NOL)?

A. An NOL is created when, in any year, a taxpayer reports more deductions than it has taxable income. Under the generally applicable tax rules, an NOL can be carried back two years or forward twenty years. In the year in which it is carried, an NOLC is treated like an additional deduction, reducing the taxable income otherwise produced in that year. The general rule is that an NOL must be carried back to the earliest possible year and then, to the extent not absorbed, applied to subsequent years in chronological order.

Q. What are the consequences of carrying an NOL forward?

A. When an NOL must be carried forward, some quantity of the deductions claimed by the taxpayer in the year that the NOL is produced will not offset taxable income and not reduce the taxpayer's tax liability – that is, until a subsequent year when the NOLC is used.

Q. Can you provide a simple example of how this works?

A. I can. Assume a 35% tax rate in all years. In each of three years, Utility produces taxable income before accelerated depreciation of $100. In both Year 1 and Year 2, Utility claims $100 of accelerated depreciation and in Year 3 it claims $300. Thus, while in Years 1 and 2, Utility produces $0 taxable income, in Year 3 Utility produces an NOL of $200 ($100 minus $300), all of which it must carry forward. In each year, $100 of accelerated depreciation is used to offset Utility's $100 taxable income before accelerated depreciation. As a result, in each year the accelerated depreciation it claimed reduces Utility's tax due by $35 ($100 multiplied by 35%). However, with respect to the remaining $200 of Year 3 accelerated depreciation, Utility receives no incremental cash. The results described above can be depicted in tabular form as follows:

TABLE I

		YEAR 1	YEAR 2	YEAR 3
1	Taxable Income Before Acc. Dep.	$100	$100	$100
2	Tax Due Before Acc. Dep.	$35	$35	$35
3	Accelerated Depreciation	$100	$100	$300
4	Taxable income	$0	$0	($200)
5	Tax due	$0	$0	$0
6	Tax Reduction - Acc. Dep. (lines 2-5)	$35	$35	$35

Q. What if Utility's Year 3 accelerated depreciation deduction was $500 or $1,000 instead of only $300?

A. It wouldn’t matter one bit. If, in Year 3, Utility were to claim $500 or $1,000 or even $1 billion of accelerated tax depreciation, no deduction in excess of $100 would produce another nickel of cash – at least, not in Year 3. Additional cash would only be produced in a future year when the NOLC is used to reduce a tax liability that would otherwise be due in that year.

Q. What, then, is the significance of an NOLC?

A. In terms of the “loan” analogy I used previously, the government does not extend a loan until the accelerated tax depreciation deduction is ***both*** claimed on a tax return ***and*** is used to reduce a tax liability. In terms of the example, as of the end of Year 3, the governmental loan extended with respect to that year’s accelerated depreciation deduction is $35 ($100 multiplied by 35%), not $105 ($300 multiplied by 35%).

Q. How is this situation represented in the Company's records?

A. The Company reflects as a DTL the tax benefit of its favorable tax deductions regardless of whether or not they actually produce cash (in the example, 35% X $300 or $105). However, it goes on to reflect the amount of the loan that has not yet been made but that will be made in the future (35% X $200 or $70) as a DTA. You can look at the DTA as a future cash flow – not unlike a receivable or any other asset. The cash will flow eventually – but not until the NOLC is used to offset a future year's taxable income. Until that time, the tax deductions that created the NOLC do not produce any cost-free capital.

Q. If an NOLC represents a governmental loan not yet made, what is the significance for ratemaking purposes?

A. Where there is an NOLC, the true level of cost-free capital possessed by the company is the net of its DTL balance and its DTA balance – in the example, the $105 DTL balance less the $70 DTA balance. The net, $35, represents the tax avoided in Year 3 by claiming accelerated depreciation and, consequently, the actual economics of the company's access to cost-free capital. This is essentially what the Company does.

Q. Does Mr. Brosch dispute any of the economics or ratemaking implications you have described above?

A. I do not believe so.

Q. What, then, is the source of the disagreement between the Company and Mr. Brosch?

A. The Company and Mr. Brosch disagree over how to determine how much of the Company's tax deductions claimed on its tax returns have not been used to reduce its tax liability and thereby, have failed to produce cost-free capital thus far.

Q. How has the Company made this determination?

A. In its calculations, the Company has used the actual amount of cost-free capital it actually possesses. That is, it has used the amounts reflected on its financial records which, in turn, reflect the actual cash that the Company has received in connection with the claiming of its tax deductions.

Q. What does Mr. Brosch propose?

A. Mr. Brosch proposes to evaluate this amount as if the Company filed and continues to file its tax returns on a "stand alone" basis – that is, as if the Company didn't file as a member of the consolidated tax return group of which Ameren is the common parent. By doing so, he proposes that this Commission impute an additional amount of cost-free capital equal to the incremental amount Ameren Missouri would have had as of the end of 2014 had it filed on this "stand alone" basis. He presumes that, on a hypothetical "stand alone" basis, as of the end of 2014, Ameren Missouri would have been able to use all of its own NOLCs (and credit carryforwards) and, hence, should not include any of its NOLC-related DTA (that is, \$57.6 million) in its rate base calculation.[4]

[4] Note that the extension of "bonus" depreciation I described at the beginning of my testimony should have a dramatic impact on Mr. Brosch's expectation that, on a "stand alone" basis, Ameren Missouri would have been able to use its own NOLCs (and credit carryforwards).

Q. Why does he propose this?

A. Mr. Brosch proposes his "stand alone" view because, using a 2014 test year, it produces more cost-free capital than the Company actually possesses. From his perspective, this is a "favorable" adjustment.

Q. Please explain how using a "stand alone" analysis can produce a result that is different from what actually occurs.

A. As I previously indicated, when a company produces an NOL, it can be carried back 2 years and forward 20 years. The same rules apply to a consolidated group. When a consolidated group produces a consolidated NOL, it can be carried back against the group's consolidated taxable income for the prior 2 years and forward to the subsequent 20 years.

Q. How does that produce a different result?

A. When a group of corporations files a consolidated income tax return, the tax results of each of the members of the group are aggregated to derive a consolidated taxable income or loss amount. Thus, NOLs produced by one member can offset taxable income produced by another member. This is generally a favorable process since it has the capacity to accelerate the use of a loss member's tax deductions.

Q. Please provide an example of how this works.

A. Assume a consolidated group consists of A, B and Utility. Further assume that A, B and Utility produce the following taxable income/(loss) for a three year period:

TABLE II

	Year 1	Year 2	Year 3
A	$100	$100	$100
B	$100	$100	$100
Utility	($200)	($200)	$400
Consolidated Taxable Income	$0	$0	$600
Consolidated Tax @35%	$0	$0	$210
Consolidated Tax Allocated to Utility	($70)	($70)	$140

Q. What would have actually happened to the members of the group under these circumstances?

A. The group would pay $0 of tax in both Year 1 and Year 2. In Year 3, the group would pay $210 of tax. Consequently, all of the deductions claimed by Utility in Years 1 and 2 immediately offset taxable income (not its own, but that of A and B). Utility would be contemporaneously paid for the use of its losses in Years 1 and 2 ($70 in each year), which would represent a source of cost-free capital (available to reduce rate base) to Utility in those years.

Q. Focusing on Utility, what would have been the situation had it filed its income tax return on a "stand alone" basis?

A. Standing alone, Utility's tax posture would have been:

TABLE III

	Year 1	Year 2	Year 3
Utility	($200)	($200)	$400
Use of NOLC			($400)
Taxable Income (After NOLC)			$0
Tax (after NOLC) @35%	$0	$0	$0

On this "stand alone" basis, Utility would not have been able to use any of its Year 1 or Year 2 NOLs in the years the deductions that created those NOLs were claimed. Consequently (and unlike the result shown in TABLE II), those deductions would have produced no cost-free capital in those years. Only when the Year 1 and Year 2 NOLCs were used (in Year 3) were the governmental loans extended and the cost-free capital produced.

Q. So, in this example, is it true that Utility is benefitted by *not* hypothesizing that it filed its tax return on a "stand alone" basis?

A. Yes, that is true. On an actual consolidated basis, all of Utility's Year 1 and Year 2 tax deductions produced cost-free capital contemporaneously that, on a "stand alone" basis, Utility would not have enjoyed until Year 3.

Q. Please provide an example of how a member might be worse off on a consolidated than on a "stand alone" basis.

A. I will use the same three members and vary the tax results somewhat to illustrate:

TABLE IV

	Year 1	Year 2	Year 3
A	$100	$100	($100)
B	($100)	($100)	($100)
Utility	($100)	($100)	$200
Consolidated Taxable Income	($100)	($100)	$0
Consolidated Tax @35%	$0	$0	$0
Portion of Utility NOL Used To Offset A's Taxable Income @50% (Utility NOL/Total NOLs)	$50	$50	
Consolidated Tax/(Benefit) Allocated to Utility (@35%)	($17.50)	($17.50)	$70

Q. What would have actually happened to the members of the group under these circumstances?

A. The group would pay no tax in any year. There would be a consolidated NOLC of $100 produced in both Year 1 and Year 2. In each of those years, $50 of that NOLC would be attributed to Utility since it provided half of the total NOLs used to offset A's $100 of taxable income in each year. Utility would be paid $17.50 in each year for the $50 of its NOL that was used to offset A's taxable income in that year. None of the Year 1 and Year 2 consolidated NOLC could be used in Year 3 because there was no consolidated taxable income in that year. Thus, as of the end of Year 3, $50 of Utility's

Year 1 tax deductions and $50 of its Year 2 tax deductions would not have produced a cash tax benefit.

Q. Focusing again on Utility, what would have been the situation had it filed its income tax return on a "stand alone" basis?

A. On a "stand alone" basis, Utility's tax posture would have been:

<u>TABLE V</u>

	Year 1	Year 2	Year 3
Utility	($100)	($100)	$200
Taxable Income After NOLC	($100)	($100)	$0
Tax (after NOLC) @35%	$0	$0	$0

Utility would have produced a $100 NOLC in each Year 1 and Year 2 and would have been able to carry it forward and apply it to its Year 3 taxable income. Consequently, as of the end of Year 3, all of Utility's Year 1 and Year 2 tax deductions would have produced a cash tax benefit and, hence, cost-free capital.

Q. So, in this example, is it true that Utility is benefitted by hypothesizing that it filed its tax return on a "stand alone" basis?

A. It depends on the point in time when you make the determination. As of the end of Year 1 on a consolidated basis, $50 of Utility's $100 NOL would have produced a cash tax benefit rather than none of it, as would have been the case on a "stand alone" basis. Thus, as of the end of Year 1, Utility is benefitted by *not* hypothesizing that it filed its tax return on a "stand alone" basis. The same would be true of Year 2 (again, $50 of Utility's tax deductions would have produced cost-free capital on a consolidated basis but not on a hypothetical "stand alone" basis). However, as of the end of Year 3 on a consolidated basis, $50 of Utility's $100 Year 1 NOL and $50 of its $100 Year 2 NOL would still not have produced a cash tax benefit while, on a "stand alone" basis, all of its NOLs would have produced such a benefit. So, as of the end of Year 3, Utility would be benefitted by hypothesizing that it files its tax return on a "stand alone" basis.

Q. What do the examples above illustrate about the nature of consolidated filing?

A. A consolidated income tax return is almost always beneficial to a group of corporations that is qualified to file one. Most often, one or more members are better off than if they had filed separate returns. That is why consolidated returns are so frequently used. Occasionally, one or more members are less well off than if they had filed separate tax returns. Once an election is made to file a consolidated return, all eligible corporations must be included in the return (there is no picking and choosing) and the election cannot be terminated without permission of the Internal Revenue Service for good cause shown. Thus, there is precious little flexibility for groups filing consolidated income tax returns.

Q. How does this observation relate to Mr. Brosch's proposal?

A. Mr. Brosch has identified a single point in time at which it appears that Ameren Missouri was worse off having been included in the Ameren consolidated income tax return than it would have been if it had filed separate tax returns. This "detriment" represents the basis of his proposed adjustment.

Q. Please explain Mr. Brosch's rationale.

A. In its tax years 2008 through 2013, Ameren Missouri produced the following taxable income/(loss):

TABLE VI

	Annual "Stand Alone" Taxable Income/(Loss)
2008	($461,008,006)
2009	($162,043,265)
2010	($130,775,965)
2011	$17,970,962
2012	$12,890,120
2013	$598,155,735
TOTAL	**($124,810,419)**

Mr. Brosch's testimony indicates his belief that, in 2014, Ameren Missouri will generate sufficient taxable income such that, on a "stand alone" basis, it should have no NOLC whatsoever as of the end of the year. It is for this reason that Mr. Brosch proposes to eliminate Ameren Missouri's $57.6 million NOLC-related DTA, thereby decreasing rate base by that amount.

Q. What is Ameren Missouri's true status in this regard?

A. In reality, as of the end of 2013, Ameren Missouri's allocated portion of the consolidated NOLC (*i.e.*, the portion of its NOLC that has not produced cost-free capital) approximates $216 million (see TABLE VII, Column (4)). Further, due to the extension of "bonus" depreciation, it is unlikely that this will change much during 2014. Thus, Mr. Brosch's proposed elimination of the Company's $57.6 million DTA (its balance as of 3/31/2014) amounts to the unjustifiable imputation of $57.6 million of cost-free capital that the Company does not possess.

Q. Is Mr. Brosch's proposal to evaluate Ameren Missouri's NOLC on a "stand alone" basis either reasonable or equitable?

A. No, it is neither. First and foremost, it does not represent reality. The Company simply does not have the cost-free capital for which Mr. Brosch proposes to give it credit. But, further, Ameren treats all members of its consolidated tax group in precisely the same way as it treats Ameren Missouri. At certain points in time, one or more members may be disadvantaged but at other points those same companies may be advantaged. There is no way to tell in advance and no way to predict over the long haul. Consistency and fairness are principles that underlie the Ameren group approach.

Q. Can you identify a specific instance in which Ameren Missouri was advantaged by Ameren's consolidated allocation methodology?

A. Several such instances are evident from the information in TABLE VI above. On a "stand alone" basis, Ameren Missouri's 2008, 2009 and 2010 NOLs could not have been used to offset any of its own taxable income. Thus, the full amount of the NOLs that the Company produced in those years would not have generated any contemporaneous cash tax benefits. However, because Ameren Missouri was part of the Ameren consolidated tax group in those years and because various members of that group produced taxable income in 2008, 2009 and 2010, part of Ameren Missouri's NOLs in those years produced cash tax benefits. The amounts can be quantified as follows:

TABLE VII

	(1)	(2)	(3)	(4)	(5)	(6)
	"Stand Alone" Ameren Missouri Taxable Income/(Loss) By Year	**Cumulative "Stand Alone" Ameren Missouri NOLC**	**Consolidated NOLC Allocated to Ameren Missouri By Year**	**Cumulative Consolidated NOLC Allocated To Ameren Missouri**	**Excess of Cumulative "Stand Alone" NOLC (2) Over Consolidated NOLC (4)**	**Approximate Ameren Missouri Rate Base Decrease/(Increase) Due to Filing Consolidated (5) X 35%**
2008	($461,008,006)	($461,008,006)	($97,421,862)	($97,421,862)	($363,586,144)	$127,255,150
2009	($162,043,265)	($623,051,271)	($65,062,485)	($162,484,347)	($460,566,924)	$161,198,423
2010	($130,775,965)	($753,827,236)	($53,170,203)	($215,654,550)	($538,172,686)	$188,360,440
2011	$17,970,962	($735,856,274)	$0	($215,654,550)	($520,201,724)	$182,070,603
2012	$12,890,120	($722,966,154)	$0	($215,654,550)	($507,311,604)	$182,070,603
2013	$598,155,735	($124,810,419)	$0	($215,654,550)	$90,844,131	($31,795,446)

Q. What does the data in TABLE VII illustrate?

A. The best way to explain TABLE VII is to analyze a single year. Focusing on 2008, column (1) indicates that Ameren Missouri produced a "stand alone" NOL of $461,008,006 in that year. Column (2) reflects that $ 97,421,862 of the 2008 Ameren group consolidated NOL was allocated to the Company. Column (5) indicates that Ameren Missouri's "stand alone" NOLC was some $363,586,144 more than the portion of the consolidated NOLC allocated to it.

Q. What does this excess represent?

A. This difference represents the portion of Ameren Missouri's 2008 "stand alone" NOLC that was used to offset taxable income produced in that year by other members of the group. Ameren Missouri was contemporaneously paid for the use of $363,586,144 of its 2008 NOL – something that would not have occurred had the Company filed on a "stand alone" basis. The amount of the payment approximated $127 million (Column 6). As a result of this payment, as of 12/31/2008, the Company's DTA was $127 million less than if it had filed on a "stand alone" basis because it was in possession of $127 million more cost-free capital than otherwise would have been the case. *Thus, if rates had been set using a 2008 test year, Ameren Missouri's rate base would have been $127 million **lower** using the approach the Company applied to its NOLC in this proceeding than if it had applied Mr. Brosch's proposed approach.*

Q. Looking at the entire period 2008 through 2013, what does TABLE VII reveal?

A. In each year from 2008 through 2010, Ameren Missouri was paid for deductions which could not have produced a cash tax benefit had the Company not filed as part of the Ameren consolidated tax group. The approximate cumulative quantity of this incremental cash benefit – this "extra" cost-free capital - is reflected in Column (6) of TABLE VII. And this significant cumulative benefit (*i.e.*, a higher ADIT balance by which to reduce rate base) prevailed through 2011 and 2012. It was only as of the end of 2013 that Ameren Missouri on a consolidated basis finally shifted into a slightly disadvantageous position.

Q. What does this suggest about Mr. Brosch's proposal?

A. In my opinion, his proposal is opportunistic and unfair. He presents his "stand alone" proposal at the one point in time when it would reduce rate base and never mentions that, at various other points in the very recent past when the Company was also having rate cases, the impact would have been exactly the opposite. At those other times when a "stand alone" proposal would have increased rate base, no such proposal was offered.[5]

Q. Please summarize your view on this proposal.

A. The methodology the Ameren group uses for determining Ameren Missouri's NOLC is eminently fair and reasonable. The group uses this same methodology for each and every member of the group and uses it consistently. Mr. Brosch offers no substantial, compelling reason to ignore this procedure and to fabricate a cash flow that does not, in fact, exist. Mr. Brosh's proposal is unfair and opportunistic, and it is inconsistent with positions he has taken in previous Ameren Missouri rate cases.

<u>Investment Tax Credit Amortization- Brosch Schedule MLB-3</u>

Q. Please describe this proposed adjustment.

A. Mr. Brosch proposes to decrease Ameren Missouri's income tax expense element of cost of service by approximately $100,000 to reflect the amortization of additional investment tax credits he asserts the Company will use on its 2014 federal income tax return.

[5] Note that the Company's three prior rate cases used "true up" periods that would have incorporated the rate base benefits described in Table VII: ER-2010-0036 (1/31/10), ER-2011-0028 (2/28/11) and ER-2012-0166 (7/31/12).

Q. What are investment tax credits?

A. Investment tax credits are credits available to taxpayers who make investments in specified depreciable assets. Once earned, these credits are applied against the taxpayer's federal income tax liability. Unused credits may be carried back 1 year and forward 20 years.

Q. How does the Company treat investment tax credits for regulatory purposes?

A. Once an investment tax credit is used to reduce the Ameren group's consolidated tax liability, the Company starts to amortize the credits so used and reduces the tax expense element of cost of service by the amount of the amortization. The amortization period is the regulatory life of the underlying asset.

Q. On what basis does Mr. Brosch propose to adjust the Company's investment tax credit amortization?

A. On its federal income tax returns for both 2009 and 2010, the Company was able to claim investment tax credits with respect to certain fixed asset investments it made in those years. However, due to a lack of consolidated taxable income, as of the end of 2013, those credits had not been used to reduce the group's income tax liability. Thus, the Company did not commence amortizing these credits. In its filing in this proceeding, the Company did not reflect amortization of any of the investment tax credits it claimed on its 2009 and 2010 income tax returns. Mr. Brosch proposes that the Company commence amortization of the credits earned in those two years based on his assumption that the ability to use the credits should be evaluated on an Ameren Missouri "stand alone" basis and that, on such a basis, the Company would use these credits to reduce its 2014 tax liability.

Q. Do you disagree with Mr. Brosch's proposal?

A. Yes, I do. Mr. Brosch's proposal should be rejected on two accounts – one based on facts and the other based on principle.

Q. Please explain the factual basis for rejecting Mr. Brosch's proposal.

A. Mr. Brosch's assumption regarding the Company's ability to use these credits on a hypothetical "stand alone" 2014 income tax return appears to be based on a misreading of the Company's responses to several Data Requests. These responses indicated that the Company anticipates generating taxable income in 2014 (subject to Congress extending "bonus" depreciation). Mr. Brosch apparently presumed that the generation of taxable income would, in and of itself, enable the Company to use its 2009 and 2010 investment tax credits. However, even if the Company were to produce taxable income in 2014, its "stand alone" NOLCs from prior years would be applied such that the Company would have no tax liability before the application of credits. The credits still could not be used. Thus, even on a hypothetical "stand alone" basis, and without considering "bonus" depreciation, the presumption upon which Mr. Brosch's proposal is premised is incorrect. Further, the advent of "bonus" depreciation materially exacerbates the error.

Q. Please explain the principled basis for rejecting Mr. Brosch's proposal.

A. As with NOLCs, the proposition that, for certain purposes and at certain times, the Company's tax position should be evaluated on a hypothetical "stand alone" basis ignores the "real" flows of cash and promotes selectivity and inequity. Absent some compelling reason to the contrary (and Mr. Brosch presents none here), I oppose the imputation of fictitious tax benefits.

<u>Section 199 Domestic Production Deduction – Brosch Schedule MLB-4</u>

Q. Please describe this proposed adjustment.

A. Mr. Brosch proposes to decrease Ameren Missouri's income tax expense element of cost of service by the benefit of a section 199 domestic production deduction (DPD) that significantly exceeds the DPD to which the Company will be entitled.

Q. What is the DPD?

A. The DPD is a tax incentive Congress provides to manufacturers. The tax law permits a business to claim a tax deduction, the DPD, equal to 9% of the lesser of certain qualified net income (referred to as QPAI) or the taxpayer's taxable income. To qualify as QPAI, the net income has to be derived from specified activities associated with manufacturing. The generation of electricity is an eligible activity. Under the tax law, the DPD is computed on a consolidated basis.

Q. Mr. Brosch discusses several adjustments that he proposes be made to the Company's DPD deduction calculation. In his discussion, does Mr. Brosch incorporate an incorrect technical conclusion regarding the computation of the DPD?

A. Yes, he does, and in Ameren Missouri's case, this flawed technical conclusion will cause Mr. Brosch's DPD calculation to be materially wrong.

Q. What is his flawed technical conclusion?

A. On page 10, lines 16-20 of his testimony, Mr. Brosch states:

> The Section 199 Production Deduction allowed under the tax code does <u>not</u> rely upon cumulative taxable income/loss balances in any way, but instead is a calculation of current

> tax year DPGR, reduced by production-related costs and direct as well as reasonably allocated indirect expenses.

This is an incorrect statement.

Q. In what regard is it incorrect?

A. As I indicated above, the DPD is calculated by applying a rate (9%) to the lesser of QPAI or taxable income. In the above excerpt from Mr. Brosch's testimony, he asserts that, for purposes of this computation, taxable income is calculated without regard to NOLCs from prior years. That is not true. This is important because Ameren Missouri has significant NOLCs that will reduce its taxable income in 2014. Because his technical conclusion is wrong, his DPD computation is materially incorrect.

Q. What evidence do you have that Mr. Brosch's technical conclusion is incorrect?

A. The Treasury Regulations relating to the DPD provide an example of how the deduction is calculated where there is an NOLC. The relevant portions of the example are:

> *Example (1).* X… engages in production activities that generate QPAI and taxable income (without taking into account the deduction under this section and an NOL deduction) of $600 in 2010. … X has an NOL carryover to 2010 of $500. X's deduction under this section for 2010 is $9 (.09 x (lesser of QPAI of $600 and taxable income of $100 ($600 taxable income - $500 NOL)).

In the example, QPAI and taxable income without regard to the NOLC are the same - $600. Thus, if Mr. Brosch were correct, the DPD in the example would be $54 (9% X $600). However, the example indicates it is not $54. The NOLC is included in the computation of taxable income and, because taxable income on that basis is less than QPAI, the DPD is only $9 (9% X ($600 - $500)).

Q. How is this relevant to the calculation of the DPD for Ameren Missouri?

A. As of the end of 2013, Ameren Missouri had a significant NOLC. Notwithstanding Mr. Brosch's assertion to the contrary, any computation of a DPD for 2014 must take the impact of this NOLC into account.

Q. Can the extension of "bonus" depreciation have an impact of the DPD calculation?

A. Yes, it can. The incremental tax deductions would reduce QPAI as well as taxable income. So, even without regard to the treatment of the Company's NOLCs, Mr. Brosch's DPD calculation would be seriously in error.

<u>Treatment of ADIT Associated With Metro East Transfer – Brosch Schedule MLB-7</u>

Q. Please describe this proposed adjustment.

A. Mr. Brosch proposes to increase Ameren Missouri's ADIT credit balance (and, therefore, to reduce its rate base) by approximately $7.4 million by including in his computation the ADIT balance that relates to the deferred intercompany gain on Ameren Missouri's 2005 transfer of the Metro East assets. The Company did not include this ADIT in its rate base computation.

Q. What does Mr. Brosch state with regard to this proposed adjustment?

A. He states that his proposed adjustment will include in Ameren Missouri's rate base calculation an amount "…that has been excluded by the Company without sufficient explanation or justification." (Brosch, page 22, lines 18-19).

Q. Will you explain how this ADIT arose?

A. Yes, I will. Ameren Missouri has always claimed accelerated tax depreciation on its depreciable assets to the extent allowed by the tax law. As a result, immediately prior to Ameren Missouri's 2005 sale of its Metro East assets to its affiliate, Central Illinois Public Service Company (CIPS), these assets had tax bases that were less than their book carrying value. The tax effect of this difference was reflected in the Company's ADIT balance (specifically, the ADIT reported in Account #282 – plant-related ADIT). As a consequence of this basis difference, the selling price of the assets (book value) exceeded their tax basis. As is always the case in such a taxable asset sale, the result was that Ameren Missouri generated a tax gain. The tax gain reversed the ADIT balance related to the Metro East assets in the Company's Account #282 – as is always the case when an asset is disposed of in a taxable transaction at a gain.

Q. If the ADIT associated with the Metro East assets was reversed upon the 2005 sale, what is the nature of the ADIT to which Mr. Brosch addresses his testimony?

A. It is produced by a provision of the tax law. When a company sells depreciable assets to an unrelated party in a taxable sale, the seller generally reports taxable gain or loss and adjusts its tax liability for the year of disposition up or down accordingly. The buyer places the purchased assets in service and depreciates them for tax purposes using its new tax basis (which is equal to the amount it paid for the assets). When a company sells depreciable assets to another member of its consolidated tax group, the consequences are somewhat different – more so for the seller than the buyer. With respect to the buyer, CIPS, since it paid an amount for the Metro East assets in excess of

Ameren Missouri's tax basis, it received a "step-up" in the tax basis of those assets. With regard to Ameren Missouri, under the tax rules, it does not have to report and pay tax on its gain immediately. Instead it reports the tax gain only when and to the extent that CIPS depreciates the "step up" in tax basis it received in the transaction. Thus, Ameren Missouri's tax gain is deferred until CIPS claims the incremental tax deductions to which it is entitled as a result of its basis "step-up" in the Metro East assets.

Q. Where is this deferral of Ameren Missouri's tax reflected on its accounting records?

A. The tax deferral (commonly referred to as a deferred intercompany gain or a DIG for short) is reflected in Ameren Missouri's accounting records in Account #283 - non-plant-related ADIT. It is this ADIT that Mr. Brosch proposes be included in the Company's rate base calculation.

Q. Can Ameren Missouri's DIG-related ADIT be associated with the Metro East assets?

A. Not in my view. Ameren Missouri no longer owns or operates those assets and they are not reflected on its accounting records or in its computation of rate base. Further, the DIG-related ADIT is not even properly recorded in the ADIT account that reflects plant-related tax deferrals. In short, this particular ADIT balance is completely unrelated to any plant Ameren Missouri currently owns.

Q. Should the DIG-related ADIT be included in Ameren Missouri's rate base calculation in any case?

A. There is no non-plant asset which Ameren Missouri includes in rate base to which the DIG-related ADIT can be attributed. Thus, its inclusion would import a tax consequence into ratemaking where the underlying item which produces the tax consequence is absent.

Q. Is there any other ratemaking convention that may be relevant to this issue?

A. Yes, there is. I have been advised that the Company "normally" reflects gains and losses on dispositions of regulated assets in subaccounts of Account #421 – Miscellaneous non-operating income. That account is a "below the line" account, meaning that it does not impact ratemaking. Similarly, the tax consequences of these gains and losses are also reported in a "below the line" account. The Company's treatment of the DIG-related ADIT would seem consistent with this classification.

Q. Is the Company's treatment of the DIG-related ADIT in this proceeding any different than it has been in prior cases?

A. No, it is not. The Company has excluded the DIG-related ADIT from its rate base computation since the transaction took place in 2005.

Q. Is it relevant that Ameren Missouri's affiliate, CIPS, argued in its Illinois rate proceeding that the ADIT consequences of its tax basis "step-up" should be recognized in computing its rate base?

A. No, it is not. CIPS owns and operates the Metro East assets. They are reflected on its accounting records and in its calculation of rate base. Consequently, it is entirely proper for CIPS to recognize the ADIT consequences associated with its ownership of the Metro East assets in ratemaking for that company.

Conclusion

Q. Does that conclude your rebuttal testimony?

A. Yes, it does.

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of Union Electric Company d/b/a Ameren Missouri's Tariffs to Increase Its Revenues for Electric Service.	)))	Case No. ER-2014-0258

AFFIDAVIT OF JAMES I. WARREN

DISTRICT OF COLUMBIA) SS

James I. Warren, being first duly sworn on his oath, states:

1. My name is James I. Warren. I work in the City of Washington, D.C., and I am a member of the law firm Miller & Chevalier Chartered.

2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony on behalf of Union Electric Company d/b/a Ameren Missouri consisting of 37 pages, and Schedule(s) N/A, all of which have been prepared in written form for introduction into evidence in the above-referenced docket.

3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct.

James I. Warren

Subscribed and sworn to before me this 12th day of January, 2015.

Notary Public

My commission expires:

ROHNDA P. WASHINGTON
NOTARY PUBLIC DISTRICT OF COLUMBIA
My Commission Expires April 14, 2017