

Exhibit No.:
Issue: Income Taxes
Witness: Michael L. Brosch
Type of Exhibit: Surrebuttal Testimony
Sponsoring Party: Missouri Industrial Energy Consumers
Case No.: ER-2011-0028
Date Testimony Prepared: April 15, 2011

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

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| _____ |) | |
| In the Matter of Union Electric |) | |
| Company, d/b/a Ameren Missouri's |) | Case No. ER-2011-0028 |
| Tariff to Increase Its Annual |) | Tariff No. YE-2011-0116 |
| Revenues for Electric Service |) | |
| _____ |) | |

Surrebuttal Testimony and Schedule of

Michael L. Brosch

Revenue Requirement

On behalf of

Missouri Industrial Energy Consumers

REDACTED VERSION

April 15, 2011

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**In the Matter of Union Electric
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Case No. ER-2011-0028
Tariff No. YE-2011-0116

Surrebuttal Testimony of Michael L. Brosch

1 **Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A My name is Michael L. Brosch. My business address is PO Box 481934, Kansas
3 City, Missouri 64148.

4 **Q ARE YOU THE SAME MICHAEL L. BROSCH WHO PREVIOUSLY SUBMITTED**
5 **DIRECT TESTIMONY IN THIS PROCEEDING?**

6 A Yes. My qualifications are described in Appendix A to my previously submitted Direct
7 Testimony.

8 **Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

9 A I am appearing on behalf of the Missouri Industrial Energy Consumers ("MIEC").

10 **Q WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

11 A This testimony explains and responds to Ameren's response to the income
12 tax-related issues that I addressed in my Direct Testimony. I will identify Ameren's
13 agreement with certain of the adjustments I previously sponsored, while discussing
14 the remaining areas of disagreement. The ratemaking adjustment I previously
15 sponsored at Schedule MLB-4 has been updated to correspond to true-up amounts

1 as of February 28, 2011, with such updates presented in Schedule MLB-5. In
2 addition, I will respond to Ameren Missouri's new Rebuttal arguments regarding its
3 proposals for non-traditional regulatory relief, including its proposed new Accounting
4 Authority Orders ("AAOs") for continued construction accounting on certain capital
5 projects.

6 **EXECUTIVE SUMMARY**

7 **Q WHICH OF YOUR PREVIOUSLY PROPOSED ADJUSTMENTS TO INCOME TAX**
8 **EXPENSE HAS AMEREN MISSOURI NOW AGREED TO IN ITS REBUTTAL**
9 **TESTIMONY?**

10 **A** The Company has agreed to recognize the Ameren Missouri Preferred Stock
11 Dividends Paid tax deduction in the calculation of ratemaking income tax expense, an
12 adjustment that I proposed in Direct Testimony,¹ but has not agreed to recognize the
13 comparable Ameren Common Stock Dividends Paid deduction for Employee Stock
14 Ownership Plan ("ESOP") Dividends.² These MIEC-proposed adjustments were
15 previously calculated in my Schedule MLB-1 and I understand the amounts set forth
16 therein are not disputed.

17 In this testimony, I will respond to Ameren witness Mr. Warren's Rebuttal
18 arguments and explain why both of these tax deductions should be recognized in
19 determining the income tax expenses used to determine Ameren Missouri's revenue
20 requirement. Mr. Warren does not dispute that Ameren Corporation claims a
21 deduction that reduces its income tax expense for the ESOP dividend payments. He
22 instead claims that this deduction should be ignored by the Commission because
23 common stock dividends are declared and paid by Ameren Corporation, not by

¹Rebuttal Testimony of James I. Warren, page 11.

²Id, pages 5-10.

1 Ameren Missouri, and are paid out of consolidated retained earnings on a
2 discretionary basis. My testimony explains how Ameren Corporation's common stock
3 dividends are partially funded by the return on equity allowed to Ameren Missouri by
4 this Commission when utility rates are established. I will also show that Ameren
5 shareholders incur no unrecovered expenses that justify ignoring the ESOP-related
6 tax savings when setting utility rates.

7 The other income tax expense adjustment I sponsored at Schedule MLB-2
8 was to remove St. Louis City Earnings Tax Expense, because Ameren Missouri is not
9 presently paying this tax. Ameren disputes full removal of this tax, but has now
10 included flow through recognition of the additional deductions and credits that
11 contribute to its recently negative actual tax liability, causing the updated amount of
12 this tax to be very small when calculated after the proposed rate increase.³ With
13 these revisions, MIEC no longer objects to recognition of the minimal amount of City
14 Earnings tax now being included by Ameren Missouri in its income tax expense
15 calculation.

16 **Q HAS AMEREN ACCEPTED ANY OF YOUR PROPOSED ADJUSTMENTS TO THE**
17 **ACCUMULATED DEFERRED INCOME TAX ("ADIT") BALANCES THAT ARE**
18 **INCLUDED IN ITS RATE BASE?**

19 **A** Yes. At Schedule MLB-3, I had proposed five adjustments to remove certain
20 elements of Ameren's Accumulated Deferred Income Tax ("ADIT") balance to be
21 included in rate base. I understand that Ameren now concurs in all five of these
22 adjustments and does not intend to include any of these items in its true-up rate base.

³Rebuttal Testimony of Gary S. Weiss, pages 14-15. Preliminary true-up calculations of this tax supplied by Ameren support an estimated true-up expense amount of \$16,000.

1 Q WHAT IS THE STATUS OF YOUR ADJUSTMENT AT SCHEDULE MLB-4 THAT
2 SEEKS TO INCLUDE ADIT AMOUNTS ASSOCIATED WITH THE COMPANY'S
3 UNCERTAIN TAX POSITIONS ("UTP")?

4 A Ameren disputes MIEC's proposal to refine the regulatory treatment in Missouri
5 regarding ratemaking treatment of UTP-related Accumulated Deferred Income Tax
6 balances. The Company's rebuttal witness, Mr. Warren, argues that the decision
7 reached by the Commission in Case No. ER-2008-0318 regarding UTP deferred
8 income taxes remains appropriate and should not be changed.⁴ Mr. Warren argues
9 that the MIEC proposal improperly treats UTP deferred taxes as an interest free loan,
10 when such amounts should actually be treated as a "with-interest" loan at IRS interest
11 rates to recognize an expectation of future disallowances of the claimed tax
12 deductions.⁵ He also discusses the mixed regulatory decisions on this matter in
13 Texas and Kentucky and argues that the FERC's disposition of this issue, as
14 referenced in my Direct Testimony, was limited to accounting guidance rather than
15 ratemaking policy.⁶

16 My Surrebuttal Testimony responds to each of these points, indicating the
17 compelling reasons that support changing the Commission's prior Order on this
18 matter, so as to give ratepayers some chance of participating in the ADIT benefits
19 that are being realized by Ameren, while still encouraging the Company to take full
20 advantage of the tax deferral opportunities available to it under the tax laws. I explain
21 that, contrary to Mr. Warren's Rebuttal, MIEC is not treating the FIN48 amounts as an
22 "interest free loan." Instead, the MIEC proposal is that Ameren be authorized to
23 specifically account for and recover any IRS interest that is ultimately determined to

⁴Rebuttal Testimony of James I. Warren, page11.

⁵Id. page 14.

⁶Id. pages 20-22.

1 be owed by the Company in connection with UTP issues, for which the related ADIT
2 balances were afforded rate base treatment.

3 Finally, I explain how Mr. Warren's "with-interest loan" illustration is useful in
4 demonstrating how unreasonable and detrimental to ratepayers the Company's
5 removal of FIN 48 reserved ADIT balances actually is. IRS interest rates payable by
6 Ameren are much lower than the rate of return that is applied to the ADIT amounts
7 associated with uncertain tax positions. Ameren Missouri's exclusion of these ADIT
8 balances increases rate base, increasing revenue requirement by the approximately
9 eleven percent pretax rate of return applied to such balances, even though the
10 comparable IRS interest rate that would be paid by Ameren if it failed to defend the
11 underlying tax deductions, would be much lower on such balances.

12 **EMPLOYEE STOCK OWNERSHIP DIVIDENDS**

13 **Q DOES AMEREN MISSOURI REBUTTAL WITNESS MR. WARREN DISPUTE THAT**
14 **AMEREN CORPORATION RECEIVES AN INCOME TAX DEDUCTION FOR THE**
15 **COMMON STOCK DIVIDENDS IT PAYS ON SHARES HELD WITHIN ITS**
16 **EMPLOYEE STOCK OWNERSHIP PLAN ("ESOP")?**

17 **A** No. After describing Ameren's 401(k) plan, which has an ESOP component, Mr.
18 Warren states, "Moreover, and of particular relevance to this proceeding, the Code
19 permits a deduction to any corporation that pays a dividend on its stock to the extent
20 that such stock is held by an ESOP."⁷ Thus, there is no dispute regarding the
21 existence of the tax deduction. Instead, this ratemaking issue involves whether
22 Ameren's ratepayers should participate in the tax savings arising from this deduction,
23 or instead, Ameren shareholders should be the sole beneficiaries of this deduction.

⁷Id. page 5.

1 Q WHAT REASONS ARE GIVEN BY MR. WARREN FOR ALLOWING AMEREN TO
2 RETAIN THE TAX SAVINGS FROM THE ESOP DIVIDEND DEDUCTION FOR THE
3 SOLE BENEFIT OF SHAREHOLDERS?

4 A Mr. Warren offers the following arguments as justification for not recognizing an
5 Ameren Missouri allocated share of these tax savings in the ratemaking income tax
6 calculation used by the Commission:

- 7 • It is the Ameren Corporation legal entity, rather than Ameren Missouri, that
8 actually pays the dividend on common stock and, according to Mr. Warren, “It is
9 Ameren, therefore, that is entitled to the dividends paid deduction under the
10 Code.”⁸
- 11 • UE does not pay dividends with respect to “applicable employer securities” nor
12 has it included any such dividend payments in its cost of service, thus, according
13 to Mr. Warren, it would be, “...inappropriate for UE to reflect the benefit of the tax
14 deduction available to Ameren in establishing its tax expense for ratemaking
15 purposes.”⁹
- 16 • Dividend payments are not necessarily related to UE’s operations – any dividends
17 paid are at the sole discretion of Ameren’s Board of Directors and their decisions
18 are “not legally dependent on anything that occurs at UE.”¹⁰
- 19 • Dividends are paid out of a corporation’s retained earnings which represent “the
20 investment its shareholders have in the company” and “a utility’s retained
21 earnings belong to its shareholders – not its customers.”¹¹
- 22 • ESOP dividends paid are, according to Mr. Warren, analogous to charitable
23 contributions that are not permitted to be included in utility cost of service. Since
24 shareholders fund the contribution, they are allocated the tax deduction benefit of
25 the contribution and this same principle should apply to the dividends paid
26 deduction.¹²
- 27 • Discretion is exercised by UE employees in electing to participate in the Ameren
28 401(k) plan and can select from 21 investment options, one of which is the
29 Ameren ESOP, making the associated tax deduction and tax savings that is
30 realized by Ameren, “unrelated to the customers’ cost of service.”

⁸Id. page 6.

⁹Id. page 7.

¹⁰Id. pages 7-8.

¹¹Id. page 8.

¹²Id. pages 8-9.

1 Q WHAT IS WRONG WITH MR. WARREN'S ARGUMENT THAT IT IS AMEREN
2 CORPORATION, RATHER THAN AMEREN UE, THAT ACTUALLY PAYS THE
3 DIVIDEND ON COMMON STOCK FOR WHICH A TAX DEDUCTION IS
4 AVAILABLE?

5 A There are several problems with this argument. First, Ameren Missouri, which is
6 referred to as "UE" in Mr. Warren's Rebuttal, is allowed an authorized return on
7 common equity for the purpose of compensating equity investors in Ameren
8 Corporation who provide the invested equity capital in Ameren Missouri. It is
9 disingenuous to suggest that the equity investors in Ameren Corporation, who are
10 paid dividends on common stock, are somehow distinct from the equity investors who
11 are compensated by Ameren Missouri ratepayers through the authorized return on
12 equity. Second, from a cash flow perspective, Ameren Missouri consistently pays an
13 upstream dividend to its parent Company, Ameren Corporation, which cash is
14 available to help fund the consistently declared and paid dividends on Ameren
15 Corporation common stock. Third, the revenue requirement asserted by Ameren
16 Missouri includes significant costs that are allocated or attributed to the Company
17 from other Ameren affiliates and there is nothing wrong with equitably allocating or
18 attributing the tax deductions and credits "owned" by these affiliates proportionately to
19 Ameren Missouri, even though such deductions relate to payments actually made by
20 a different legal entity. Finally, if we rigidly applied the legal entity distinction between
21 Ameren Corporation and Ameren Missouri/UE that is advanced by Mr. Warren, we
22 are left with an absurd result through which the Commission could find that Ameren
23 Missouri/UE is not a taxpayer at all and owes no income taxes, since Ameren
24 Corporation actually files the returns and is liable for the Company's income tax
25 liability. Obviously, income tax expenses are included within Ameren Missouri's
26 revenue requirement because of the fact that Ameren Corporation files a

1 consolidated tax return that includes Ameren Missouri's taxable revenues and
2 deductible expenses.

3 **Q SHOULD AMEREN MISSOURI RATEPAYERS BE DENIED AN ALLOCATED**
4 **SHARE OF THE AMEREN CORPORATION TAX DEDUCTION FOR DIVIDENDS**
5 **PAID ON ESOP SHARES BECAUSE AMEREN MISSOURI DOES NOT PAY**
6 **DIVIDENDS WITH RESPECT TO "APPLICABLE EMPLOYER SECURITIES" AS**
7 **SUGGESTED BY MR. WARREN?**

8 A No. It is not necessary for Ameren Missouri to directly pay a cost for its ratepayers to
9 be equitably allocated either the cost or the tax benefits arising from such payments.
10 As an example, when Ameren Services Company incurs expenses for shared service
11 activities that are allocated among Ameren Missouri, Ameren Illinois and the other
12 operating subsidiaries of Ameren Corporation, there is no dispute that associated tax
13 deductions are also proportionately allocated. The same principle should apply to
14 dividends, which are funded proportionately by Ameren Missouri and the other
15 operating subsidiaries, even though they are actually paid by the parent company.
16 Ameren Missouri includes in its asserted cost of service a return on equity capital that
17 contemplates a dividend yield and growth component. As this equity return is actually
18 collected through utility rates and accumulates within Ameren Missouri's retained
19 earnings, it is periodically paid to the parent as an upstream dividend that provides
20 cash to support the payment of dividends to holders of Ameren Corporation common
21 stock.

1 Q HOW DO THE DIVIDENDS PAID BY AMEREN MISSOURI TO THE PARENT
2 COMPANY COMPARE TO THE DIVIDENDS PAID BY AMEREN CORPORATION
3 IN RECENT YEARS?

4 A Ameren Missouri has consistently provided funding to support a significant share of
5 the parent company's common stock cash dividends, as illustrated by this table:

Table 1
Summary of UE and Ameren Dividends

| <u>Year</u> | <u>UE Common Dividends</u> | <u>Ameren Common Dividends</u> | <u>UE Percent</u> |
|-------------|--------------------------------|------------------------------------|-----------------------|
| 2001 | \$213,900,000 | \$348,818,727 | 61% |
| 2002 | \$299,700,000 | \$377,403,404 | 79% |
| 2003 | \$287,960,000 | \$410,490,390 | 70% |
| 2004 | \$314,570,000 | \$478,966,667 | 66% |
| 2005 | \$280,040,000 | \$512,441,326 | 55% |
| 2006 | \$249,270,000 | \$522,363,848 | 48% |
| 2007 | \$266,710,000 | \$526,822,159 | 51% |
| 2008 | \$264,220,000 | \$533,872,027 | 49% |
| 2009 | \$174,500,000 | \$333,083,137 | 52% |
| 2010 | \$234,950,000 | \$367,925,537 | 64% |

Source: Ameren Response to MIEC 31.03

6 Q ACCORDING TO MR. WARREN, DIVIDENDS ARE PAID AT THE SOLE
7 DISCRETION OF AMEREN'S BOARD OF DIRECTORS AND THEIR DECISIONS
8 ARE "NOT LEGALLY DEPENDENT ON ANYTHING THAT OCCURS AT UE."
9 DOES THIS MEAN THAT NO DIVIDEND-RELATED TAX DEDUCTIONS CAN
10 REASONABLY BE ATTRIBUTED TO AMEREN MISSOURI RATEPAYERS?

11 A No. The fact is that both Ameren Missouri and Ameren Corporation pay dividends as
12 a component of their return to common equity investors. Purely as a result of the
13 Company's selection of a holding company corporate structure, the dividends that are

1 publicly paid occur at the parent company level. This distinction does not cause
2 Ameren Missouri to request any lower authorized return on common equity capital
3 because it has no dividend expectations. Mr. Warren's assertion that Ameren's
4 dividends paid on its publicly issued common stock are "not legally dependent on
5 anything that occurs at UE" is not relevant to the issue of whether or not Ameren
6 Missouri ratepayers are responsible for providing a reasonable overall return on
7 common equity capital, from which discretionary dividends can be paid by Ameren
8 Missouri and its parent/owner. Dividends on common equity are inherently
9 discretionary and are paid out of residual earnings after all other costs are satisfied.
10 Any notion of "legal dependency" is inapplicable to such discretionary payments.

11 **Q DOES THE FACT THAT DIVIDENDS ARE PAID OUT OF RETAINED EARNINGS**
12 **OR THAT RETAINED EARNINGS BELONG TO SHAREHOLDERS INDICATE**
13 **THAT RATEPAYERS HAVE NO ENTITLEMENT TO TAX DEDUCTIONS ARISING**
14 **FROM SUCH DIVIDENDS?**

15 **A** No. Legal ownership of retained earnings is not dispositive of ratemaking treatment.
16 Shareholders own the entire balance of equity capital in Ameren Missouri and this
17 balance is fully recognized in determining the capitalization balances and ratios used
18 for ratemaking purposes. Ownership distinctions do not preclude consideration of
19 dividend yields and market expectations for dividend growth when the Commission
20 determines a reasonable return on equity capital in setting rates for Ameren Missouri.
21 Ameren does not dispute attribution of a tax deduction for interest expenses incurred
22 by Ameren Missouri, even though the cash used to pay interest belongs to Ameren
23 and its shareholders. Ameren Missouri readily includes in its rate base all of its
24 jurisdictional Plant in Service, Inventories and other assets, even though all of these
25 assets belong to its shareholders rather than to its ratepayers. Ownership of retained

1 earnings has nothing to do with equitable attribution of dividend related tax
2 deductions.

3 **Q ARE DIVIDENDS THAT ARE PAID ON ESOP SHARES COMPARABLE TO**
4 **DISALLOWED CHARITABLE CONTRIBUTIONS, AS SUGGESTED BY MR.**
5 **WARREN?**

6 A No. Mr. Warren has not identified any costs associated with Ameren's 401(k) plan or
7 its return on equity that have been "disallowed" by the Commission. The wages paid
8 to Ameren employees that are jurisdictional to Missouri electric operations are
9 routinely allowed within the revenue requirement. The Missouri jurisdictional portion
10 of costs to administer the Ameren 401(k) plan, including \$12.1 million of Ameren
11 Missouri test year employer match 401k expenditures, are not being disallowed by
12 the Commission.¹³ I previously explained how the equity return allowed for Ameren
13 Missouri in its revenue requirement provides earnings and cash flow to support
14 dividend payments. There is no basis to conclude that the dividends paid on Ameren
15 Corporation stock held in employee's retirement savings accounts represent costs
16 that have ever been disallowed by the Commission in determining rate levels in
17 Missouri.

18 **Q SHOULD AMEREN BE ALLOWED TO RETAIN FOR THE SOLE BENEFIT OF ITS**
19 **SHAREHOLDERS THE ESOP DIVIDENDS TAX DEDUCTION BECAUSE AMEREN**
20 **EMPLOYEES HAVE CHOICES AND EXERCISE DISCRETION IN PARTICIPATING**
21 **IN THE ESOP?**

22 A No. The discretion exercised by employees has an impact upon the size of the tax
23 deduction, but not upon how the deduction should be treated for ratemaking

¹³Ameren response to MIEC Data Request No. 31.04.

1 purposes. For example, if more employees elect to direct their 401(k) investments
2 into the ESOP, the dividends paid on such investments and the related tax deduction
3 amount may increase. Mr. Warren has not disputed the amount of the deduction that
4 has been quantified for the test year or how that amount is allocated to Ameren
5 Missouri by the Staff and MIEC.

6 **Q AT PAGE 11 OF HIS REBUTTAL, MR. WARREN AGREES WITH YOUR**
7 **ADJUSTMENT TO INCLUDE THE INCOME TAX DEDUCTION ASSOCIATED WITH**
8 **AMEREN MISSOURI'S PREFERRED STOCK DIVIDENDS IN THE RATEMAKING**
9 **INCOME TAX CALCULATION. IS HIS POSITION ON THIS MATTER**
10 **INCONSISTENT WITH HIS ARGUMENTS RAISED AGAINST INCLUSION OF THE**
11 **AMEREN CORPORATION COMMON STOCK ESOP DIVIDENDS?**

12 **A** Yes. I would observe that both preferred and common stock dividends are declared
13 and paid at the discretion of a Board of Directors. Both preferred and common stock
14 dividends are paid out of retained earnings, which Mr. Warren argues "belong to"
15 shareholders and not ratepayers. If Mr. Warren's comparison of dividends to
16 charitable contributions is applicable to common stock dividends, which it is not, the
17 same comparison would be applicable to preferred stock dividends. However, Mr.
18 Warren appears to support rate case consideration of the preferred stock dividend tax
19 deduction but not the common stock dividend deduction. This is an indication of the
20 frailty of his arguments seeking to unreasonably retain the ESOP dividends paid tax
21 deduction for the sole benefit of shareholders.

1 **FIN 48 DEFERRED TAX BALANCES**

2 **Q AT PAGE 11 OF HIS REBUTTAL, MR. WARREN STATES HIS OPINION THAT**
3 **THERE IS NO REASON WHATSOEVER THAT THE COMMISSION SHOULD**
4 **ALTER THE JUDGMENT IT REACHED IN CASE NO. ER-2008-0318. DO YOU**
5 **AGREE?**

6 **A** I believe that the Commission’s previous decision on this issue was well intentioned,
7 but could be improved to be more equitable to both Ameren and its customers. The
8 Commission was seeking to encourage the utility to optimize its income tax
9 compliance strategies aimed at deferring and reducing overall tax expense over the
10 long term. Unfortunately, the Commission’s decision provided this encouragement by
11 completely denying ratepayers any participation in the immediate tax deferral benefits
12 of these strategies. The MIEC position is not seeking to re-litigate the issue, but to
13 refine the treatment of FIN 48 ADIT balances in a more balanced manner without
14 removing the incentive for management performance.

15 **Q ACCORDING TO MR. WARREN, THE FUNDAMENTAL ISSUE WITH REGARD TO**
16 **FIN 48, “DISTILLS DOWN TO WHETHER OR NOT THIS COMMISSION SHOULD**
17 **SET RATES USING THE BEST EXPERT INFORMATION AVAILABLE. THE**
18 **COMPANY SUPPORTS THIS. MR. BROSCH OPPOSES IT.”¹⁴ DO YOU AGREE**
19 **WITH MR. WARREN’S SUMMARY OF THE ISSUE?**

20 **A** I do not. The approach I recommend is based upon specific known amounts of tax
21 liability today, to be adjusted in the future whenever known changes in tax liability
22 occur in connection with any uncertain tax positions. In determining the ADIT
23 balances to be included in rate base, the “best expert information” Mr. Warren would

¹⁴Id. page 12.

1 rely upon consists of management judgments regarding, how much tax is at risk with
2 respect to each uncertain tax position and corresponding estimates of the amounts of
3 future incremental tax is likely to be paid or recovered.¹⁵

4 In contrast, the approach I recommend would remove this judgment process
5 and would include a more exact, known and measurable amount of ADIT in rate base
6 that corresponds to the tax returns filed by the Company, as well as the Ameren
7 Missouri taxable revenues and deductions claimed on these returns. Then, in
8 recognition of the risk that some of the as-filed tax positions may be revised upon
9 audit by the IRS, I propose a mechanism through which Ameren would be made
10 whole for any future disallowances of its uncertain tax positions, once those
11 outcomes are resolved and become known and measurable.

12 **Q AT PAGE 12, MR. WARREN STATES, “THE FIN 48 ISSUE IS NOT**
13 **CONCEPTUALLY COMPLEX. THE COMPANY HAS, THROUGH ITS INCOME**
14 **TAX RETURN FILINGS, ESSENTIALLY BORROWED MONEY FROM THE**
15 **FEDERAL GOVERNMENT. THE GOVERNMENT MAKES LOANS FOR WHICH IT**
16 **CHARGES INTEREST AND ONES FOR WHICH IT DOES NOT CHARGE**
17 **INTEREST. THE ISSUE IS WHICH OF THESE TWO TYPES OF LOANS THE**
18 **COMPANY HAS RECEIVED. THE COMPANY HAS TREATED ITS FIN 48**
19 **LIABILITY AS A LOAN REQUIRING INTEREST. MR. BROSCHE PROPOSES TO**
20 **TREAT IT AS INTEREST-FREE.” DOES THE COMPANY KNOW AT THIS TIME**
21 **WHETHER THE FIN 48 BALANCES AT ISSUE IN THIS CASE REPRESENT AN**
22 **INTEREST OBLIGATION TO THE IRS THAT MUST BE PAID?**

23 **A** No. This is the key uncertainty surrounding Ameren’s uncertain tax positions –
24 whether or not after review by the IRS, the positions will be rejected, triggering tax

¹⁵Id. page 16.

1 assessments and interest, or be approved, resulting in what Mr. Warren characterizes
2 as the interest free form of ADIT balances. At page 18 of his Rebuttal, Mr. Warren
3 states, “Admittedly, it is not absolutely certain that the governmental loans will require
4 interest.”

5 **Q HAS “THE COMPANY TREATED ITS FIN 48 LIABILITY AS A LOAN REQUIRING**
6 **INTEREST,” AS ASSERTED BY MR. WARREN?**

7 A No. A far more punitive approach is actually being employed, under which the FIN 48
8 liability increases rate base, charging ratepayers a full overall rate of return on such
9 amounts, plus income taxes on the equity element of the return. Treating the FIN 48
10 liability as an IRS loan in the manner suggested by Mr. Warren would actually be
11 much more favorable to ratepayers than the Company’s rate case treatment, which is
12 to exclude such amounts from rate base. The highest current IRS interest rate on tax
13 underpayments by corporate taxpayers is now six percent,¹⁶ which is far lower than
14 the return requirement on the ADIT balances being removed from rate base under
15 Ameren’s approach. For example, a \$100 million rate base adjustment removing FIN
16 48 ADIT estimated liability adds about \$11 million to the Company’s revenue

¹⁶Internal Revenue Service interest rates for the calendar quarter beginning April 1, 2011 are:

- four (4) percent for overpayments (three (3) percent in the case of a corporation);
 - four (4) percent for underpayments;
 - six (6) percent for large corporate underpayments; and
 - one and one-half (1.5) percent for the portion of a corporate overpayment exceeding \$10,000.
- Internal Revenue Service today announced that interest rates for the calendar quarter beginning April 1, 2011, will increase by one percentage point. The rates will be:
- four (4) percent for overpayments (three (3) percent in the case of a corporation);
 - four (4) percent for underpayments;
 - six (6) percent for large corporate underpayments; and
 - one and one-half (1.5) percent for the portion of a corporate overpayment exceeding \$10,000.

Under the Internal Revenue Code, the rate of interest is determined on a quarterly basis. See Under the Internal Revenue Code, the rate of interest is determined on a quarterly basis. See <http://www.irs.gov/pub/irs-drop/rr-11-05.pdf> for additional information.

1 requirement.¹⁷ In contrast, if we treat these amounts as a “loan requiring interest” as
2 suggested by Mr. Warren, the revenue requirement impact could be no higher than
3 \$6 million.

4 **Q DOES MR. WARREN’S TESTIMONY REGARDING TREATMENT OF FIN 48**
5 **LIABILITIES AS A LOAN WITH INTEREST SUGGEST A COMPROMISE**
6 **RATEMAKING ADJUSTMENT THAT COULD BE ADOPTED BY THE**
7 **COMMISSION THAT WOULD MAINTAIN ITS POLICY ESTABLISHED IN CASE**
8 **NO. ER-2008-0318 ON THIS MATTER, WHILE MITIGATING THE NEGATIVE**
9 **IMPACT OF FIN 48 LIABILITIES UPON RATEPAYERS?**

10 A Yes. The Commission could adopt the MIEC adjustment to reinstate the ADIT
11 balances that Ameren has classified as FIN 48 UTP amounts, by approving the rate
12 base adjustment set forth in my Schedule MLB-5, and then add to Operating
13 Expenses for the test year an imputation of IRS interest at six percent of this amount.
14 Such an approach would accomplish what Mr. Warren claims to be the Company’s
15 position – treating the FIN 48 amounts as a “loan with interest”. It would also mitigate
16 the harsh impact of FIN 48 estimates upon the revenue requirement paid by
17 customers by about half. If this alternative were adopted, the Commission could also
18 specify a future tracking and reconciliation of the amounts of FIN 48 interest charged
19 to ratepayers, compared to amounts actually paid to the IRS, upon UTP resolution.

¹⁷The Pretax rate of return of 11.04% sponsored by MIEC witness Mr. Gorman can be found in Mr. Gorman’s workpapers at Schedule MPG-SR-17, Page 2 of 5.

1 Q AT PAGE 18, MR. WARREN STATES THAT YOUR POSITION ON THIS ISSUE,
2 "... IN EFFECT, ASSUMES THAT THE COMPANY WILL PREVAIL ON EVERY
3 UNCERTAIN TAX POSITION IT HAS TAKEN – EVEN THOSE WITH RESPECT TO
4 WHICH THE EXPERTS HAVE DETERMINED IT IS LIKELY THAT THE COMPANY
5 WILL NOT PREVAIL. IS THIS A FAIR CHARACTERIZATION OF YOUR
6 POSITION?

7 A This is a completely unfair characterization of my recommendation. My
8 recommended approach to FIN 48 would fully and equitably account for each
9 instance where the Company ultimately does not prevail on any uncertain tax position
10 ADIT balances that were included in rate base. Specifically, I have proposed that,
11 "Ameren Missouri would be granted the right to recognize a regulatory asset for
12 carrying charges on the amounts of any UTP-reserved amounts of ADIT that were
13 included in a rate base now, but later disallowed upon tax audit and resolution of any
14 appeals. The carrying charges should be based upon the lesser of the overall rate of
15 return applied to the rate base amounts of subsequently reversed ADIT amounts or
16 the interest assessed by the IRS in connection with any subsequent disallowance of
17 the underlying UTP.¹⁸ This important make-whole provision that does not assume the
18 Company will prevail on every uncertain tax position it has taken.

19 Q DOES MR. WARREN ACKNOWLEDGE THE MERIT OF A TRACKING
20 MECHANISM THAT WOULD NOT PERMANENTLY DENY RATEPAYER THE
21 CASH FLOW BENEFIT OF FIN 48 TAX POSITIONS IF THOSE POSITIONS ARE
22 SUCCESSFULLY DEFENDED BY AMEREN BEFORE THE IRS?

23 A Yes – he seems to. However, he stops short of actually proposing a more equitable
24 regulatory solution to address Ameren's uncertain tax position problem. At page 23,

¹⁸Brosch Direct Testimony at page 19.

1 Mr. Warren disparages the MIEC proposal for a make-whole provision because it
2 would start with Ameren's as-filed income tax positions, rather than reducing recorded
3 ADITs for estimated FIN 48 liabilities. Instead, Mr. Warren claims that any make
4 whole provision, "...should utilize the better-informed conclusions—that FIN 48
5 amounts are not cost-free capital – and, in the event that this conclusion proves
6 incorrect, provide customers with the IRS interest avoided by virtue of the Company's
7 successful assertion of its uncertain tax position." The essential difference in these
8 two make-whole approaches is that, under Mr. Warren's alternative, the Company
9 would assert uncertain tax positions within its filed tax returns, keep the cash flow
10 benefits for the sole immediate benefit of shareholders, and then only credit
11 customers for any benefit when and if the Company prevails on audit and avoids
12 paying any interest to the IRS.

13 **Q DOES MR. WARREN ACTUALLY RECOMMEND ADOPTION OF A PROCESS**
14 **THAT WOULD EQUITABLY "PROVIDE CUSTOMERS WITH THE IRS INTEREST**
15 **AVOIDED BY VIRTUE OF THE COMPANY'S SUCCESSFUL ASSERTION OF ITS**
16 **UNCERTAIN TAX RETURN POSITIONS"?**

17 **A** No. Ameren apparently would prefer to maintain the existing treatment of FIN 48
18 amounts previously approved by the Commission, rather than adopt any equitable
19 make-whole provision. This is not surprising, because under the treatment approved
20 for FIN 48 amounts in Case No. ER-2008-0318 only shareholders receive any current
21 benefit from the Company's assertion of uncertain tax positions. This situation should
22 not be allowed to continue. Either FIN 48 amounts should not be excluded from the
23 ADIT balances that reduce rate base, with the make-whole treatment I recommend in
24 the event Ameren later pays IRS interest, or, if FIN 48 amounts are recognized in

1 accordance with past Commission practice, ratepayers must be credited for avoided
2 IRS interest when Ameren prevails on its uncertain tax positions.

3 **Q AT PAGE 20 OF HIS REBUTTAL, MR. WARREN CONCEDES YOUR POINT THAT**
4 **THE FERC REQUIRES THAT FIN 48 AMOUNTS BE ACCOUNTED FOR AS**
5 **DEFERRED TAX LIABILITIES, BUT HE CLAIMS THAT YOU NEGLECTED TO**
6 **MENTION THAT FERC EXPLICITLY CAVEATED ITS GUIDANCE WITH REGARD**
7 **TO RATEMAKING PRACTICE. HOW DO YOU RESPOND?**

8 A The FERC caveat is irrelevant and potentially misleading. This is because FERC
9 permits a form of formula ratemaking that relies upon recorded FERC Form 1
10 expense and tax classifications, as reflected on the books in compliance with FERC
11 accounting guidance. Under this approach, a FERC accounting requirement has the
12 effect of also defining ratemaking practice for those utilities participating in its formula
13 ratemaking regime. Notably, Mr. Warren's Rebuttal does not identify any FERC case
14 in which FIN 48 liabilities were treated in a manner other than is required by FERC for
15 accounting disclosures. Ameren's response to Data Request No. MIEC 31.13 states
16 that, "Mr. Warren is unaware of any expressed FERC policy with regard to ratemaking
17 for FIN 48 items."

18 **Q MR. WARREN ALSO ATTEMPTS TO DISTINGUISH AMEREN MISSOURI FROM**
19 **THE TEXAS ONCOR DECISION YOU MENTIONED IN YOUR DIRECT**
20 **TESTIMONY. DOES THE CERTAINTY OF IRS AUDIT DISTINGUISH THE UE**
21 **SITUATION FROM THE ONCOR ONE,¹⁹ AS MR. WARREN SUGGESTS?**

22 A No. Uncertain tax positions exist because of the risk of review and disallowance of
23 the positions taken by the taxpayer. If there was really no reasonable expectation of

¹⁹Rebuttal Testimony of James I. Warren, page 21.

1 IRS audit or risk of disallowance for Oncor, as suggested by Mr. Warren, there could
2 have been no uncertain tax positions requiring resolution in the cited Texas case.

3 **Q HAVE THE AMOUNTS OF AMEREN MISSOURI UNCERTAIN TAX POSITIONS**
4 **BEEN REVISED AS PART OF THE COMPANY'S TRUE-UP OF RATE BASE?**

5 A Yes. I have included within Schedule MLB-5 an updated and revised calculation of
6 the rate base adjustment required to replace the FIN 48 estimates that Ameren has
7 excluded from its true-up ADIT balances.

8 **NET OPERATING TAX LOSSES**

9 **Q IN YOUR DIRECT TESTIMONY, YOU NOTED THAT AMEREN MISSOURI ADIT**
10 **BALANCES WOULD CHANGE BECAUSE OF THE NET OPERATING LOSSES**
11 **("NOL's") BEING REPORTED AND CARRIED FORWARD TO FUTURE TAX**
12 **YEARS. HAS THE COMPANY INCLUDED THE EFFECT OF NOLS IN ITS**
13 **TRUE-UP CALCULATIONS?**

14 A Yes. The Company's true-up calculations now include debit ADIT balances
15 associated with its carry-forward of Net Operating Losses.

16 **Q HOW DO THE UNCERTAIN TAX POSITIONS THAT ARE SUBJECT TO FIN 48**
17 **ACCOUNTING CONTRIBUTE TO THE COMPANY'S NOL POSITION AND IMPACT**
18 **THE RESULTING DEBIT ADIT BALANCES?**

19 A The additional tax deductions that Ameren has treated as uncertain, and subject to
20 FIN 48, have the effect of increasing the Company's NOL position, thus increasing
21 the resulting debit ADIT balances that are includable in rate base. It is essential that
22 rate base not be increased for NOL carry-forward ADIT amounts that have been

1 enlarged by FIN 48 positions -- for which the associated ADIT credit balances are not
2 being recognized in rate base. I understand, from correspondence with Staff and
3 Company personnel, that adjustments have been made to properly coordinate the
4 treatment of NOL carry-forward balances with the ADIT balances actually included in
5 rate base.

6 **Q DOES YOUR UPDATE OF THE FIN 48 ADJUSTMENT IN SCHEDULE MLB-5**
7 **ACCOUNT FOR THE NOL CARRY-FORWARD POSITION OF AMEREN**
8 **MISSOURI AS OF FEBRUARY 28, 2011?**

9 A Yes. Schedule MLB-5 sets forth each element of FIN 48 reductions to the ADIT
10 balances, while at line 7 adding back the NOL carry-forward amount that is
11 associated with the uncertain tax positions.

12 **NEW ACCOUNTING AUTHORITY ORDERS**

13 **Q DOES AMEREN MISSOURI CONTINUE TO SUPPORT THE ADOPTION OF NEW**
14 **ACCOUNTING AUTHORITY ORDERS (“AAO”) IN THIS PROCEEDING?**

15 A Yes. Company witness Mr. Weiss continues to argue for what he calls “construction
16 accounting for government for governmental relocations and other projects” over the
17 objections of Staff witness Mr. Rackers and my position explained in Direct
18 Testimony.²⁰

²⁰Rebuttal Testimony of Gary S. Weiss, page 18

1 Q MR. WEISS CLAIMS THAT THE REVENUE AND EXPENSE LEVELS DEVELOPED
2 IN THE TEST YEAR ARE NOT IMPACTED BY THE COMPANY'S PROPOSED
3 CONSTRUCTION ACCOUNTING.²¹ IS THIS CORRECT?

4 A Not really. The Company's proposal disturbs the matching of revenue and expense
5 levels in the test year – by reaching beyond test year-end to add piecemeal carrying
6 charges (so-called construction accounting) for certain construction projects active
7 after the test year. The problem with this proposal is that it ignores the fact that other
8 elements of the Company's rate base, revenues and expense will continue to change
9 after the test year. For example, Ameren Missouri will continue to depreciate its
10 existing Plant in Service causing its Accumulated Depreciation balance to increase,
11 yet the Company proposes no post test-year piecemeal accounting for this known
12 change. Similarly, ADIT balances can be expected to grow significantly throughout
13 2011 due to the extension of bonus tax depreciation applicable to qualifying
14 investments in 2011, yet again Ameren has made no post test-year piecemeal
15 accounting proposed to account for this known change.

²¹Id.

1 Q MR. WEISS ARGUES THAT REGULATORY LAG IS A MAJOR ISSUE THE
2 COMMISSION AND UTILITIES ARE DEALING WITH.²² DOES MR. WEISS
3 PRESENT ANY SUPPORTING ANALYSIS OR QUANTIFICATION IN HIS
4 REBUTTAL TO SUPPORT THE PREMISE THAT THE COMPANY HAS A PROVEN
5 FINANCIAL NEED FOR AN EXTRAORDINARY RATE MECHANISM, SUCH AS
6 CONTINUED CONSTRUCTION ACCOUNTING, TO COMBAT REGULATORY
7 LAG?

8 A No. Mr. Weiss has not presented in his Rebuttal Testimony any analysis of earnings
9 attrition or any financial projections to support a financial need for continued
10 construction accounting at this time. While Ameren Missouri would no-doubt
11 appreciate the additional earnings and revenues that would result from its piecemeal
12 continued construction accounting proposals, ratepayers should not be burdened with
13 higher rates in the absence of a proof of financial need for such exceptional
14 ratemaking procedures.

15 Q DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

16 A Yes.

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²²Id., page 19.

Witness: M. Brosch

AMEREN MISSOURI
CASE NO. ER-2010-0028
UPDATED FIN 48 DEFERRED INCOME TAX REVISIONS
TEST YEAR ENDED MARCH 31, 2010
\$000

REDACTED VERSION

| LINE NO. | DESCRIPTION | REFERENCE | AMOUNT |
|----------|---|-----------------|--------|
| | (A) | (B) | (C) |
| 1 | <u>True-up Revised Accumulated Deferred Income Tax FIN 48 Reclassifications:</u> | | |
| 2 | | Note (a) | |
| 3 | | " | |
| 4 | | " | |
| 5 | | " | |
| 6 | Sum of FIN 48 Uncertain Tax Position Reclassifications by Ameren | Lines 2..5 | |
| 7 | Less: FIN 48 Amounts Offset Against NOL Carryforward Tax Asset | Note (b) | |
| 8 | MIEC Adjustment to Include Uncertain Tax Position ADIT Elements in Rate Base | Line 6 + Line 7 | |

THIS SCHEDULE UPDATES AND SUPERSEDES SCHEDULE MLB-4

Footnotes:

- (a) Amounts provided via E-mail from Brenda Mencke, 4/4/2011 "Accum Def Inc Tax True-up 4-4-11.xls"
- (b) Ameren is in a Net Operating Loss ("NOL") Carryforward Position at 2/28/2011 and reduced the NOL tax asset otherwise includable in rate base by the portion of this amount that was generated by FIN 48 liability deductions, so as to consistently present FIN 48 exclusions. These amounts must therefore be added back to fully recognize ADITs and the larger actual NOL carryforward.