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Witness: James I. Warren

Sponsoring Party: Missouri Gas Energy

Case No.: GR-2004-0209

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MISSOURI PUBLIC SERVICE COMMISSION

MISSOURI GAS ENERGY

CASE NO. GR-2004-0209

REBUTTAL TESTIMONY

OF

JAMES I. WARREN

ON BEHALF OF MISSOURI GAS ENERGY

Jefferson City, Missouri

May 2004

**REBUTTAL TESTIMONY OF JAMES WARREN  
ON BEHALF OF  
MISSOURI GAS ENERGY**

1

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

3 A. My name is James I. Warren. My business address is 875 Third Avenue, New York,  
4 New York 10022.

5 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

6 A. I am a tax partner in the law firm of Thelen Reid & Priest LLP.

7 **Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF THELEN REID & PRIEST.**

8 A. Thelen Reid & Priest is a general practice law firm employing approximately 430  
9 attorneys in its offices in New York, San Francisco, Washington D.C., Los Angeles,  
10 Silicon Valley and New Jersey. It has particularly active practices in the energy,  
11 construction and litigation areas. Our tax practice is national in scope and provides  
12 services to many electric and gas companies throughout the country.

13 **Q. PLEASE DESCRIBE YOUR CURRENT RESPONSIBILITIES AT THELEN  
14 REID & PRIEST LLP.**

15 A. I am engaged in the general practice of taxation. I specialize in the taxation of and the  
16 tax issues relating to regulated public utilities. Included in this area of specialization is  
17 the treatment of taxes in regulation. I also chair the firm's Tax, Benefits and Trusts and  
18 Estate Department

19 **Q. PLEASE DESCRIBE YOUR PROFESSIONAL BACKGROUND.**

20 A. I joined Thelen Reid & Priest LLP in November of 2003. Prior to that time I was  
21 affiliated with the international accounting firms of Deloitte & Touche LLP (Oct. 2000 –  
22 Oct. 2003), PricewaterhouseCoopers LLP (Jan. 1998 – Sept. 2000) and Coopers &  
23 Lybrand (Mar. 1979 – June 1991) and the law firm Reid & Priest LLP (July 1991 – Dec.  
24 1997). At each of these professional services firms, I provided tax services primarily to  
25 electric, gas and telephone industry clients. My practice has included tax planning for the  
26 acquisition or transfer of business assets, operational tax planning and the representation  
27 of clients in tax controversies with the Internal Revenue Service ("IRS") at the audit and

1 appeals levels. I have often been involved in procuring rulings or technical advice from  
2 the IRS National Office. On several occasions, I have represented one or more segments  
3 of the utility industry before the IRS and/or the Department of Treasury regarding certain  
4 tax positions adopted by the federal government. I have testified regarding tax, tax  
5 accounting and regulatory tax matters before a number of regulatory bodies including the  
6 FERC and the commissions in Texas, Florida, Louisiana, Nevada, New Jersey, New  
7 York, Connecticut, California, Missouri, Illinois, Pennsylvania and Maryland. I have  
8 also testified before several Congressional committees and subcommittees and at  
9 Department of Treasury hearings regarding legislative and administrative tax issues of  
10 significance to the utility industry. I am a member of the New York and New Jersey Bars  
11 and also am licensed as a Certified Public Accountant in those two states. I am a member  
12 of the American Bar Association, Section of Taxation where I am a past chair of the  
13 Committee on Regulated Public Utilities and also a member of the AICPA.

14 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

15 A. I received a B.A. (Political Science) from Stanford University, a law degree (J.D.) from  
16 New York University School of Law, a Master of Laws (LL.M.) in Taxation from New  
17 York University School of Law and a Master of Science (M.S.) in Accounting from New  
18 York University Graduate School of Business Administration.

19 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

20 A. The purpose of my testimony is (1) to rebut the position reflected in Staff's Direct  
21 Testimony that no amount of the alternative minimum tax ("AMT") incurred by the  
22 Southern Union consolidated tax return group ("Group") should be allocated to Missouri  
23 Gas Energy ("MGE") and (2) to support MGE's position that it is appropriate to allocate  
24 the Group AMT based on relative AMT adjustments and preferences.

25  
26 **Q. HOW MUCH DID MGE REFLECT IN ITS FILING IN THIS PROCEEDING AS  
27 ITS PORTION OF THE GROUP'S AMT?**

28 A. MGE reflected approximately \$13 million as its portion of the Group's AMT. This  
29 amount was included as an increase to rate base.  
30

1 **Q. HOW MUCH DID STAFF REFLECT IN ITS FILING IN THIS PROCEEDING**  
2 **AS MGE'S PORTION OF THE GROUP'S AMT?**

3 A. Staff's filing reflected no portion of the Group's AMT as being allocable to MGE.  
4

5 **Q. WILL YOU PLEASE SUMMARIZE YOUR TESTIMONY?**

6 A. Certainly. Where the AMT applies, it represents a complicated way in which the tax  
7 code imposes a deferral on the benefit of certain tax deductions – particularly accelerated  
8 depreciation. For example, in a 35% regular tax rate environment, a \$1 incremental  
9 depreciation deduction may produce less than a 35 cent reduction in tax due where the  
10 AMT applies. The deferred benefit can, however, be claimed in a subsequent year. Due  
11 to application of the AMT, the Group has had approximately \$26 million of tax benefits  
12 deferred. The issue in dispute is how much of this benefit deferral should be properly  
13 associated with MGE's operations. MGE allocates the deferral based on its deductions  
14 the benefits of which have been deferred. I believe that this methodology recognizes the  
15 real cash consequences of the AMT and achieves an appropriate result. Staff proposes to  
16 employ a "stand alone" MGE AMT calculation to determine MGE's benefit deferral. I  
17 believe that such a calculation is not an appropriate basis upon which to associate AMT  
18 because it does not reflect the reality of the AMT tax and is an unreliable indicator of  
19 AMT responsibility. Moreover, the use of a MGE stand-alone computation for AMT is  
20 inconsistent with the way in which Staff approaches MGE's regular tax liability. If the  
21 same approach were to be used for both purposes, then MGE should recognize a  
22 significant increase in its rate base over and above that which is has proposed in its filing  
23 in this proceeding.  
24

25 **Q. GENERALLY, HOW DOES THE AMT WORK?**

26 A. The AMT has been in effect since 1987. It require a separate and distinct tax  
27 computation after a corporation has computed its tax under the regular tax rules. The  
28 AMT rules provide that each corporation adjust its regular taxable income for a number  
29 of "adjustments" and "preferences" (collectively, "Adjustments") to arrive at alternative  
30 minimum taxable income ("AMTI"). A "tentative" AMT ("TAMT") is computed on  
31 AMTI at a 20% rate. To the extent that this TAMT exceeds the corporation's tax

1 computed in the regular way, the corporation pays the regular tax and an amount equal to  
2 the excess. This excess is the corporation's AMT. The amount of AMT paid in any year  
3 is generally creditable against a corporation's tax liability in future years, but only to the  
4 extent that its regular tax exceeds its TAMT in that subsequent year. This credit is the  
5 Minimum Tax Credit ("MTC") carryforward. Economically, the Adjustments represent  
6 tax deductions the full benefits of which are "cut back" on by operation of the AMT.  
7 However, due to the crediting mechanism of the MTC carryforward, these "cut backs"  
8 are only temporary. In effect, the full benefit of the items is deferred until such time as  
9 the MTC carryforward is used to reduce a tax liability in a subsequent year.

10  
11 **Q. WHAT ADJUSTMENTS ARE MOST RELEVANT TO THE GROUP?**

12 A. There have been two Adjustments which have been primarily responsible for generating  
13 the Group's AMT – the AMT depreciation adjustment and the Adjusted Current Earnings  
14 ("ACE") adjustment. The AMT depreciation adjustment is simply the "addback" to  
15 regular taxable income of the difference between regular tax depreciation and the slower  
16 depreciation permitted by the Internal Revenue Code for purposes of computing AMTI.  
17 The ACE adjustment requires that regular taxable income be adjusted by 75% of the  
18 difference between AMTI (before considering the ACE adjustment) and ACE. ACE  
19 is yet another measure of income starting with AMTI (before considering the ACE  
20 adjustment) and adjusting for a number of items, one of which is depreciation.

21  
22 **Q. PLEASE PROVIDE A SIMPLE EXAMPLE OF THE AMT.**

23 A. Assume X, a regulated utility in its first year of operation, has \$300 of pre-tax income  
24 (after \$100 of book depreciation) and \$200 of tax depreciation in excess of book  
25 depreciation. Also assume a tax rate of 35%. X will have regular taxable income of  
26 \$100 and will incur a regular tax liability of \$35.

27  
28 **Q. HOW MUCH COST-FREE CAPITAL WOULD X HAVE AVAILABLE TO IT  
29 BEFORE CONSIDERATION OF THE AMT?**

30 A. X would have tax expense of \$105 (\$300 of pre-tax book income taxed at 35%). X  
31 would pay a tax of \$35 (\$100 of taxable income taxed at 35%). Thus, X would have \$70

1 of cost-free capital (*i.e.*, deferred tax) available to it before considering any effects of the  
2 AMT.

3  
4 **Q. WHAT ABOUT THE EFFECT OF THE AMT ON X?**

5 A. Assume also that the year is 1995, that AMT depreciation equals \$200 and that this is the  
6 only AMT adjustment or preference. As described above, AMTI will be computed by  
7 adding to regular taxable income (\$100) the difference between AMT depreciation  
8 (\$200) and regular tax depreciation (\$300). Thus, X's AMTI will equal \$200 [ $\$100 +$   
9  $(\$300 - \$200)$ ]. At the 20% AMT rate, X's TAMT will equal \$40. Since that amount  
10 exceeds the \$35 regular tax liability, X will pay both the \$35 regular tax liability and \$5  
11 more in AMT – a total of \$40. This \$5 AMT would produce an MTC carryforward  
12 which would then be available to offset taxes paid in the future.

13  
14 **Q. WILL YOU CHARACTERIZE WHAT HAPPENS IN THE EXAMPLE ABOVE?**

15 A. Due to the AMT, X did not realize the entire \$70 benefit of its \$200 of accelerated tax  
16 depreciation. The AMT caused a portion of the benefit to be deferred until such time as  
17 the MTC carryforward is used. In fact, \$5 of the regular tax benefit produced by the  
18 accelerated depreciation is deferred until such later time as the MTC carryforward is  
19 used.

20  
21 **Q. HOW SHOULD X REFLECT THIS BENEFIT "CUT BACK?"**

22 A. X should reflect this "cutback" by "booking" the full, pre-AMT benefit of the accelerated  
23 depreciation (\$70) as a deferred tax credit and then reflecting the \$5 "cutback" as a  
24 deferred tax debit.

25  
26 **Q. WHAT IS THE AMOUNT OF COST-FREE CAPITAL AVAILABLE TO X?**

27 A. As a result of the AMT "cut back", X has a total of only \$65 of cost-free capital available  
28 to it.

1 Q. HOW SHOULD THIS "CUT BACK" BE REFLECTED IN THE CONTEXT OF A  
2 RATE REGULATED ENTERPRISE?

3 A. The "cut back" should either reduce that enterprise's accumulated deferred federal  
4 income tax credit balance or be reflected as a deferred tax debit. In either case, the effect  
5 is an increase in regulated rate base.  
6

7 Q. HOW IS THE AMT COMPUTED IN THE CASE OF A CONSOLIDATED TAX  
8 RETURN GROUP?

9 A. The AMT is computed on a consolidated basis, taking into account all of the Adjustments  
10 produced by all of the entities included in the consolidated return filing in a single  
11 computation.  
12

13 Q. WHAT IS THE AMOUNT OF THE AMT INCURRED BY THE GROUP WHICH  
14 HAS NOT YET BEEN USED TO OFFSET ITS REGULAR TAX LIABILITY?

15 A. Through its 2003 tax return year, the Group has approximately \$26 million in MTC  
16 carryforwards. This means that the Group has incurred approximately \$26 million of  
17 AMT which it has not yet been able to use to reduce its regular tax liability. Thus, the  
18 benefits of certain tax deductions, primarily depreciation, have been deferred to that  
19 extent.  
20

21 Q. IS THE \$26 MILLION AMOUNT REFERENCED ABOVE THE SUBJECT OF  
22 DISAGREEMENT?

23 A. I don't believe so.  
24

25 Q. WHAT, THEN, IS ISSUE ABOUT WHICH MGE AND STAFF DISAGREE?

26 A. As I indicated above, each year's AMT calculation is a consolidated computation. Thus,  
27 the entire Group computes its AMT as if it were a single operation. Because, for various  
28 purposes - one of which is the setting of regulated rates - the Group must be viewed as  
29 being composed of a number of discrete operations, the results of this unified  
30 computation must be allocated. In short, because the economic consequences of the  
31 AMT have regulatory implications, that AMT must be "broken apart" and "parceled out"

1 in order that these implications might be properly considered. The disagreement between  
2 MGE and Staff relates to the appropriate method for accomplishing this.

3  
4 **Q. HOW DOES MGE PROPOSE TO ALLOCATE THE GROUP'S AMT?**

5 A. MGE allocates to itself the consolidated AMT based on the ratio of the Adjustments it  
6 generated to all of the Adjustments produced by all of the operations included within the  
7 Group. In other words, MGE was allocated AMT in proportion to the dollar volume of  
8 Adjustments it produced.

9  
10 **Q. WHAT IS THE BASIS UPON WHICH THIS ALLOCATION METHODOLOGY**  
11 **IS PREMISED?**

12 A. The purpose underpinning this methodology is to accurately reflect the economic impact  
13 of the AMT. As indicated previously, the AMT "cuts back" (*i.e.*, defers) the benefit of  
14 the regular tax deductions generated by the Adjustments specified in the statute (in  
15 MGE's case, primarily depreciation). In fact, where there is AMT, the benefit of each  
16 Adjustment generated by any Group member is affected and each Adjustment is affected  
17 in precisely the same way. Since this is the structure of the tax, it is entirely appropriate  
18 to allocate the consolidated AMT based on relative quantities of Adjustments. That is  
19 precisely the basis upon which MGE's allocation was performed.

20  
21 **Q. IS THIS METHODOLOGY A NEW OR NOVEL ONE?**

22 A. Not at all. This is the methodology that MGE has employed for regulatory purposes for  
23 years. In fact, it is my understanding that no other methodology has ever been employed  
24 by MGE.

25  
26 **Q. WHAT IS YOUR UNDERSTANDING OF THE BASIS FOR STAFF'S**  
27 **PROPOSAL TO RECOGNIZE NO AMT WHATSOEVER IN ITS MGE RATE**  
28 **BASE COMPUTATION?**

29 A. It is my understanding that Staff requested MGE provide it with a "stand alone" MGE-  
30 only tax computation. MGE did so. However, due to an apparent misunderstanding, the  
31 data transmitted to Staff did not reflect any allocation of joint costs nor any MGE-related



1 interest costs. The computation that was transmitted indicated, erroneously, that if MGE  
2 had filed a tax return on a "stand alone" basis without the reflection of either joint costs  
3 or interest costs, it would have incurred only a minimal AMT liability. Based on this,  
4 Staff concluded that MGE should not reflect any AMT in its rate base computation.  
5

6 **Q. IS THIS "MISUNDERSTANDING" BEING ADDRESSED?**

7 A. Yes it is. MGE and Staff have discussed the misunderstanding and a new MGE "stand  
8 alone" tax computation has been transmitted by MGE. While Staff has not yet audited  
9 and analyzed this document and the source material upon which it is based, the  
10 computation discloses that MGE "stand alone" produced a net operating loss of  
11 approximately \$90 million and a MTC carryforward of approximately \$8 million. This  
12 means that if MGE had always been a separate corporation which had always filed a  
13 separate corporate federal income tax return, not only would about \$90 million of its tax  
14 deductions not have produced any tax benefit at all, it also would have paid  
15 approximately \$8 million in AMT. The cost of not being able to produce the tax benefits  
16 would have approximated \$35 million. And that would be in addition to payment of \$8  
17 million of AMT. In short, had this hypothetical situation actually occurred, MGE would  
18 have been denied some \$43 million of tax benefits. As explained later in more detail, this  
19 \$43 million should then be added to MGE's rate base for rate setting purposes.  
20

21 **Q. WHY IS STAFF'S "STAND ALONE" COMPUTATION AN IMPROPER**  
22 **METHOD OF DETERMINING THE APPROPRIATE QUANTITY OF AMT TO**  
23 **ASSOCIATE WITH THE MGE OPERATIONS?**

24 A. The payment of consolidated AMT is an empirical fact. It is not a hypothetical  
25 calculation. It is a real tax computation with real cash consequences. The allocation of  
26 this consequence should be based on similarly "hard" facts – not on what would have  
27 transpired had MGE filed a corporate tax return on an unconsolidated basis. In fact,  
28 MGE isn't even a separate corporate entity and, thus, couldn't file that way if it wanted  
29 to.  
30

1 **Q. DOES STAFF'S APPROACH TO AMT AMOUNT TO AN ALLOCATION OF A**  
2 **CONSOLIDATED COMPUTATION?**

3 A. No it does not. Staff's methodology amounts to the calculation of a hypothetical tax, not  
4 the allocation of a real tax. The use of hypothetical AMT computations raises difficult  
5 issues because it cannot be squared with the mechanics of the tax itself.  
6

7 **Q. WHAT ISSUES DO HYPOTHETICAL AMT CALCULATIONS RAISE?**

8 A. Because of the way in which AMT is calculated, it is entirely possible that the actual  
9 AMT which must be paid will be quite different from the sum of the hypothetical, "stand  
10 alone" AMT computations for each of the Southern Union operations.  
11

12 **Q. CAN YOU ILLUSTRATE THIS?**

13 A. Assume a consolidated tax return group consisting of A and B, a 35% regular tax rate and  
14 a 20% AMT rate. A has \$100 of regular taxable income and \$50 of Adjustments. B has  
15 a \$50 tax loss and \$50 of Adjustments. The group's total regular taxable income would  
16 be \$50 (A's income of \$100 less B's loss of \$50). The group's regular tax liability would  
17 therefore be \$17.50 ( $\$50 \times 35\%$ ). To compute the group AMT, one starts with regular  
18 taxable income (\$50) and adds to it all of the Adjustments (\$100 [\$50 each from A and  
19 B]). This sum (\$150) is then multiplied by the AMT tax rate (20%) to produce a tentative  
20 AMT of \$30. Because this latter tax (\$30) is higher than the regular tax (\$17.50), the  
21 group pays the regular tax of \$17.50 as well as an additional AMT of \$12.50 (the \$30  
22 tentative AMT less the \$17.50 regular tax).  
23  
24  
25  
26  
27  
28  
29  
30  
31

In tabular form, this data appear as follows:

<b>REGULAR TAX</b>	Corp A	Corp B	Consolidated
Regular Taxable Income	\$100	(\$50)	\$50
Regular Tax	\$35	\$0	\$17.50

<b>AMT</b>	Corp A	Corp B	Consolidated
Regular Taxable Income	\$100	(\$50)	\$50
AMT Adjustments	\$50	\$50	\$100
AMT Income	\$150	\$0	\$150
Tentative AMT	\$30	\$0	\$30
AMT	\$0	\$0	\$12.50

**Q. WHY DOES THIS CREATE AN ISSUE?**

A. When one tries to assign responsibility for the \$12.50 of AMT as between A and B, one runs into a conundrum. If A were to file as a separate entity, it would pay no AMT. This is because its regular tax of \$35 (\$100 of regular taxable income multiplied by 35%) would exceed its tentative AMT of \$30 (\$100 of regular taxable income plus \$50 of Adjustments multiplied by the AMT rate of 20%). Similarly, if B had filed as a separate entity, it would pay no AMT. This is because its regular tax of \$0 (it had a regular tax loss) was not exceeded by its tentative AMT which was also \$0 (-\$50 of regular taxable income plus \$50 of Adjustments multiplied by the AMT rate of 20%). Thus, while the group incurred an AMT, neither A nor B would have done so separately.

**Q. WHAT DOES THIS ILLUSTRATE?**

A. It illustrates that hypothetical "stand alone" AMT computations can be an unreliable method upon which to premise AMT responsibility. It is not uncommon for the sum of the parts to diverge from the whole – sometimes significantly so. And the divergence can go in either direction. One or more individual operations could each have been subject to AMT on a "stand alone" basis while, on a consolidated basis, no AMT is due.

1  
2 **Q. ARE SUCH ANOMOLIES POSSIBLE WITH MGE'S PROPOSED**  
3 **ADJUSTMENT-BASED ALLOCATION METHODOLOGY?**

4 A. No they are not.  
5

6 **Q. DOES THE ADJUSTMENT-BASED METHODOLOGY MAKE SENSE FROM A**  
7 **TECHNICAL TAX PERSPECTIVE?**

8 A. Yes it does. The AMT was intended as a "cut back" on the tax benefits of certain  
9 deductions. When an AMT is incurred, the benefits of those deductions – all of those  
10 deductions – should be "cut back" proportionately. Thus, allocating AMT based on  
11 Adjustments is entirely consistent with the underlying intent and mechanics of the AMT.  
12

13 **Q. IF THIS COMMISSION ADOPTS STAFF'S "STAND ALONE"**  
14 **METHODOLOGY FOR COMPUTATION OF MGE'S AMT, IS THERE AN**  
15 **ADDITIONAL ADJUSTMENT THAT SHOULD BE ADOPTED?**

16 A. Yes there is. If this Commission adopts Staff's "stand alone" proposal for AMT, it  
17 should employ the same methodology for its regular tax liability. By this I mean that, to  
18 be consistent, it should recognize the \$35 million of regular tax benefits MGE would not  
19 have realized had it always filed on a "stand alone" basis. This amount should be an  
20 increase to rate base – in addition to the \$8 AMT that MGE would have paid on that same  
21 "stand alone" basis.  
22

23 **Q. ARE THERE ANY TAX RISKS ASSOCIATED WITH THIS COMMISSION'S**  
24 **USING A "STAND ALONE" APPROACH FOR MEASURING AMT AND A**  
25 **DIFFERENT APPROACH FOR MEASURING REGULAR TAX?**

26 A. There is one potential risk, involving the tax depreciation normalization rules.  
27  
28  
29  
30

1 **Q. PLEASE EXPLAIN THE PURPOSE AND STRUCTURE OF THE TAX**  
2 **DEPRECIATION NORMALIZATION RULES.**

3 A. In making accelerated depreciation available to American businesses, Congress intended  
4 to create a capital formation subsidy and, thereby, promote investment in capital assets.  
5 It was made available to all businesses, including utilities. The normalization rules were  
6 promulgated by Congress to insure that the benefits of accelerated depreciation claimed  
7 by a regulated utility would not be immediately extracted through the rate process (either  
8 directly by virtue of "tax flow through" rate setting or indirectly by virtue of the  
9 manipulation of deferred tax balances in the computation of regulated rate base) thereby  
10 negating the incentive Congress intended to provide to these businesses. The mechanism  
11 employed to preserve this benefit is deferred tax accounting. The provision of deferred  
12 taxes in the rate setting process permits a utility to retain the incremental funds provided  
13 by the government by virtue of allowing accelerated depreciation. Customers receive the  
14 benefit of this additional cash flow insofar as it reduces the financing costs which they  
15 would otherwise shoulder. The mechanism for recognizing this latter benefit is the  
16 offsetting of rate base by accumulated deferred income tax ("ADIT") balances. In short,  
17 the normalization rules effect a sharing between the company and its customers of the  
18 benefit of accelerated tax depreciation, providing cash flow to the company and financing  
19 benefits to customers. It should be noted that these rules apply only to the federal tax  
20 benefits produced by accelerated tax depreciation and not to ADIT attributable to other  
21 book/tax differences or to non-federal income taxes.

22  
23 **Q. WHAT IS THE PENALTY FOR VIOLATION OF THE NORMALIZATION**  
24 **RULES?**

25 A. When a normalization violation occurs, the taxpayer is no longer entitled to claim  
26 accelerated depreciation with respect to *any* depreciable assets subject to the jurisdiction  
27 of the commission. For example, if a MPSC order failed to comply with the  
28 normalization rules, MGE would be compelled to file its tax returns utilizing regulatory  
29 rates of depreciation for all of its jurisdictional assets - and this would continue (and  
30 would apply to all after-acquired jurisdictional assets) until the violative order is

1 corrected. Congress offered access to accelerated depreciation for a specific purpose and  
2 concluded that, where that purpose is frustrated, then the access will be withdrawn.  
3

4 **Q. DO THESE NORMALIZATION RULES APPLY TO AMT?**

5 A. The normalization rules address the cash flow benefits associated with the deduction of  
6 accelerated tax depreciation. Insofar as the AMT directly impacts the cash benefits that  
7 flow from these deductions, the normalization rules should be applicable. This logical  
8 inference is confirmed by the language in section 56 of the Internal Revenue Code of  
9 1986, the provision that describes the AMT depreciation adjustment. That section  
10 specifically provides that regulations should be promulgated to describe exactly how the  
11 normalization rules apply to the AMT. Unfortunately, no such regulations have been  
12 developed. Thus, we are left with uncertainty.  
13

14 **Q. IS THERE A PROVISION OF THE NORMALIZATION RULES WHICH YOU**  
15 **BELIEVE CREATES THE POTENTIAL RISK TO WHICH YOU PREVIOUSLY**  
16 **REFERRED?**

17 A. Yes there is. The single provision that concerns me greatly is the one that states that it is  
18 a violation of the normalization rules where inconsistent procedures or adjustments are  
19 employed in the calculation of any of the aspects of ratemaking that are relevant to  
20 normalization – tax expense, depreciation expense, deferred taxes and rate base.  
21 Specifically, I am quite concerned that the use of two different methodologies to compute  
22 the level of depreciation tax benefits not realized by MGE, one for AMT and a different  
23 one for regular tax, represents precisely such an inconsistent procedure. The  
24 consequence of such an inconsistency might be the loss of significant tax benefits going  
25 forward.  
26

27 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

28 A. Yes it does.

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's  
Tariff Sheets Designed to Increase Rates  
for Gas Service in the Company's Missouri  
Service Area.

)  
) GR-2004-0209  
)  
)

AFFIDAVIT OF JAMES I. WARREN

STATE OF NEW YORK       )  
                                  )  
COUNTY OF NEW YORK    ) ss.

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

  
JAMES I. WARREN

Subscribed and sworn to before me this 21<sup>st</sup> day of May 2004.

  
Notary Public

My Commission Expires: 7/31/06

**ARGY TSOUKLIDIS**  
**Notary Public, State of New York**  
**No. 01TS4773808**  
**Qualified in Queens County**  
**Commission Expires July 31, 20 06**