

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

AMEREN ILLINOIS COMPANY)	
)	
Rate MAP-P, Modernization Action Plan)	Docket No. 13-0301
Pricing Annual Update Filing)	

**REBUTTAL TESTIMONY OF DAVID J. EFFRON
ON BEHALF OF
THE PEOPLE OF THE STATE OF ILLINOIS**

AG Exhibit 4.0

AUGUST 26, 2013

ILLINOIS COMMERCE COMMISSION
DOCKET NO. 13-0301
REBUTTAL TESTIMONY OF DAVID J. EFFRON
TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	1
II. RATE BASE ISSUES	1
A. Accumulated Deferred Income Taxes	1
B. Accrued Vacation Pay	2
III. ACTUAL RATE BASE TO BE USED IN COLLAR CALCULATION	4
IV. CALCULATION OF INTEREST ON RECONCILIATION ADJUSTMENTS	8

1 **I. INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. My name is David J. Effron. My business address is 12 Pond Path, North Hampton,
4 New Hampshire, 03862.

5

6 **Q. Have you previously submitted testimony in this docket?**

7 A. Yes. I submitted direct testimony on July 3, 2013, marked as AG Exhibit 2.0. My
8 qualifications and experience are included with my direct testimony.

9

10 **Q. What is the purpose of your rebuttal testimony?**

11 A. In this rebuttal testimony, I respond to the rebuttal testimony of Company witnesses
12 Stafford and Mill.

13

14 **II. RATE BASE ISSUES**

15 **A. Accumulated Deferred Income Taxes**

16 **Q. Mr. Stafford states that he does not agree with your testimony that the net value**
17 **of the Metro East assets included in the rate base of CIPS was greater than what**
18 **the net book value of the transferred assets had been in the hands of the affiliate.**
19 **Do you have a response?**

20 A. Yes. Mr. Stafford focuses on the wrong value. I agree that if the net book value is
21 defined as the plant in service minus accumulated depreciation, then that net book
22 value did not change as a result of the transfer. However, for the purpose of
23 determining a utility's revenue requirement, the relevant measure of the net rate base

24 value is the plant in service minus accumulated depreciation minus accumulated
25 deferred income taxes (“ADIT”), as this is the measure of value that ultimately goes
26 into the revenue requirement. Focusing on this measure of value, the net rate base
27 value clearly increased as a result of the transfer of the assets from UE to CIPS. Mr.
28 Stafford acknowledges that prior to the transfer there was a balance of ADIT on the
29 books of UE. As a result of the transfer, the balance of ADIT on the books of UE
30 was, in effect, eliminated. Obviously, if the rate base value is equal to plant in service
31 minus accumulated depreciation minus ADIT, and the ADIT is eliminated, then the
32 rate base value of the subject assets must increase.

33 As I stated in my direct testimony, utility holding companies should not be
34 allowed to increase the net rate base value of assets by transferring the assets between
35 affiliates. AG/CUB Ex. 2.0 at 5-6. Therefore, the deferred tax asset related to the
36 Tax Depreciation Step-Up Basis - Metro should be eliminated from the Company’s
37 rate base, and the Company’s rate base should be reduced accordingly.

38

39 **B. Accrued Vacation Pay**

40 **Q. How does the Company respond to your proposal to deduct the accrued liability**
41 **for vacation pay from rate base?**

42 A. Mr. Stafford states that “Accrued vacation is a current liability on AIC’s books due
43 and payable within one year. Accordingly, accrued vacation is not a source of non-
44 investor supplied capital available to finance Rate Base investment.” (Ameren Ex.
45 9.0, at 46:1033-1035). This is identical to his rebuttal testimony in Docket No. 12-

46 0293. He repeats these statements once again at page 46, lines 1039-1042 of his
47 rebuttal testimony in the present case.

48

49 **Q. Do you agree that because the accrued vacation is due and payable within one**
50 **year that means it is not a source of non-investor supplied capital available to**
51 **finance rate base investment?**

52 A. No. Regardless of how many times Mr. Stafford states this claim, it is not accurate. As
53 I stated in my rebuttal testimony in Docket No. 12-0293, the fact that the accrued
54 vacation is payable within one year has nothing to do with whether it is a source of
55 non-investor supplied capital. In fact, as the vacation accrual from the prior year is
56 paid off, it is replaced with accruals for vacation pay in the current year. In effect, the
57 accrued vacation pay becomes a continuing, permanent balance.

58

59 **Q. Mr. Stafford also presents an example that purports to show that vacation pay is**
60 **not a source of non-investor supplied capital because it has not been fully**
61 **recovered in rates in prior cases. Does the example presented by Mr. Stafford**
62 **have any probative value?**

63 A. No. Again, this testimony is identical to the rebuttal testimony that Mr. Stafford
64 presented in Docket No. 12-0293. The example presented by Mr. Stafford on pages 46-
65 48 of his rebuttal testimony (in the present case) arbitrarily uses a rate case filed in 2005
66 with a 2004 test year as a starting point. Mr. Stafford then states that “There was no
67 rate case test year filed for 2005, so the 2005 accruals were not recovered in rates.”
68 (Ameren Ex. 9.0, at 47:1051-1052) However, the 2005 rates reflected the vacation

69 pay that was accrued in whatever the test year used to establish the rates in effect in
70 2005 was. Mr. Stafford has not established that the vacation accrual in 2005 was
71 materially different from the vacation accrual in that test year. Just because a given
72 year was not a test year in a rate case does not mean that the expenses incurred in that
73 year were not recovered from ratepayers, as Mr. Stafford appears to assume.

74 Further, the accrual from the 2004 test year was recovered in rates and
75 continued to be recovered in rates for as long as the rates based on the 2004 test year
76 were in effect (for example, in 2007). Mr. Stafford has provided no evidence that the
77 accrual in the 2004 test year was not a reasonable representation of the prospective
78 vacation accruals going forward, as is the case for any other test year expense. Mr.
79 Stafford's example is irrelevant to whether a given expense was or was not recovered
80 in rates. The fact that a particular expense might not have been explicitly addressed in
81 an order by a regulatory commission does not mean that the expense was not included
82 in the revenue requirement and recovered from ratepayers.

83

84 **III. ACTUAL RATE BASE TO BE USED IN COLLAR CALCULATION**

85 **Q. Mr. Stafford commences his rebuttal testimony on your proposal to use the**
86 **average rate base for the purpose of determining the earned return on equity**
87 **(“ROE”) in the collar calculation by stating that your proposal “would require**
88 **changes to the Commission approved formula rate template,” and that “Such**
89 **changes can only be made in a Section 9-201 proceeding.” Ameren Ex. 9.0, at**
90 **30:665-669. Do you have a response?**

91 A. Yes. Mr. Stafford cross references the rebuttal testimony of Company witness Mill on
92 this point. First, let me say that like Mr. Stafford and Mr. Mill, I am not an attorney,
93 and as a general matter, I believe that arguments regarding the Commission’s authority
94 are best left to the attorneys. However, I do not see this to be a substantive issue. The
95 Company is also proposing certain changes to the Commission approved formula rate
96 template in the present case (see response to Staff Data Request TEE-13.01). On
97 pages 13-14, of his rebuttal testimony, Mr. Mill states that at some point in the next
98 several weeks, “AIC intends to make appropriate filings pursuant to Section 9-201
99 whereby it will propose certain adjustments to the Rate MAP-P tariff, underlying rate
100 template and formulae.” Ameren Ex. 17.0, at 13-14:286-301. Assuming for the sake
101 of argument that the use of the average rate base in the ROE collar computation
102 would require changes to the approved formula rate template, and that such changes
103 cannot be accommodated in the present docket, such changes can be incorporated into
104 the docket addressing the AIC filings pursuant to Section 9-201.

105

106 **Q. Do you agree with Mr. Stafford that use of an average rate base in the ROE collar**
107 **computation “tend[s] to artificially inflate the earned ROE relative to**
108 **authorized” Ameren Ex. 9.0, at 30:679-681?**

109 A. No. When rate base increases over the course of the year, the use of a year-end rate
110 base tends to artificially deflate the calculated earned ROE relative to the ROE actually
111 earned, as I explained in my direct testimony. Mr. Stafford goes on to present a
112 hypothetical example that purports to illustrate his claim. His hypothetical example
113 rests entirely on the premise that new long-term debt and common equity of \$100

114 million are issued on February 1 of a given year. He then states that under my method
115 the ROE collar computation would only include 50% of the debt and equity issuance.

116 Mr. Stafford's hypothetical example has nothing to do with the use of an
117 average vs. year end rate base. It is actually directed at the convention of using only the
118 year-beginning and year-end rate base values to determine the average. In theory, if
119 there is a large increase in rate base at the beginning of the year, that convention will
120 understate the average rate base, and if there is a large increase in rate base at the end of
121 the year, that convention will overstate the average rate base. A more precise
122 calculation of the average rate base could be derived by use of a thirteen month
123 average, at much increased effort. The Commission has previously adopted the
124 convention of using the beginning and end points to determine the average rate base,
125 implicitly recognizing that any improvement to the precision of the calculation of the
126 average rate base from use of a thirteen- month average did not warrant the increased
127 time and cost.

128 If anything, Mr. Stafford's hypothetical example illustrates why the Company's
129 use of a year-end rate base tends to deflate the calculated ROE relative to the actual
130 ROE. In his example, the use of the year-end rate base includes twelve months of the
131 debt and equity issuance even though the balances were outstanding for only eleven
132 months of the year. In the more typical case of rate base increasing gradually over
133 the course of the year, the distortion would be even greater. In effect, what Mr.
134 Stafford is claiming is that we should use a method that we know *always* understates
135 the actual return on equity (when rate base is growing), because it is hypothetically

136 possible that the alternative could theoretically in some circumstances potentially be
137 less than perfect.

138

139 **Q. Have you failed to properly take Senate Bill 9 into account, as Mr. Stafford**
140 **contends?**

141 A. No. Again, I believe that arguments regarding whose proposal comports with the law
142 are best left to attorneys. However, I made explicit reference to Senate Bill 9 as the
143 context for the recommendation in my direct testimony. In fact, Mr. Stafford does
144 not explain how use of an average rate base would be inconsistent with any
145 provisions of SB 9 with regard to the ROE collar computation.

146 SB 9 made no explicit change to the language regarding the calculation of the
147 ROE collar. Mr. Stafford is correct that the collar formula in SB 9 requires that return
148 on equity be calculated using “costs and capital structure approved by the
149 Commission as provided in subparagraph (2) of this subsection (c).” The cross
150 referenced subparagraph (2) requires the use of “the utility's actual year-end capital
151 structure for the applicable calendar year.” However, the capital structure enters into
152 the formula rate template only in the form of the capital structure ratios, and is
153 therefore not relevant to the rate base to be used in the ROE collar computation.

154 Mr. Stafford’s claim that my method “inappropriately imputes average capital
155 structure balances” is simply wrong, as I am not proposing any changes to the capital
156 structure used to develop the capital ratios used in calculating the rate of return. His
157 statement that my proposal has the effect of “understating the common equity amount
158 supporting reconciliation revenue requirement” is also wrong, as I have not proposed

159 any changes that affect the reconciliation revenue requirement either directly or
160 indirectly.

161

162 **Q. Has Mr. Stafford presented any specific citation to support his claim that your**
163 **proposal “is not authorized under PA 098-0015” (Ameren Ex. 9.0, at 32:729-**
164 **731)?**

165 A. No. Again, this is purely a legal conclusion. However, Mr. Stafford does not cite any
166 provision in PA 098-0015 that requires the use a year-end rate base in the earned ROE
167 calculation.

168

169 **Q. Do you have a response to Mr. Stafford’s assertion that your method of**
170 **calculating the ROE is not consistent with the express provisions of PA 098-**
171 **0015?**

172 A. Yes. It may be Mr. Stafford’s interpretation, as a non-lawyer, that my method is not
173 consistent with PA 098-0015, but he cites no “express provision” to that effect, because
174 no such express provision exists.

175

176 **IV. CALCULATION OF INTEREST ON RECONCILIATION ADJUSTMENTS**

177 **Q. As with your proposal to use the average rate base in the ROE collar computation,**
178 **Mr. Stafford and Mr. Mill claim that the proposal to accrue interest on the net-of-**
179 **tax reconciliation balance “would require changes to the Commission approved**
180 **formula rate template,” and that “Such changes can only be made in a Section 9-**
181 **201 proceeding.” Ameren Ex. 9.0, at 34:754-756. Do you have a response?**

182 A. Yes. Again, matters of this nature are best left to the attorneys. However, I would
183 again note that to the extent that the use of the net-of-tax reconciliation balance in the
184 calculation of interest requires any changes to the formula rate template that cannot
185 be accommodated in the present docket, such changes can be incorporated into the
186 docket addressing the AIC filings pursuant to Section 9-201.

187

188 **Q. Do you agree with Mr. Stafford's assertion that your proposal to reduce the**
189 **reconciliation balance by associated deferred taxes for the purpose of calculating**
190 **interest is not consistent with "the express provisions of PA 98-0015"?**

191 A. No, and I believe that Mr. Stafford's "testimony" on this matter demonstrates why
192 interpretations of statutes are best left to attorneys. According to Mr. Stafford, the
193 supposed inconsistency with the "express" provisions of PA 98-0015 exists because
194 "There is no provision in the EIMA to determine reconciliation interest amount net of
195 taxes." The absence of a provision requiring the determination of reconciliation
196 interest amount net of taxes is not an express provision prohibiting it. The so-called
197 "express provision" that Mr. Stafford does cite says nothing whatsoever about the
198 balance on which the interest is to be calculated. It is my understanding that
199 determination of the appropriate method to apply in these circumstances is within the
200 purview of the Commission, and the Commission can make a determination of the
201 accounting and ratemaking principles that are appropriate in the circumstances.

202

203 **Q. Do you claim, as Mr. Stafford asserts, that “deferred income taxes recorded by**
204 **the Company on any reconciliation under-recoveries will provide a source of**
205 **cash to the Company” (Ameren Ex. 9.0, at 34:779-781)?**

206 A. No, and I never said any such thing in my direct testimony. What I stated is that when
207 the reconciliation represents an under-recovery, the current income tax expense is lower
208 than it would have been in the absence of the under-recovery and that the reduction to
209 income taxes currently payable is a real cash benefit and should be recognized in the
210 calculation of interest on the reconciliation balances. In other words, it’s not that the
211 recording of deferred taxes by itself *provides* a cash benefit, but rather that the deferred
212 tax balance *represents* the cash benefit to the Company of the reduced income taxes
213 currently payable.

214 Mr. Stafford’s claim that there is no cash received from deferred income taxes
215 (Ameren Ex. 9.0, at 35:782) is the equivalent of me claiming that recording an under-
216 recovery does not require any cash outlay and that the Company is therefore not
217 entitled to any interest on an under-recovered reconciliation balance. The only reason
218 that the Company gets interest on under-recovered reconciliation balances is that the
219 balance represents revenues foregone (or the “under-collection indicated by such
220 reconciliation” to employ the terms used by PA 98-0015) by the Company because
221 the revenue requirement in effect for a given year was less than the actual revenue
222 requirement for that year. By the same token, the deferred taxes on that reconciliation
223 balance represent the reduction to taxes currently payable because the revenue
224 requirement in effect was less than the actual revenue requirement for that year. The
225 cash benefit represented by a deferred tax credit balance is every bit as real as the

226 cash requirement represented by an under-recovered reconciliation balance. The
227 reality of the cash benefit represented by the deferred taxes should be recognized in
228 the calculation of interest on the reconciliation balance.

229

230 **Q. Does the hypothetical example presented by Mr. Stafford on page 35 of his**
231 **rebuttal testimony illustrate his point that deferred taxes do not represent cash to**
232 **the utility?**

233 A. No. First, he attempts to confuse the issue by using the example of a mortgage loan
234 with interest. The principal on the mortgage loan has no income tax consequences, and
235 the collection of principal has no effect on income taxes. With regard to interest, if the
236 mortgage company defers collection of the interest and records deferred income taxes
237 on the interest receivable, the deferred taxes do, in fact represent an actual cash benefit.
238 That is, the income taxes currently payable are lower than if the interest had been
239 received currently rather than being deferred. As Mr. Stafford notes, the income taxes
240 would be paid in future periods rather than currently, and there can be no dispute that
241 this provides a real cash flow benefit.

242

243 **Q. Mr. Stafford asserts that your claim that deferred income taxes provides a source**
244 **of cash to the Company cannot be reconciled with the operation of the**
245 **reconciliation balance with interest calculation and that this point is confirmed**
246 **by your response to AIC-AG 1.09. Is there any merit to his assertion?**

247 A. No. Again, I never claimed that recording deferred taxes provides the Company with a
248 source of cash. Rather, what I stated is that the deferred taxes represent a cash benefit

249 to the Company. Mr. Stafford accurately re-stated my reply to AIC-AG 1.09: “Mr.
250 Effron agrees that any 2013 over or under recovery will not be credited to or collected
251 in customer rates until 2015.” Similarly, the related cash income tax effects
252 associated with any 2013 over or under recovery will not be realized until 2015.

253

254 **Q. Mr. Stafford expresses an additional concern that it is “not clear if the AG's**
255 **proposal is to adjust the entire reconciliation balance to be recovered from or**
256 **charged to customers or just adjust the calculated interest amount” Can you**
257 **allay this concern?**

258 A. Yes. I am not clear as to what isn't clear to Mr. Stafford. My testimony is that the
259 interest should be calculated on the reconciliation adjustment net of applicable deferred
260 income taxes. I made no mention of reducing the reconciliation balance to be
261 recovered or refunded. My adjustment unambiguously pertains only to adjustment of
262 the calculated interest amount.

263

264 **Q. Do you understand Mr. Stafford's testimony that netting deferred taxes does not**
265 **benefit the utility when there is a credit balance?**

266 A. No. The netting of deferred income taxes against the reconciliation balance will reduce
267 the amount of interest paid to customers when there is a credit balance. Reduction of
268 interest expense clearly is beneficial to the utility and its shareholders.

269

270 **Q. Can you concisely summarize why it is appropriate to calculate interest on the**
271 **reconciliation balance net of deferred income taxes?**

272 A. When the Company ultimately recovers (or refunds) the reconciliation balance, the net
273 cash it receives (or refunds) will be that reconciliation balance net of income taxes.
274 *There is no dispute on this point.* This net cash is what the Company has foregone (or
275 what it is holding pending the refund), and it is this net cash requirement (or source) on
276 which interest should be calculated. It's that simple.

277

278 **Q. Does this conclude your rebuttal testimony?**

279 A. Yes.