STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

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

CORRECTED REBUTTAL TESTIMONY OF MICHAEL L. BROSCH ON BEHALF OF THE PEOPLE OF THE STATE OF ILLINOIS

AG Exhibit 3.0C

AUGUST 26, 2013
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III. RECONCILIATION INTEREST CHARGES

Q. In your Direct Testimony, you recommended that interest at the Company's Weighted Average Cost of Capital from Sch. FR D-1 be applied to the actual invested capital that AIC has invested in the reconciliation balance, which is necessarily a net of income tax balance.[7] How has the Company responded to this proposal?

A. AIC does not agree that Accumulated Deferred Income Taxes ("ADIT") associated with the reconciliation regulatory asset should be considered in the application of interest. The Company's rebuttal consists of several arguments that include:

- An assertion by Mr. Stafford that considering ADIT when applying interest to the reconciliation balance represents a change to the "formula rate template"[8], which according to Mr. Mill's testimony cannot be made without a filing under Section 9-201 of the Act.

- Mr. Stafford's, "…reading of the Act [which] expressly states that interest is to be applied to the reconciliation balance, and not the reconciliation balance net of deferred income taxes."[9]

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7 AG Exhibit 1.0, page 9 line 198 to page 17 line 373.
8 Ameren Exhibit 9.0, page 8, lines 167-169, page 9, lines 217-219 and page 33, lines 753-756.
9 Id. page 34, lines 757-778.

- Mr. Stafford’s claim that, “There is no cash received from deferred income taxes, as the deferred income taxes correspond to accounting accruals for revenues to be received. If the Company had billed and collected the revenues that corresponded to the recording of deferred income taxes, then there would be actual cash in hand. Under that scenario, the deferral of income tax payments would generate cash benefit. However, in this case, there is no source of cash to support AG's proposed netting of income taxes against the reconciliation balance.”[10]

- Mr. Stafford’s argument that, “…the question is not whether the Company can defer paying income taxes, but rather when and how the Company will get ***actual*** cash in hand from the reconciliation balances.”[11]

- Mr. Stafford’s concern that “It is not clear if the AG's proposal is to adjust the entire reconciliation balance to be recovered from or charged to customers or just adjust the calculated interest amount.”[12] He states that, “…any proposal to net the total reconciliation balance for deferred income taxes would not provide sufficient funds to the Company to cover the revenue requirement shortfall and pay income taxes on amounts collected.”[13]

- Mr. Mill’s opinion that applying interest to the net of tax reconciliation balances is an inappropriate matter in this Docket and, “…to implement rate template changes for purposes of the final revenue requirements in this update proceeding, tariff/template revisions must be accepted in an Order by December 1.”[14]

For these reasons, the Company recommends no consideration be given to the ADIT balances associated with the reconciliation balance when calculating and applying interest to such balance.

[10] Id. page 35, lines 782-787.
[11] Id. page 36, lines 807-814.
[12] Id. page 36, lines 823-838.
[13] Id. page 38, lines 851-853.
[14] Ameren Exhibit 17.0, page 14, lines 286-301.

Q. Will you be addressing the legal issues that are alleged to be raised by changes in the method of calculating reconciliation interest to recognized related ADIT amounts?

A. No. I expect any legal issues to be addressed by counsel for the Company and other parties. My testimony will instead focus upon the factual and accounting issues raised by Mr. Stafford on this matter.

Q. Mr. Stafford quotes from Section 16-108.5(d)(1) and offers his non-legal opinion that the Act "expressly states that interest is to be applied to the reconciliation balance, and not the reconciliation balance net of deferred income taxes."[15] Does the language quoted by Mr. Stafford include any reference to a "reconciliation balance" as you read it?

A. No. Mr. Stafford adds *emphasis* to the statutory language that identifies, "[a]ny over-collection or under-collection indicated by such reconciliation" and what should be done with such amounts, but the quoted language is silent with regard to any "reconciliation balance" and is also silent regarding "deferred income taxes". From this, I would assume that the Commission is responsible for determining the specific procedures to be employed in calculating over and under-collections and related interest amounts, within the framework of the Act.

Q. Mr. Stafford claims that deferred taxes do not provide a source of cash, stating, "If the Company had billed and collected the revenues that corresponded to the recording of deferred income taxes, then there would be actual cash in hand.

[15] Ameren Exhibit 9.0, page 34, lines 757-778,

Under that scenario, the deferral of income tax payments would generate cash benefit. However, in this case, there is no source of cash to support AG's proposed netting of income taxes against the reconciliation balance."[16] Is this true?

A. No. As I explained in my Direct Testimony, "changes in ADIT balances provide incremental cash flow through the change in timing of the payment of cash income taxes." This issue can be considered from two different perspectives that are aligned with the pending filings under consideration for AIC and for ComEd, respectively:

- When the utility has over-recovered its overall cost of service according to reconciliation calculations and has recorded a regulatory liability for the amounts to later be returned to customers, or
- When the utility has under-recovered its overall cost of service according to reconciliation calculations and has recorded a regulatory asset for the amounts to later be collected from customers.

In both instances, which will be discussed in greater detail in this testimony, the utility has recorded either a regulatory asset/liability as well as an offsetting ADIT amount, to recognize the fact that regulatory asset/liability entries do not result in immediately taxable revenues until they reverse and revenues are actually charged/credited to customers in future periods.

[16] Ameren Exhibit 9.0, page 35, lines 783-785.

Q. How is cash "in hand" impacted when a utility has over-collected its revenue requirement and has accrued a regulatory liability to recognize its obligation to return such excess revenues after reconciliation calculations are approved?

A. Over recoveries represent excessive cash revenues, relative to the utility's overall cost of service. To recognize the refund obligation and to not overstate current year revenues and earnings, the utility records a regulatory liability for amounts owed to ratepayers that corresponds with an entry reducing per book revenues in that same amount. However, this book entry reducing revenues does not create any corresponding reduction in taxable revenues or income. In this situation, the utility has more cash revenue in hand by virtue of its over-collection of its overall costs, but must use some of this extra cash to pay additional income taxes that cannot be eliminated on its tax return. Thus, the net cash available to the utility in years when over-collection has occurred is the gross amount of such excess revenues, reduced by the income taxes payable on that excessive revenue. The excess revenues, removed from the utility's books by the recording of the regulatory liability but still reported on the utility's tax return, represent a book/tax timing difference for which ADIT must be recorded under Generally Accepted Accounting Principles ("GAAP"), as more fully discussed in my Direct Testimony.

Q. What happens to the ADIT balance when over-recovery revenues are returned in cash to ratepayers through the reconciliation process?

A. During the period when over-recovered revenues are being refunded to customers, the regulatory liability balance is ratably reversed and the offsetting ADIT debit balance is also ratably reversed as the income subject to tax is reduced. The reversal of the regulatory liability "puts back" into the income statement the reduced cash revenues being credited during the refund period, to recognize that the full amount owed to customers was previously subtracted from book revenues. The reversal of the offsetting debit ADIT balance accounts for the fact that income taxes on the over-collected cash revenues were already paid in the prior period, while cash income taxes during the refund period will be reduced because of the lower billed revenues caused by the refunds.

Q. Does this entire process work in reverse for the utility that has under-recovered its overall cost of service?

A. Yes. The utility that has under-recovered has reduced cash in hand, because it has not fully recovered its cost of service. As a result, the utility has reduced taxable revenues that create immediate and offsetting cash income tax savings relative to the taxes that will later be due when the reconciliation revenues are collected from customers. This occurs because the regulatory asset that is recorded to recognize additional <u>book</u> revenues that can be collected through the reconciliation process is not includable in taxable income. During the reconciliation recovery period, the accrued regulatory asset is ratably reversed to recognize that the billed revenues then being recovered were actually recorded on the books in a prior period. The offsetting ADIT balance is also ratably reversed during the recovery period to account for the higher taxable income caused by delayed rate recovery of the reconciliation revenue amounts that were not previously taxed.

Q. Is Mr. Stafford correct in stating that "[t]here is no cash received from deferred taxes"[17]?

A. Only in the sense that all cash is received from the utility's customers and not from any particular expense until it is recovered from customers. The more valid point to understand is that the reconciliation process changes both the timing of cash receipts of revenues, and the timing of cash payments for income taxes. Whenever cash reconciliation revenue is recovered from customers before or after the year in which the related overall cost of service was incurred, a timing difference is accrued within the revenue accounts and regulatory asset/liability balances, so that the utility's revenues generally "match" recoverable costs on the utility's books. Then, when the reconciliation occurs and the cash over or under-recoveries are flowed to or from customers, these recorded accruals on the books are reversed.

On the utility's income tax return, however, these recorded revenue reconciliation accruals are <u>not</u> recognized. Instead, the incremental cash revenue arising from any over or under-recovery of the overall cost of service is currently taxable. This is why the utility's actual amount of invested capital in the regulatory asset or liability is properly quantified on a net of tax basis.

Q. According to Mr. Stafford, "If the Company had billed and collected the revenues that corresponded to the recording of deferred income taxes, then

[17] Ameren Exhibit 9.0, page 35, lines 782.

there would be actual cash in hand. Under that scenario, the deferral of income tax payments would generate cash benefit."[18] Is this true?

A. I believe that Mr. Stafford is making my point. Ameren has calculated an over-recovery of its 2012 revenue requirement. This means that the Company has billed and collected cash revenues that correspond to its recorded regulatory liability for revenues owed to ratepayers as well as recorded the negative deferred income taxes associated with that regulatory liability on its books. In this instance, the recorded deferred income taxes are negative (or debit) balance amounts representing taxable revenues that were billed to customers and that caused the Company's taxable income and currently payable tax expenses to be temporarily larger, but that are subject to reversal in future periods. As these excess cash revenues are returned to customers via the reconciliation process in future years, both the regulatory liability account and the related ADIT accounts will be reversed. In the meantime, the incremental cash in hand arising from AIC's over-collection has been reduced by its temporarily higher current income tax expenses. Under these circumstances, AIC should not be made to pay interest on the full reconciliation amount, but rather should pay interest to ratepayers only upon the cash amount collected, reduced by the corresponding cash required for earlier payment of income taxes.

Q. Does Mr. Stafford's individual home mortgage example have any applicability to these circumstances?

[18] Ameren Exhibit 9.0, page 35, lines 783-786.

A. No. His example has nothing to do with book/tax timing differences arising from revenue recognition for utility revenue requirement reconciliations. In his example, book accounting for any interest income prior to tax recognition of such interest would result in very real cash flow benefits to the hypothetical mortgage company, to the extent cash payment of income taxes can be delayed. This would be true without regard to when the borrower actually makes his payments to the mortgage company.

Q. Mr. Stafford has included your response to AIC-AG 1.05 within Ameren Exhibit 9.7. Does this document indicate that accumulated deferred income taxes associated with reconciliation balances do not represent cash in hand?

A My response within Mr. Stafford's exhibit correctly indicates that income taxes will be payable whenever reconciliation revenues can be billed to and collected from customers, causing such revenues to be included in the utility's taxable income. This fact is entirely consistent with my testimony and supports my conclusion that the "cash in hand" for the utility, to which interest should be applied in Schedule FR A-4, is the cumulative reconciliation revenue amount at any point in time, offset by the related income taxes that were either paid on prior revenue over-recoveries, or deferred due to prior under-recovery of revenues.

IV. CASH WORKING CAPITAL ISSUES

Q. How did Mr. Heintz respond to your proposal to disaggregate income tax expenses between the cash-basis currently payable amounts and the non-cash deferred income tax expense amounts?

A. On this point, unlike the treatment of pass-through taxes, Mr. Heintz would prefer to support recent Commission decisions regarding the lead lag study treatment of AIC's income taxes and the use of statutory tax due dates, while he urges rejection of my proposal to more precisely account for the timing of income tax-related cash flows. He states:

> "The Company has a long-standing practice of employing statutory tax rates and payment dates when calculating its income tax expense for revenue requirement purposes. As such, the Company does not distinguish between current and deferred tax expense. Nor does the Company include permanent tax differences in its income tax expense calculation."[24]

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[23] Ameren Exhibit 15.0, pages 7-10.

[24] Ameren Exhibit 15.0, page 16 , lines 310-313

Mr. Heintz did respond to my discussion of the Commission's past inconsistent treatment of income taxes in ComEd lead lag studies[25], even though he dwells upon the more dated inconsistencies that once existed in past Commission orders involving pass through taxes.

Q. Should the Commission allow AIC to pick and choose among the past lead lag study procedures and lag day values, so as to select for updating only the elements that increase the amount of cash working capital included in rate base?

A. No. If AIC desires to update the lead/lag analysis every three years for purposes of the formula rate, as indicated by Mr. Stafford, there should be no piecemeal updating of lead day values for only the pass-through tax items that Mr. Heintz has selected for modification, based upon the Company's preference for the treatment provided pass through taxes in an earlier Docket No. 11-0282 AIC rate order.[26]

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[25] AG Exhibit 1.0, page 26, line 586 to page 28, line 637.

[26] See Ameren Exhibit 1.0, page 23, lines 473-497 where this proposed selective modification of formula rate approved lead days is proposed by Mr. Stafford.