

**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

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

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

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**AG Exhibit 4.0**

**AUGUST 26, 2013**

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

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