

Exhibit No.:
Issues: Tax Issues
Witness: James I. Warren
Sponsoring Party: Union Electric
Type of Exhibit: Cross-Surrebuttal Testimony
Case No.: EC-2002-1
Date Testimony Prepared: June 24, 2002

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. EC-2002-1

CROSS-SURREBUTTAL TESTIMONY

OF

JAMES I. WARREN

ON

BEHALF OF

**UNION ELECTRIC COMPANY
d/b/a AmerenUE**

**St. Louis, Missouri
June, 2002**

1 **CROSS SURREBUTTAL TESTIMONY**

2 **OF**

3 **JAMES I. WARREN**

4

5 **CASE NO. EC-2002-1**

6

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

8 A. My name is James I. Warren. My business address is 2 Hilton Court,
9 Parsippany, New Jersey 07054.

10 A. **Are you the same James I. Warren who previously filed rebuttal**
11 **testimony in this proceeding?**

12 A. Yes I am.

13 **Q. What is the purpose of your testimony?**

14 A. The purpose of my testimony is to respond to certain aspects of the
15 Rebuttal testimony of David J. Effron filed on behalf of the Missouri Office of Public
16 Counsel.

17 **Q. What aspects of Mr. Effron's testimony will you address?**

18 A. I shall rebut his proposal to exclude certain deferred tax debits from the
19 computation of regulated rate base. Specifically, I shall explain why it would be
20 improper to single out the future tax benefits associated with the three items identified by
21 Mr. Effron - deferred compensation, the sale of NUEXCO collateral and the Company's
22 reserve and clearing accounts – for such adverse treatment. Effron, Rebuttal, page 4, line
23 2 through page 6, line 18.

1 **Q. What are the amounts of the deferred tax debits he proposes to**
2 **exclude?**

3 A. According to Schedule DJE-1, he proposes to exclude \$15,311,000
4 relating to deferred compensation, \$1,768,000 relating to the NUEXCO Sale of Collateral
5 and \$8,242,000 relating to various reserve and clearing accounts, all on a Missouri
6 jurisdictional basis.

7 **Q. What is Mr. Effron's rationale for the proposed exclusion?**

8 A. With respect to deferred compensation and the reserve and clearing
9 accounts, his rationale appears to be simply that the underlying liabilities are not
10 components of the rate base computation. Effron, Rebuttal, page 5, lines 12 through 15
11 and page 6, lines 9 through 11. With respect to the NUEXCO item, he asserts merely that
12 "...it does not appear that this item should be included in the utility cost of service."
13 Effron, Rebuttal, page 5, line, 21 through page 6, line 1.

14 **Q. In what order will you address these three items?**

15 A. I will address deferred compensation and reserve and clearing account-
16 related deferred tax debits first and will thereafter discuss the NUEXCO-related deferred
17 tax debit.

18 **Q. What is your understanding regarding the regulatory treatment of the**
19 **deferred compensation?**

20 A. According to the Cross-Surrebuttal of Mr. Gary S. Weiss, this deferred
21 compensation is included in cost of service. The liability for deferred compensation is
22 not included in the computation of rate base.

1 **Q. Will you describe the tax consequences of this deferred**
2 **compensation?**

3 A. Mr. Effron's description is, more or less, correct. Effron, Rebuttal, page 5,
4 lines 7 through 12. Notwithstanding that deferred compensation may be appropriately
5 recognized as a regulatory expense in the year to which it economically relates, the tax
6 law imposes certain restrictions on the deductibility of many types of deferred
7 compensation such that they will produce tax benefits (by means of becoming deductible)
8 only at some later point in time. The precise details of the operation of the tax law in this
9 regard are really not important for our purposes. Suffice it to say that there is no cash tax
10 benefit available to the Company with respect to this expense in the year of its
11 recognition for regulatory purposes.

12 **Q. Does the Company provide to its customers a tax benefit**
13 **commensurate with the level of compensation expense, including deferred**
14 **compensation expense, recognized for regulatory purposes?**

15 A. Yes it does.

16 **Q. Will you explain what you mean by this?**

17 A. Yes. The Company's tax expense is reduced by a tax benefit computed by
18 reference to the amount of this expense. Thus, if deferred compensation expense is \$100
19 in a given period, federal tax expense is reduced by \$35. The reflection of the benefit in
20 this way is conventionally described as normalization. Customers receive a tax benefit
21 commensurate with the level of compensation expense they fund irrespective of when the
22 Company is actually able to realize that tax benefit.

23 **Q. What are the cash consequences of this procedure?**

1 A. The Company provides a cash tax benefit to its customers through the
2 reduction in its tax expense without having received an offsetting cash inflow from the
3 Internal Revenue Service. In short, the Company has “fronted” the cash to its customers
4 before it receives it. It is “out” that cash.

5 **Q. Is it appropriate to reflect this net cash outflow as a deferred tax debit**
6 **to be included in rate base?**

7 A. Yes it is. The Company’s use of cash in this way involves an expenditure
8 of its capital. This expenditure is appropriately reflected by the Company as an element
9 of regulated rate base. Only in this way can the Company be afforded an opportunity to
10 recover the cost of “fronting” the tax benefit to its customers.

11 **Q. What is the relevance to the above discussion of the rate base**
12 **treatment afforded the accrued, but unpaid, deferred compensation?**

13 A. The Company did not systematically synchronize each and every one of
14 the components of its deferred tax debits and credits with the rate base status of the
15 underlying items giving rise to them. Instead, these deferred tax balances are, in general,
16 handled separately and distinctly for rate base purposes. This has been accepted practice
17 and the Company has continued it in this proceeding.

18 **Q. Is the above analysis also applicable to Mr. Effron’s assertion**
19 **regarding the treatment of reserve and clearing account deferred tax debits?**

20 A. Mr. Weiss’ Cross-Surrebuttal Testimony indicates that the various
21 reserves and clearing accounts received regulatory treatment which was identical to that
22 afforded deferred compensation. The basic nature of the temporary differences generated
23 by these items is very similar to that created by deferred compensation. Thus, my

1 analysis with respect to these items is precisely the same as the one applicable to deferred
2 compensation.

3 **Q. Is Mr. Effron's conclusion regarding the NUEXCO transactions**
4 **correct?**

5 **A.** No it is not. Due to the default on a uranium supply contract by a
6 particular vendor, the Company was compelled to take a number of steps to protect itself
7 and its customers. Among these steps were the acquisition of uranium from other sources
8 as well as the sale of collateral from the defaulting vendor. As a result of these various
9 protective measures, the Company was obliged by the applicable tax law to report some
10 amount of taxable income even though no book income resulted. This tax posture
11 required a cash outlay. However, as a consequence of this tax payment, the Company's
12 nuclear fuel acquired a higher tax basis and this will provide benefits in the future
13 through additional tax depreciation. This deferred tax debit represents a classic "book/tax
14 timing difference" related to a fully regulated asset, nuclear fuel. It is appropriately
15 reflected as an element of rate base.

16 **Q. Does this conclude your testimony?**

17 **A.** Yes it does.

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

The Staff of the Missouri Public Service Commission,)

Complainant,)

vs.)

Case No. EC-2002-1

Union Electric Company, d/b/a)

AmerenUE,)

Respondent.)

AFFIDAVIT OF JAMES I. WARREN

STATE OF NEW JERSEY)

) ss

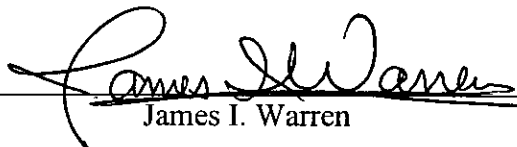
COUNTY OF MORRIS)

James I. Warren, being first duly sworn on his oath, states:

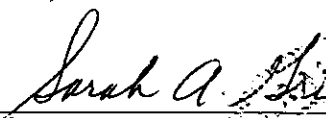
1. My name is James I. Warren. I work in Parsippany, New Jersey and I am a tax partner in the accounting firm of Deloitte & Touche LLP.

2. Attached hereto and made a part hereof for all purposes is my Cross Surrebuttal Testimony on behalf of Union Electric Company d/b/a AmerenUE consisting of 5 pages, which has been prepared in written form for introduction into evidence in the above-referenced docket.

3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct.


James I. Warren

Subscribed and sworn to before me this 18th day of June, 2002.


Notary Public

My commission expires:

SARAH A. GRIECO
Notary Public of New Jersey
My Commission Expires March 05, 2007

