

Exhibit No.:
Issue: Income Taxes
Witness: Melissa K. Hardesty
Type of Exhibit: Surrebuttal Testimony
Sponsoring Party: Great Plains Energy
Incorporated; Kansas City Power &
Light Company; and KCP&L Greater
Missouri Operations Company
Case No.: EM-2018-0012
Date Testimony Prepared: February 21, 2018

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: EM-2018-0012

FILED²

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Missouri Public
Service Commission

SURREBUTTAL TESTIMONY

OF

MELISSA K. HARDESTY

ON BEHALF OF

GREAT PLAINS ENERGY INCORPORATED
KANSAS CITY POWER & LIGHT COMPANY
KCP&L GREATER MISSOURI OPERATIONS COMPANY

February 2018

Applicant Exhibit No. 8
Date 3/12/18 Reporter JB
File No. EM-2018-0012

SURREBUTTAL TESTIMONY

OF

MELISSA K. HARDESTY

Case No. EM-2018-0012

1 **Q: Please state your name and business address.**

2 A: My name is Melissa K. Hardesty. My business address is 1200 Main Street, Kansas City,
3 Missouri, 64105.

4 **Q: By whom and in what capacity are you employed?**

5 A: I am employed by Kansas City Power & Light Company as Senior Director of Taxes.

6 **Q: On whose behalf are you testifying?**

7 A: I am testifying on behalf of Great Plains Energy Incorporated (“GPE”) and its wholly-
8 owned subsidiaries, Kansas City Power & Light Company (“KCP&L”) and KCP&L
9 Greater Missouri Operations Company (“GMO”). Together with Westar Energy, Inc.
10 and Kansas Gas and Electric Company (collectively, “Westar”), GPE, KCP&L and GMO
11 (all parties collectively referred to as “Applicants”) seek approval of the Missouri Public
12 Service Commission for the merger of GPE and Westar (“Merger”). In addition, I am
13 providing information regarding Westar Energy, Inc.’s method of computing deferred tax
14 assets.

15 **Q: What are your responsibilities?**

16 A: My responsibilities include management of taxes for GPE, KCP&L, and GMO, including
17 income, property, sales and use, and transactional taxes.

1 **Q: Please describe your education, experience, and employment history.**

2 A: I graduated from the University of Kansas in 1996 with a Bachelor of Science in
3 Accounting. After completion of my degree, I worked at the public accounting firm
4 Marks, Stallings & Campbell, P.A. as a staff accountant from 1996 to 1999. In 1999, I
5 went to work for Sprint Corporation as a Tax Specialist in the company's federal income
6 tax department. I held various positions at Sprint from 1999 to 2006. When I left Sprint
7 to join KCP&L in December 2006, I was Manager of Income Taxes for Sprint's Wireless
8 Division. I joined KCP&L as the Director of Taxes and was subsequently promoted to
9 my current position of Senior Director of Taxes for KCP&L in May of 2009.

10 **Q: Have you previously testified in a proceeding at the Missouri Public Service**
11 **Commission ("MPSC"), Kansas Corporation Commission ("KCC") or before any**
12 **other utility regulatory agency?**

13 A: Yes. I have previously testified before both the MPSC and the KCC.

14 **Q: What is the purpose of your Surrebuttal Testimony?**

15 A: The purpose of my testimony is to respond to the Direct Testimony of Michael L. Brosch
16 filed on behalf of Missouri Energy Consumers Group ("MECG") as it pertains to the
17 methods used by GPE and Westar to allocate income taxes to subsidiaries for regulatory
18 purposes.

19 **Q: Please summarize your conclusions from your Surrebuttal Testimony.**

20 A: First, Mr. Brosch's recommendation to change KCP&L's tax allocation method is
21 inconsistent with the Commission's order in KCP&L's 2014 rate case (Case No. ER-
22 2014-0370), would immediately disadvantage GMO customers and should be rejected.

1 In addition, Mr. Brosch’s recommendation to add three conditions to GPE’s Tax
2 Allocation Agreement are not appropriate and should be rejected just as they have also
3 been addressed in other recent proceedings before the Commission.

4 **Q: Please describe how GPE and Westar currently allocate income taxes to**
5 **subsidiaries.**

6 A: GPE and Westar each file consolidated income tax returns which include all subsidiaries
7 of each company. The subsidiaries will have varying amounts of taxable income or loss
8 in any given tax year. The taxable income of one subsidiary may be offset by taxable
9 losses of another subsidiary in arriving at the consolidated tax liability. In order to ensure
10 that each subsidiary is allocated a fair amount of tax liability and remits enough cash up
11 to the parent holding company to pay any tax liabilities, each company has adopted a Tax
12 Allocation Agreement addressing how the tax liability should be computed and paid for
13 by each subsidiary. In years where there is a consolidated net taxable loss, also referred
14 to as a net operating loss (“NOL”), each company uses this Tax Allocation Agreement to
15 determine how to allocate the remaining NOL to each subsidiary. GPE uses a method
16 known as “benefits for losses” to allocate NOLs. Westar uses the “separate return”
17 method. Both methods are acceptable under GAAP.

18 **Q: Did Mr. Brosch express concerns regarding these methods?**

19 A: Yes. Mr. Brosch testifies that the method used by GPE increases the amount of deferred
20 tax assets related to NOLs in rate base and is disadvantageous to Missouri and Kansas
21 customers. He asserts that KCP&L and GMO should be required to employ the separate
22 return allocation method currently used by Westar after the Merger is completed.¹

¹ Rebuttal Testimony of Michael L. Brosch, at 24.

1 **Q: Is Mr. Brosch correct that the “benefits for losses” method of allocating taxes to**
2 **subsidiaries disadvantages customers?**

3 A: No. While the use of the “benefits for losses” method can increase or decrease the
4 amount of deferred tax assets related to NOLs included in rate base at any specific
5 measurement date, the same is true for the “separate return method.” Over longer periods
6 of time both methods yield very similar results.

7 **Q: Please explain the difference between the “benefits for losses” and the “separate**
8 **return” methods for allocating income taxes to subsidiaries.**

9 A: The “benefits for losses” method used by GPE allocates the loss to each subsidiary using
10 consolidated return income tax regulations. Under this method, a subsidiary is allocated
11 benefits when the consolidated group uses the subsidiary tax assets, and any remaining
12 NOLs are allocated on a pro-rata basis to all loss subsidiaries. Under the “separate
13 return” method used by Westar, subsidiaries with taxable income are not required to pay
14 the separate tax liability to the parent until such time as payment is required to be made
15 by the consolidated group to the Internal Revenue Service (“IRS”). Therefore, when the
16 consolidated group is in an NOL position, individual subsidiaries retain the amount of
17 NOL generated on a separate company basis. Again, either method is acceptable under
18 GAAP.

19 **Q: Why does GAAP allow more than one method?**

20 A: There are positive and negative aspects of each method. Further, the facts and
21 circumstances of each individual company may influence which method is used.
22 However, GAAP does require that the method used be systematic, rational, and applied
23 consistently year over year.

1 **Q: Why does Mr. Brosch believe the “benefits for loss” method is detrimental to**
2 **Missouri customers?**

3 A: Mr. Brosch testifies that the current estimate of deferred tax assets for NOLs in rate base
4 and revenue requirement for KCP&L is higher under the “benefits for losses” method
5 than it would be under the “separate return” method.

6 **Q: Does the “benefits for losses” method always create a higher deferred tax asset in**
7 **rate base related to NOLs?**

8 A: No. In fact, even Mr. Brosch acknowledges that GMO’s current estimate of deferred tax
9 assets in rate base for NOLs is less using this method.² Mr. Brosch also acknowledges
10 that Westar’s deferred tax assets for NOLs using the “separate return” method are
11 currently higher than they would be using the “benefits for losses” method.³

12 **Q: Would it be appropriate to adopt Mr. Brosch’s proposal to change the methods used**
13 **to compute deferred tax assets for NOLs for KCP&L and GMO in rate base?**

14 A: No. GPE has consistently applied its current methodology since 2001, and perhaps
15 earlier by KCP&L. GPE continued to use this method following its acquisition of Aquila
16 in 2008. Likewise, Westar has consistently applied its current methodology since 2008.
17 As I noted earlier, the results of the “benefits for losses” method can be higher or lower,
18 as compared to the “separate return” method at any specific measurement date. I
19 illustrated that this situation exists today with KCP&L being higher under the “benefits
20 for losses” method and GMO being lower under that method. Over time, however, both
21 methods yield very similar results, and the amount of deferred tax assets will ultimately
22 be the same under both methods once all of the NOLs are used by each company.

² Id.

³ Ibid, at 23.

1 Further, remaining consistent and applying the same method going forward ensures that
2 results are not manipulated in favor of either KCP&L/GMO or the customer.

3 **Q: What is the basis of the computation that GPE uses to compute the NOL allocated**
4 **to its subsidiaries?**

5 A: The “benefits for losses” method GPE has consistently used reflects the allocation
6 methodology described by the IRS’s Internal Revenue Code Section 1502 regulations
7 used for consolidated income tax returns. This is the method that the IRS would require a
8 taxpayer to use to allocate NOLs to subsidiaries. Therefore, GPE continues to use a
9 valid, rational and consistent method year over year to compute the amount of deferred
10 tax assets included in rate base for KCP&L and GMO.

11 **Q: Has the Commission addressed the computation of deferred tax assets related to**
12 **NOLs in other proceedings?**

13 A: Yes. MECG raised this issue recently, and the Commission studied the issue at that time.
14 The Commission ruled in favor of KCP&L by rejecting MECG’s arguments on this issue
15 in KCP&L’s 2014 rate case (Case No. ER-2014-0370). In the Report and Order in this
16 case, the Commission found that:

17 MECG attempts to distinguish the prior case by alleging that the Tax
18 Allocation Agreement to which KCPL is obligated does not benefit KCPL
19 or its ratepayers. Even if no benefits have accrued to KCPL in the recent
20 past, that does not mean that KCPL and its ratepayers will not benefit in
21 the future. There is no evidence in the record showing that KCPL has
22 attempted to manipulate its tax obligations to take advantage of ratepayers,
23 and the Commission will not question management decisions made by the
24 company with regard to its tax filings under such a tax allocation
25 agreement. The Commission concludes the proposed adjustment to the
26 computation of ADIT assets related to net operating losses should be
27 rejected.⁴

⁴ Case No. ER-2014-0370 Report and Order, at 86.

1 **Q: Is the Merger expected to create any tax-related benefits for customers?**

2 A: Yes. KCP&L, GMO and Westar expect to continue to compute the deferred tax assets
3 for NOLs using the methodology that they have historically used. After the Merger
4 closes, the taxable income of Westar is expected to allow the new holding company to
5 use its NOLs faster and to reduce the deferred tax assets for NOLs of KCP&L and GMO
6 in rate base more quickly than GPE could on a standalone basis absent the Merger. Since
7 Westar currently computes its NOLs on a separate return basis, and Applicants intend for
8 Westar to continue to do so, there is not expected to be any difference for Westar's
9 customers.

10 **Q: Would requiring GPE to use the "separate return" method as proposed by Mr.**
11 **Brosch disadvantage KCP&L's or GMO's customers in Missouri in the near term?**

12 A: Yes. The deferred tax assets in rate base for NOLs for GMO in its current rate case (Case
13 No. ER-2018-0146) would be higher at this time and rates would increase for its Missouri
14 customers relative to continuing to use the "benefits for loss" method used by GPE.

15 **Q: Has Mr. Brosch made other income Tax Allocation Agreement-related**
16 **recommendations?**

17 A: Yes. Mr. Brosch has also recommended that the Company include the following three
18 new commitments pertaining to the tax allocation agreement:⁵

19 1) A sentence should be added to Merger Commitments and Conditions 28 that states
20 "No preferential treatment of Affiliated entities shall occur as a result of Tax
21 Allocation Agreement terms or procedures."

22 2) A sentence should be added to Merger Commitments and Conditions 31(a) that
23 states "The new holding company's adopted Tax Allocation Agreement shall be

1 included among the corporate cost allocations and affiliate transactions protocols
2 and included in the audit.”

3 3) Add to Merger Commitments and Conditions 33 that “the scope of the meetings
4 and filed updates to the Cost Allocation Manual include documentation and
5 quantification of allocations and transactions arising from the affiliate Tax
6 Allocation Agreements effected by the new holding company.”

7 **Q: Are these Tax Allocation Agreement commitments necessary or appropriate?**

8 A: No. It appears that Mr. Brosch is asking the Commission to use the affiliate transaction
9 rules to alter and monitor how tax obligations are allocated under the Tax Allocation
10 Agreement. However, the affiliate transaction rules do not apply to the Tax Allocation
11 Agreement. As a result, the commitments proposed by Mr. Brosch are not applicable and
12 should be rejected by the Commission.

13 **Q: Has the Commission addressed the proposed application of its affiliate transaction
14 rules to the Tax Allocation Agreement in other proceedings?**

15 A: Yes. The Commission ruled in favor of KCP&L by rejecting MECG’s arguments on this
16 issue in 2014 rate case (Case No. ER-2014-0370). In the Report and Order in that case,
17 the Commission found that:

18 MECG has proposed an adjustment that would reduce KCPL’s rate base
19 amount as a result of reducing the NOL carryforward ADIT asset by
20 computing the NOL amounts on a KCPL “stand-alone” basis instead of
21 using the amounts computed under the Tax Allocation Agreement.
22 MECG suggests that the Commission’s affiliate transaction rule may be
23 used to justify a change in the way the NOL deferred tax assets are
24 computed for KCPL.

25
26 Commission Rule 4 CSR 240-20.015(2) states:

⁵ Ibid, at 26.

1 (2) Standards.

2 (A) A regulated electrical corporation shall not provide a financial
3 advantage to an affiliated entity. For the purposes of this rule, a regulated
4 electrical corporation shall be deemed to provide a financial advantage to
5 an affiliated entity if –
6

7 1. It compensates an affiliated entity for good or services above the
8 lesser of –

9 A. The fair market price; or

10 B. The fully distributed cost to the regulated electrical
11 corporation to provide the goods or services for itself; or

12 2. It transfers information, assets, goods or services of any kind to
13 an affiliated entity below the greater of –

14 A. The fair market price; or

15 B. The fully distributed cost to the regulated electrical
16 corporation.
17

18 Section 4 CSR 240-20.015(1)(B) defines affiliate transaction as:
19

20 B. Affiliate transaction means any transaction for the provision,
21 purchase or sale of any information, asset, product or service, or
22 portion of any product or service, between a regulated electrical
23 corporation and an affiliated entity, ...
24

25 The Commission has ruled on this issue in a recent case with a very
26 similar fact situation. In that case, the Commission stated that “[t]he
27 Commission’s affiliate transaction rules do not apply in this situation
28 because there is no transaction involved. The affiliate transaction rules are
29 intended to control transfers of goods or services between regulated
30 utilities and their affiliates ... where there is no transaction, the restrictions
31 of the rule have no meaning.” The Commission finds that the affiliate
32 transaction rule does not apply to this situation.
33

34 ...

35 MECG attempts to distinguish the prior case by alleging that the Tax
36 Allocation Agreement to which KCPL is obligated does not benefit KCPL
37 or its ratepayers. Even if no benefits have accrued to KCPL in the recent
38 past, that does not mean that KCPL and its ratepayers will not benefit in
39 the future. There is no evidence in the record showing that KCPL has
40 attempted to manipulate its tax obligations to take advantage of ratepayers,
41 and the Commission will not question management decisions made by the
42 company with regard to its tax filings under such a tax allocation
43 agreement. The Commission concludes the proposed adjustment to the

1 computation of ADIT assets related to net operating losses should be
2 rejected.⁶

3 **Q: Has the Commission addressed this issue in proceedings other than the ER-2014-**
4 **0370 case?**

5 A: Yes. The Commission also ruled on this issue in an Ameren rate case (Case No. ER-
6 2014-0258). Like GPE, Ameren uses the “benefits for losses” method in its tax
7 allocation agreement. In response to certain parties’ recommendations that Ameren be
8 required to apply affiliate transaction rules to its tax allocation agreement, the
9 Commission found that:

10 Ameren Missouri proposes to use a NOLC [net operating loss
11 carryforward] it has actually accumulated rather than a hypothetical
12 NOLC proposed by MIEC [Missouri Industrial Electric Consumers] and
13 supported by Staff.] MIEC advocates a policy that arrangements between
14 affiliates should always be interpreted in a manner that benefits ratepayers,
15 even if that results in a detriment to the utility. There is no basis in law or
16 fact for such a policy. The Commission must balance the interest of
17 ratepayers and shareholders to set just and reasonable rates. Ameren
18 Missouri’s position is fair and will be adopted.⁷

19 **Q: Does the Merger create any facts or circumstances that would warrant changing the**
20 **tax allocation method used for KCP&L and GMO?**

21 A: No. The facts have not changed. Applicants intend to continue to use the method
22 approved by the Commission for KCP&L in Case No. ER-2014-0370 for both KCP&L
23 and GMO. Likewise, Applicants intend to continue to use the method Westar has
24 consistently used in general rate proceedings before the KCC.

25 **Q: Does that conclude your Surrebuttal Testimony?**

26 A: Yes, it does.

⁶ ER-2014-00370, Report and Order at 85-86 (footnote omitted).

⁷ ER-2014-0258, Report and Order at 22.

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

In the Matter of the Application of Great Plains)
Energy Incorporated for Approval of its Merger) Docket No. EM-2018-0012
with Westar Energy, Inc.)

AFFIDAVIT OF MELISSA K. HARDESTY

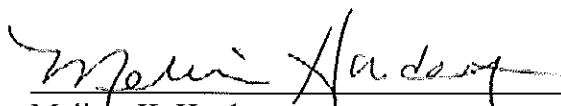
STATE OF MISSOURI)
) ss
COUNTY OF JACKSON)

Melissa K. Hardesty, being first duly sworn on his oath, states:

1. My name is Melissa K. Hardesty. I work in Kansas City, Missouri, and I am employed by Kansas City Power & Light Company as Senior Director of Taxes.

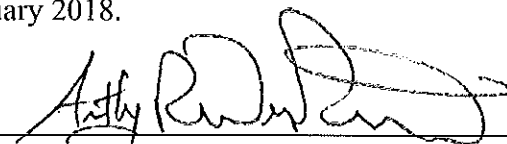
2. Attached hereto and made a part hereof for all purposes is my Surrebuttal Testimony on behalf of Great Plains Energy Incorporated, Kansas City Power & Light Company, KCP&L Greater Missouri Operations Company consisting of eleven (11) pages, having been prepared in written form for introduction into evidence in the above-captioned docket.

3. I have knowledge of the matters set forth therein. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded, including any attachments thereto, are true and accurate to the best of my knowledge, information and belief



Melissa K. Hardesty

Subscribed and sworn before me this 21st day of February 2018.



Notary Public

My commission expires: 4/26/2021

