

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-2017-0226, et al.
Date Testimony Prepared: March 27, 2017

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: EM-2017-0226, et al.

SURREBUTTAL TESTIMONY

OF

MELISSA K. HARDESTY

ON BEHALF OF

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

**Kansas City, Missouri
March 2017**

**Certain Schedules Attached To This Testimony Designated “(HC)”
Contain Highly Confidential Information.
All Such Information Should Be Treated Confidentially
Pursuant To 4 CSR 240-2.135.**

SURREBUTTAL TESTIMONY

OF

MELISSA K. HARDESTY

Case No. EM-2017-0226, et al.

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 (“KCP&L” or the “Company”)
6 as Senior Director of Taxes.

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

8 A: My responsibilities include management of KCP&L’s taxes, including income, property,
9 sales and use, and transactional taxes.

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

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

19 **Q: Have you previously testified in a proceeding at the Missouri Public Service**
20 **Commission (“MPSC”), Kansas Corporation Commission (“KCC”) or before any**
21 **other utility regulatory agency?**

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

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

2 A: The purpose of my testimony is to respond to two income tax-related issues and
3 associated conditions proposed by Michael P. Gorman, on behalf of the Midwest Energy
4 Consumers' Group ("MECG").

5 **Q: Please identify the two issues,**

6 A: Mr. Gorman identifies two income tax related issues that he believes should be addressed
7 by the Commission requiring and enforcing certain protection measures.

8 The first issue, referred to several times in his testimony, is related to the
9 possibility that Great Plains Energy ("GPE") might make income tax elections or
10 decisions at the holding company that would effectively harm the customers of the utility
11 operating subsidiaries by increasing the cost of service and rates that they pay. He
12 focuses on the potential to take actions related to goodwill, net operating losses
13 ("NOLs"), and bonus depreciation in an effort to provide benefits to other affiliated
14 entities.¹

15 The second issue implies that GPE, motivated by pressure to pay debt service,
16 will make decisions that increase income tax payments to the parent company, and thus
17 enhance GPE's cash flow available for acquisition debt service.²

18 **Q: Please explain the first issue regarding income tax elections and decisions.**

19 A: Mr. Gorman's concerns appear to be that GPE will make income tax elections or other
20 accounting decisions that will benefit the non-regulated affiliates of GPE or the holding
21 company (GPE) at the expense of the regulated utilities. The two examples he gives
22 relate to the amortization of goodwill for income tax purposes by the parent company,
23 and electing out of bonus depreciation at the utilities in order to increase taxable income

¹ Gorman Rebuttal, pp. 6, 20-21, 24. Note: All cites are to the March 23, 2017 Michael P. Gorman Rebuttal testimony filed in EM-2017-0226 *et al.*, based upon representations of MECG counsel that this is the only Gorman Rebuttal that will be offered into evidence.

² Gorman Rebuttal, p. 24.

1 of the consolidated group in order for the parent company to take advantage of NOLs
2 generated by its non-regulated affiliates.³

3 **Q: Are the examples given possible due to the transaction proposed in this case?**

4 A: No and yes. With respect to the amortization of goodwill, there is no goodwill that can
5 be amortized by GPE for tax purposes from this Transaction because Westar Energy Inc.
6 (“Westar”) will be merged in a tax free merger with a newly created subsidiary owned
7 directly by GPE to ensure that there will be no taxable gain related to the assets of Westar
8 in this Transaction. Without the recognition of taxable gain on Westar assets, the current
9 tax laws do not allow goodwill to be amortized and thereby reduce taxable income of the
10 new consolidated group. In short, this first example is not possible, should not be a
11 concern, and there is no need for a merger condition that protects customers.

12 However, it would be conceivable for the utilities to elect out of bonus
13 depreciation to increase taxable income at the utilities and enable the use of non-
14 regulated NOLs to increase cash flow that can be used to pay Transaction debt.

15 **Q: Please explain what bonus depreciation is and how it impacts taxable income.**

16 A: Bonus depreciation is additional, and optional, tax depreciation allowed by tax law for
17 certain taxable years. The amount of bonus depreciation can vary depending on the
18 taxable year (30%, 40%, 50%, or 100%). For 2017, the additional tax depreciation is
19 generally 50% of qualifying capital additions placed in service for the year. The
20 remaining capital after deducting the impact of bonus depreciation is then depreciated
21 using the normal accelerated tax depreciation allowed under tax law. This additional or
22 “bonus” depreciation significantly lowers taxable income in the years that it is taken.
23 However, companies are not required to take advantage of bonus depreciation; there is a
24 provision in current tax law that allows a company to elect out of taking this additional or
25 bonus depreciation.

³ Gorman Rebuttal, pp. 20-21.

1 **Q: What is Mr. Gorman's concern with respect to the flexibility of the operating**
2 **utilities to opt out of bonus depreciation?**

3 A: Mr. Gorman expresses concern that the Company will make income tax decisions,
4 including electing out of bonus depreciation, at the utilities in order to increase the
5 intercompany income tax payments to the parent company to facilitate the servicing of
6 the debt of GPE due to this proposed transaction.

7 **Q: How does GPE compute the intercompany income tax payments made by**
8 **subsidiaries?**

9 A: GPE makes intercompany tax payments based on its current tax sharing agreement which
10 is customary and fairly standardized in the context of holding company structures. It is
11 my understanding that Westar has a similar agreement in place with its subsidiaries.
12 GPE's agreement requires all subsidiaries to pay up to GPE or receive a payment from
13 GPE based on the amount of tax liability or tax benefit allocated to each subsidiary in
14 relation to the taxable income and tax credits generated and used by each subsidiary.
15 Any NOLs are allocated in accordance with Internal Revenue Code ("IRC") Section 1502
16 that details consolidated income tax return regulations. These procedures were developed
17 and are followed in order to ensure each subsidiary receives or pays a fair amount to GPE
18 for its tax benefits and liabilities. The intercompany tax payment procedures apply
19 equally to all subsidiaries.

20 **Q: Will the tax sharing agreement be revised to include Westar legal entities?**

21 A: Yes. We will revise the GPE tax sharing agreement to include all of the Westar entities
22 as soon as the transaction closes.

1 **Q: How does Mr. Gorman propose to solve these two issues in his testimony?**

2 A: Mr. Gorman proposes to solve both of these issues by requiring GPE to make a
3 commitment *“that the tax elections at the utilities will be made to produce the best*
4 *results for cost of service for the utility.”*⁴

5 **Q: Do you agree with Mr. Gorman’s proposal?**

6 A: No. The proposal is neither appropriate nor necessary and may actually harm customers
7 by impairing GPE’s flexibility to manage the income taxes of its subsidiaries to minimize
8 tax liabilities on a consolidated basis.

9 **Q: Please explain why Mr. Gorman’s proposal is unnecessary.**

10 A: As part of its broad general authority and, more specifically, its ratemaking process, the
11 Commission reviews decisions made by GPE and its affiliates to determine if the actions
12 of the Company, including income tax elections and decisions, are prudent. In my
13 experience, parties to utility rate cases thoroughly review the utility’s tax elections to
14 assess whether the utility acted reasonably. If any party believes the utility has made
15 unreasonable elections, that party can raise that issue with the Commission. If the
16 Commission determines that we have acted imprudently, it can act to ensure that
17 customers are not harmed. Therefore, this additional provision is already accommodated
18 by existing regulatory reviews and a special condition is not necessary, and may in fact
19 be harmful.

20 **Q: How may Mr. Gorman’s solution harm customers?**

21 A: Customers will best be served if GPE is able to make income tax elections and decisions
22 to ensure that it preserves as many of its tax benefits as possible for all subsidiaries,
23 including regulated and non-regulated benefits. Two examples that present the potential
24 for harm to customers come to mind immediately.

⁴ Gorman Rebuttal, p. 2.

1 **Q: What are those examples?**

2 A: KCP&L has approximately \$87 million of unused federal advanced coal investment tax
3 credits (“coal tax credits”) (which should flow back to customers once used) that can only
4 be used for federal tax purposes once all of GPE’s NOLs (regulated and non-regulated)
5 are used. If we are forced to take bonus depreciation at KCP&L so that we do not use
6 non-regulated NOLs, KCP&L could forego these coal tax credits forever. Therefore, it
7 may be necessary for KCP&L to elect out of bonus depreciation at some point in time in
8 order to use non-regulated NOLs and preserve the coal tax credits for KCP&L’s
9 customers.

10 As another example, Westar has over \$170 million of Kansas High Performance
11 Incentive Plan credits which should also flow back to customers and could be at risk if
12 we are not allowed the flexibility to make decisions for the whole group.

13 More importantly, one needs to recognize that bonus depreciation is really just a
14 temporary timing difference in taxes to be paid, but tax credits are permanent differences
15 in the amount of taxes to be paid. If we were to follow Mr. Gorman’s proposal, it would
16 likely mean forfeiting permanent tax savings just to create temporary tax payment
17 differences, likely requiring more total taxes to be paid by the utilities over the long term.
18 The taxable income of the utilities and the Company can vary dramatically depending on
19 the federal tax policies pursued by the President and Congress. GPE needs the flexibility
20 to make income tax elections and decisions that are in the best interest of all of its
21 subsidiaries and preserve tax benefits for the whole group. Mr. Gorman’s proposal
22 would impair the flexibility necessary for GPE to make tax elections to the benefit of
23 customers and ignore the fact that utility tax elections are customarily reviewed for
24 reasonableness in rate cases.

1 **Q: Has GPE ever elected out of bonus depreciation at the utilities in order to increase**
2 **taxable income in the past to use non-regulated NOLs?**

3 A: No. Bonus depreciation has been available for more than 10 years and GPE has had over
4 \$800 million of non-regulated NOLs that were acquired due to the merger with Aquila in
5 2008. Through 2016, GPE has not elected out of bonus depreciation on any qualifying
6 capital assets placed in service at its utility subsidiaries for any tax years during this time.

7 **Q: Does GPE plan to elect out of bonus depreciation in the future?**

8 A: No. Based on the current tax law, whereby bonus depreciation is available until 2019,
9 even without the merger with Westar, GPE believes it will have enough taxable income
10 to utilize all of our NOLs and tax credits without electing out of bonus depreciation. In
11 fact, the acquisition of Westar should accelerate the utilization of NOLs. An estimate of
12 the utilization of NOLs and tax credits with and without the acquisition of Westar was
13 provided as a schedule attached to my rebuttal testimony in Kansas Docket No. 16-
14 KCPE-593-ACQ. I have also attached it to this testimony as Schedule MKH-1.
15 However, Congress routinely changes tax laws, sometimes with very little notice, which
16 could impact our ability to use NOLs and tax credits. The results of the recent
17 presidential and congressional election increase the likelihood of tax law changes in the
18 not too distant future. Therefore, it is imperative that GPE have the flexibility and ability
19 to make income tax elections and decisions that are in the best interest of all subsidiaries.
20 Locking the companies into a particular strategy is neither wise nor necessary given that
21 the Commission will have full authority to review our actions and take steps to protect
22 customers in future rate cases if it believes we have not acted prudently.

23 **Q: Does that conclude your Rebuttal Testimony?**

24 A: Yes, it does.

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

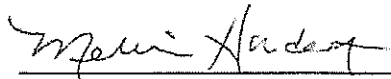
IN THE MATTER OF THE APPLICATION OF)
GREAT PLAINS ENERGY INCORPORATED FOR) **Docket No. EM-2017-0226**
APPROVAL OF ITS ACQUISITION OF WESTAR)
ENERGY, INC.)

AFFIDAVIT OF MELISSA K. HARDESTY

STATE OF MISSOURI)
) ss
COUNTY OF JACKSON)

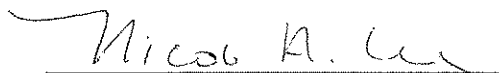
Melissa K. Hardesty, being first duly sworn on his oath, states:

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, and KCP&L Greater Missouri Operations Company consisting of seven (7) 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.



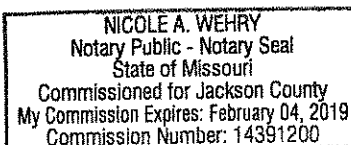
Melissa K. Hardesty

Subscribed and sworn before me this 27th day of March, 2017.



Notary Public

My commission expires: Feb. 4, 2019



SCHEDULE MKH-1

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