

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**

**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**

**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.<sup>1</sup>

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<sup>1</sup> 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.<sup>2</sup> 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.<sup>3</sup>

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.

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<sup>2</sup> Id.

<sup>3</sup> 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.<sup>4</sup>

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<sup>4</sup> 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:<sup>5</sup>

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:

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<sup>5</sup> 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.<sup>6</sup>

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.<sup>7</sup>

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.

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

<sup>7</sup> 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**

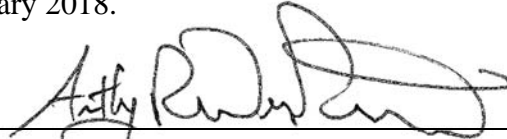
**STATE OF MISSOURI**     )  
   ) ss  
**COUNTY OF JACKSON**     )

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 21<sup>st</sup> day of February 2018.

  
\_\_\_\_\_  
Notary Public

My commission expires: 4/26/2021

