Exhibit No.:	
Issue:	Crossroads Deferred Taxes; Property Tax Expense; Cost of Removal
Witness:	Melissa K. Hardesty
Type of Exhibit:	Rebuttal Testimony
Sponsoring Party:	KCP&L Greater Missouri Operations Company
Case No.:	ER-2009-0090
Date Testimony Prepared:	March 13, 2009

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO: ER-2009-0090

REBUTTAL TESTIMONY

OF

MELISSA K. HARDESTY

ON BEHALF OF

KCP&L GREATER MISSOURI OPERATIONS COMPANY

Kansas City, Missouri
March 2009

REBUTTAL TESTIMONY

OF

MELISSA K. HARDESTY

Case No. ER-2009-0090

Q: Please state your name and business address.

A: My name Melissa K. Hardesty. My business address is 1201 Walnut, Kansas City, Missouri 64106.

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

A: I am employed by Kansas City Power & Light Company ("KCP&L") as Director of Taxes.

Q: What are your responsibilities?

A: My responsibilities include management of taxes, including income, property, sales and use, and transactional taxes for KCP&L Greater Missouri Operations Company ("GMO" or the "Company") and KCP&L.

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

A: I graduated from the University of Kansas in 1996 with a Bachelor of Science in Accounting. I am a Certified Public Accountant with a permit to practice in the State of Kansas. After completion of my degree, I worked at the public accounting firm Marks, Stallings & Campbell, P.A. as a staff accountant from 1996 to 1999. In 1999, I went to work for Sprint Corporation as a Tax Specialist in the company's federal income tax department. I held various positions from 1999 to 2006. When I left Sprint to join

KCP&L in December 2006, I was Manager of Income Taxes for Sprint's Wireless Division. Since December of 2006, I have been Director of Taxes for KCP&L.

Q: Have you previously testified in a proceeding at the Missouri Public Service Commission ("MPSC" or the "Commission") or before any other utility regulatory agency?

A: Yes. I provided testimony in Case No. ER-2007-0291 for KCP&L.

Q: What is the purpose of your Rebuttal Testimony?

A: The purpose of my testimony is to respond to Ag Processing, Inc., Sedalia Industrial Energy Users Association, and Wal-Mart Stores, Inc. ("AGP/SIEA/Wal-Mart") witness Greg Meyer regarding deferred taxes associated with the Crossroads unit; to respond to Commission Staff ("Staff") witness Karen Herrington regarding Staff's adjustment to property tax expense; and to respond to Staff's exclusion of an adjustment to income tax expense for tax benefits related to cost of removal tax deductions previously flowed through.

CROSSROADS DEFERRED TAXES

Q: Is the Company in agreement with Mr. Meyer's proposal for recognizing the transfer of deferred taxes associated with the Crossroad units?

A: The Company agrees that approximately $1.7 million of deferred taxes created after the transfer of the Crossroads units from GMO's non-regulated merchant subsidiary to GMO's MPS regulated unit ("GMO-MPS") should be included in GMO-MPS's rate base if the Crossroad units are also included in rate base at net book value. However, the Company does not agree that the deferred taxes of $13.4 million related to the deferred gain on the sale of the Crossroad units recorded on the non-regulated merchant subsidiary should be included in the regulated utility rate base.

Q: Please explain why you do not agree that the deferred taxes on the non-regulated merchant subsidiary should be included in rate base.

A: As per Staff witness Paul R. Harrison's testimony on page 142 of the Staff Report,

> MPS's and L&P's deferred income tax reserve represents, in effect, a prepayment of income taxes by MPS's customers. As an example, because MPS and L&P are allowed to deduct depreciation expense on an accelerated basis for income tax purposes, depreciation expense used for income taxes is significantly higher than depreciation expense used for financial reporting (book purposes) and for ratemaking purposes…The net credit balance in the deferred tax reserve represents a source of cost-free funds to MPS and L&P. Therefore, MPS's and L&P's rate base is reduced by the deferred tax reserve balance to avoid having customers pay a return on funds that are provided cost-free to the Company.

The deferred taxes related to these units prior to the transfer to GMO-MPS were never a prepayment of income taxes by GMO-MPS's customers or any other customer in a regulated environment. Therefore, the Company does not believe that it is appropriate to reduce its rate base for these deferred taxes.

Q: Are deferred taxes generally transferred on the sale of an asset?

A: If an asset that has been included in a regulated environment since it was constructed or purchased, the deferred taxes associated with that asset are generally required to be included in rate base for the purchasing Company. This procedure ensures that customers who provided "cost-free" funds do not have to pay a return on those funds when they are transferred to a different but also regulated entity. In this case, the Crossroads units' accelerated tax benefits were never a source of "cost-free" funds for GMO-MPS or any other regulated entity and it is not appropriate to include the resulting deferred taxes created while a part of the non-regulated subsidiary in rate base.

PROPERTY TAX EXPENSE

Q: Is GMO in agreement with Staff's property tax expense calculation as documented by Ms. Herrington?

A: No, the Company does not agree with her calculation.

Q: Please explain your concerns with this adjustment.

A: While the Company agrees with Staff that annualized property tax expense in this rate proceeding should be based on 2008 actual costs, Staff has excluded from these costs a component of 2008 property tax cost, specifically, property taxes in the amount of $126,425 (GMO-L&P's share) assessed on the new Air Quality Control System ("AQCS") at the Iatan I generating station.

Q: Was this cost an Operations & Maintenance ("O&M") expense in 2008?

A: No, the cost was capitalized as part of the Iatan 1 AQCS project because the project was classified as Construction Work in Progress throughout 2008.

Q: If the 2008 Iatan 1 AQCS property tax cost was not a 2008 O&M expense, then why should this cost be included in property tax expense in this rate proceeding?

A: Beginning with the in-service of the Iatan 1 AQCS project in early 2009 the associated property tax will be classified as O&M property tax expense. In actuality, the amount paid and charged to O&M in 2009 will be based on valuations at January 1, 2009 and will be substantially higher than the taxes paid and capitalized for 2008, which were based on the valuation as of January 1, 2008. It is for this reason that the Company considers inclusion of the actual 2008 Iatan 1 AQCS property tax cost as a component of property tax expense in this rate proceeding to be fair, reasonable and appropriate.

Q: Please summarize the differences between Ms. Herrington's property tax expense and that of the Company.

A: The Company believes that the capitalized property taxes related to the Iatan 1 AQCS in the amount of $126,425 should be included in property tax expense in this rate proceeding. This is the only issue that GMO has with the Staff's recommendations concerning property taxes, as set forth in the Staff Cost of Service report.

COST OF REMOVAL

Q: What concerns do you have with the treatment of taxes related to cost of removal?

A: GMO requested in direct testimony by Ronald Klote that the Company and the Staff discuss the handling of the tax regulatory asset associated with the tax benefits flowed through for cost of removal deductions from 1971 through 2001 that currently exists on the books of GMO-MPS and GMO-L&P. Cost of removal tax deductions are expenses incurred to retire or remove assets that are deductible when paid for tax return purposes. The tax benefits associated with cost of removal tax deductions from 2002 and later have been normalized, and are not an issue. The Company has had discussions with interested parties on this issue. However,, the issue has not been resolved and Staff has not included an adjustment for cost of removal tax benefits previously flowed through in its calculation of income tax expense. By excluding an adjustment, the Staff has, in effect, not allowed the company a mechanism to recover the tax regulatory asset at issue.

Q: What is normalization vs. flow-through?

A: Normalization and flow-through refer to accounting methods used to account for timing differences between deductions recorded on the financial books and those taken on the income tax return.

Q: When is flow-through used and how does it work?

A: In the past, utilities were often required to "flow through" tax benefits to ratepayers immediately to reduce current rates. This occurred as a result of reflecting a higher level of expense deductions when calculating the income tax expense for regulatory purposes than the level of expense deductions reflected in cost of service for regulatory purposes. When the tax became due in the future, higher rates would be provided to cover the tax liability. Flow-through can still be used for tax timing differences not covered by the tax codes mandatory normalization requirements. Cost of removal is a timing difference that is not required to be normalized. Under flow-through accounting, taxes are computed based on the income tax return deduction instead of the book deduction. The tax due based on the tax deduction is then recorded for book purposes and is used when calculating tax expense for regulatory purposes. Deferred taxes are not recorded on the difference between the book deduction and the tax deduction.

Q: What is normalization and how does it work?

A: Normalization is the process whereby taxes are calculated and recorded for book and regulatory purposes based on all taxes expected to be paid, without regard to when the taxes will be paid. Under normalization, revenues and deductions used to calculate book and regulatory income tax expense are the same as those used to record book and regulatory net income before income taxes. Any differences between the tax calculated per the books and the tax payment due based on the filed income tax return for the same period are provided for by recording a deferred tax liability. All timing differences between book income or deductions and tax income or deductions must have a deferred tax liability recognized that will be available in the future to satisfy the tax liability when the tax payment becomes due. Under normalization, a utility is allowed to recover taxes from the ratepayers based on the tax expense calculated for book purposes. The resulting deferred tax on the Balance Sheet, generally a liability, is reflected for ratemaking as a rate base offset.

Q: Has GMO consistently applied flow-through for cost of removal for regulatory purposes since 1971?

A: GMO consistently flowed through the tax benefits for cost of removal in the annual surveillance reports filed with the Staff from 1971 until 2001. In addition, it has reflected the flow-through of these tax benefits in its financial records. In Case No. ER-2004-0034, GMO agreed to normalize the tax benefits associated with cost of removal with the understanding that it would be able to discuss recovery of the outstanding tax regulatory asset in the future. Therefore, the tax benefits related to cost of removal from 2002 forward have been normalized.

Q: What is the balance of the tax regulatory asset for MPS and L&P?

A: The tax regulatory assets that currently exist are $22,262,436 for GMO-MPS and $6,653,007 for GMO-L&P. These regulatory assets have been grossed up for deferred taxes under Financial Accounting Standards Board Statement No. 109. The net of deferred tax balance is $13,716,843 for GMO-MPS and $4,009,203 for GMO-L&P.

Q: What would be the revenue requirement effect if the tax benefits are allowed to be flowed through for cost of removal?

A: At this time, the Company requests a 20-year amortization of the tax regulatory asset. The result of a 20-year amortization would be an increase to income tax expense of

$685,842 ($13,716,843 divided by 20) for GMO-MPS and $200,460 ($4,009,203 divided by 20) for GMO-L&P.

Q: If the Commission does not allow an amortization or some other mechanism to recover the previously flowed through tax benefits, what effect would that have on GMO?

A: If GMO is granted amortization of the regulatory asset, it will recover the accelerated tax benefits over the time period agreed to by the Commission. If the Commission disallows recovery of the regulatory assets, GMO will have to write off the regulatory assets and tax-gross up recorded on it financial statements. The net write-off amount would be $13,716,843 for GMO-MPS and $4,009,203 for GMO-L&P.

Q: Has the Commission approved an amortization of previously flowed through cost of removal before?

A: In KCP&L's Case No. ER-2007-0291 the Commission approved the Unamimous Stipulation and Agreement as to Certain Issues dated October 3, 2007 wherein the parties agreed to a 20-year amortization of previously flowed through tax benefits related to cost of removal deductions.

Q: Were the facts and circumstances surrounding KCP&L's cost of removal issue in that case similar to those for GMO in this case?

A: Yes, the issue was basically the same- how should previously flowed through tax benefits related to cost of removal deductions be recovered?

Q: Does that conclude your testimony?

A: Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Aquila, Inc. dba)
KCP&L Greater Missouri Operations Company to) Case No. ER-2009-0090
Modify Its Electric Tariffs to Effectuate a Rate Increase)

AFFIDAVIT OF MELISSA K. HARDESTY

STATE OF MISSOURI)
) ss
COUNTY OF JACKSON)

Melissa K. Hardesty, being first duly sworn on her 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 Director, Taxes.

2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony on behalf of KCP&L Greater Missouri Operations Company consisting of eight (8) pages ~~and Schedule(s)~~ ______ ~~through~~ ______, all of which 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 Hardesty
Melissa K. Hardesty

Subscribed and sworn before me this 13th day of March 2009.

Nicole A. Wehry
Notary Public

My commission expires: Feb. 4, 2011

" NOTARY SEAL "
Nicole A. Wehry, Notary Public
Jackson County, State of Missouri
My Commission Expires 2/4/2011
Commission Number 07391200