Exhibit No.:
Issue: Income Taxes
Witness: Melissa K. Hardesty
Type of Exhibit: Surrebuttal Testimony
Sponsoring Party: KCP&L Greater Missouri Operations Company
Case No.: ER-2012-0175
Date Testimony Prepared: October 10, 2012

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: ER-2012-0175

SURREBUTTAL TESTIMONY

OF

MELISSA K. HARDESTY

ON BEHALF OF

KCP&L GREATER MISSOURI OPERATIONS COMPANY

Kansas City, Missouri
October 2012

"[redacted]**" Designates "Highly Confidential" Information Has Been Removed.**
Certain Schedules Attached To This Testimony Designated "Highly Confidential" Have Been Removed Pursuant To 4 CSR 240-2.135.

SURREBUTTAL TESTIMONY

OF

MELISSA K. HARDESTY

Case No. ER-2012-0175

Q: Please state your name and business address.

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

Q: Are you the same Melissa K. Hardesty who pre-filed Direct and Rebuttal Testimony in this matter?

A: Yes, I am.

Q: On whose behalf are you testifying?

A: I am testifying on behalf of KCP&L Greater Missouri Operations Company ("GMO") for St. Joseph Light & Power ("L&P") and Missouri Public Service ("MPS") territories.

Q: What is the purpose of your Surrebuttal Testimony?

A: The purpose of my testimony is to address the Rebuttal Testimony of Missouri Public Service Commission Staff ("Staff") witness Cary G. Featherstone related to Iatan 2 Advanced Coal Tax Credits and Deferred Income Taxes for Crossroads.

IATAN 2 ADVANCED COAL TAX CREDITS

Q: What is Staff's position regarding the reallocation of Iatan 2 Advanced Coal Tax Credits to GMO from Kansas City Power & Light Company ("KCP&L")?

A: Mr. Featherstone states on page 19 of his Rebuttal Testimony that Staff continues to support its recommendations related to the Iatan 2 Advanced Coal Credits as presented in

its Staff's Revenue Requirement/Cost of Service report ("Staff Report") on pages 202-203.

Q: What were the Staff's recommendations?

A: Staff recommended the following actions:

1. That the Commission order Great Plains Energy Incorporated ("GPE"), KCP&L and GMO ("the Companies") to request a reallocation [for a second time] between KCP&L and GMO of the Iatan 2 Qualifying Advanced Coal Tax Credits from the Internal Revenue Service ("IRS").

2. If the IRS does not reallocate these credits to the IRS, then the Staff recommended that KC&L should be ordered to provide the monetary equivalent to GMO of the value of the coal credits that should be allocated to GMO.

Q: Does GMO agree with these recommendations?

A: No. We do not.

Q: Why does GMO disagree with the recommendation to request for a second time a reallocation of credits from KCP&L to GMO from the IRS?

A: The Commission has already ordered the Companies to request a reallocation of credits from KCP&L and GMO in the last case. The Companies complied with this order and the IRS denied our request. We do not believe that the IRS would be willing to reallocate the credits, even if it was requested again.

Q: Did you retain counsel to provide you with advice on whether to request for a second time a reallocation of credits from KCP&L to GMO?

A: Yes. The Companies requested that Gary Wilcox, an attorney with Morgan, Lewis & Bockius LLP, provide us with an analysis of the risks associated with another request and chances of whether or not he believed we would be successful.

Q: What was Mr. Wilcox's advice?

A: Mr. Wilcox stated in his analysis that he believes **[redacted]** ** A copy of Mr. Wilcox's full analysis is attached as Schedule MKH-3 HC.

Q: Why does GMO disagree with the recommendation for KCP&L to pay the monetary equivalent of the value of the coal credits to GMO?

A: GMO believes that paying the monetary equivalent of the value of the coal credits to GMO would be a normalization violation and may subject both KCP&L and GMO to severe penalties under the normalization rules. The normalization rules and the penalties imposed by the IRS for violating them are discussed in Direct, Rebuttal and Surrebuttal Testimony of GMO witness, Salvatore Montalbano.

Q: Mr. Featherstone states on page 13 of his Rebuttal Testimony that there is uncertainty surrounding whether or not a reallocation of credits to GMO without a reallocation from the IRS, or alternative remedies, would be a normalization violation. Do you agree with Mr. Featherstone?

A: Yes. The Companies have always stated that there is not specific guidance related to the normalization rules based on our facts in this case. However, we have consulted with two consulting firms who have national experts on the normalization rules. The first firm is PricewaterhouseCoopers LLP ("PricewaterhouseCoopers"). PricewaterhouseCooper's representative, Salvatore Montalbano is an expert witness in this case and he has stated in his Direct, Rebuttal and Surrebuttal Testimony that the actions recommended by Staff whereby credits are reallocated to GMO directly or indirectly from KCP&L would likely be a normalization violation. The second firm, Deloitte LLP ("Deloitte"), has prepared a private letter ruling ("PLR") for us that we are waiting to send to the IRS to get a definitive ruling on this issue. As part of this process, KCP&L has also sought guidance from Deloitte and relied on their guidance for the KCP&L position as well as the way the PLR has been prepared. KCP&L has found no one – including Mr. Featherstone – who is willing to opine that a reallocation of the credits would *not* be a normalization violation. KCP&L simply does not believe taking the risk would be prudent.

Q: Mr. Featherstone also states in his Rebuttal Testimony on page 19 that "what Mr. Montalbano's testimony is really attempting to do is scare the Commission about these alleged tax consequences of imputing coal credits to GMO." Do you agree with this statement?

A: No. The testimony provided by Mr. Montalbano indicates that there is a very real possibility that a normalization violation would occur if coal credits were reallocated to GMO without a reallocation by the IRS. The Companies take this risk very seriously and believe it would not be prudent to agree to a reallocation of credits without guidance from the IRS that specifically states that it would not be a normalization violation in this case.

Q: Is GMO willing to request guidance from the IRS on whether a reallocation would be a violation?

A: Yes. As stated in my Rebuttal Testimony on page 17, the Companies have prepared a PLR request to get guidance from the IRS and is waiting for information from the Missouri Staff to send to the IRS. More detail is provided in my Rebuttal Testimony on the PLR requirements and the information we are waiting on to send the request.

Q: If the IRS states in a PLR that any of the proposed actions in the PLR request related the Advanced Coal Tax Credits would NOT be a normalization violation, would the Companies take such action?

A: Yes. As stated and outlined in more detail on pages 18 and 19 in my Rebuttal Testimony, the Companies would agree to provide GMO ratepayers with the equivalent amount of tax benefits they would have gotten if the IRS had agreed to reallocate the Advanced Coal Tax Credits to GMO. Any action should only impact the revenue requirement of KCP&L and GMO by the approximate amount of tax benefits that GMO ratepayers would have received if the IRS had agreed to reallocate the Advanced Coal Tax Credits.

Q: Why has KCP&L not yet sent the request for the PLR?

A: As discussed in prior testimony, the IRS requires the Commission to provide certain information for the PLR. Although the Kansas Corporation Commission has already signed the needed documentation, KCP&L has not yet received final documentation from the Staff of this Commission.

Q: Mr. Featherstone also states on page 18 of his Rebuttal Testimony that the Staff believes that "the actions of KCPL constitute affiliate abuse toward GMO." Do you agree?

A: No. Every action taken by GPE and KCP&L has been to maximize the amount of Advanced Coal Tax Credits for all of the affected ratepayers. KCP&L was the only joint owner of the plant who pursued the Advanced Coal Tax Credits with the IRS and the Department of Energy before the acquisition of GMO. And all actions KCP&L has taken since it received an allocation of the credits have been taken to avoid any potential normalization violations. It is absurd to state that KCP&L actions taken to prevent a normalization violation should be considered affiliate abuse toward GMO.

Q: On page 18 of Mr. Featherstone's Rebuttal Testimony, he has provided a list of six key facts [imprudent actions] that were not addressed in KCP&L's Direct Testimony related to the coal credits. Have these actions been addressed in subsequent testimony?

A: Yes. I have specifically addressed each allegation outlined by Mr. Featherstone in my Rebuttal Testimony starting on page 8. The Companies strongly disagree with each assertion and have provided a detailed explanation in my Rebuttal Testimony.

Q: Have the Companies addressed these actions in any other manner in this case?

A: Yes. KCP&L has had multiple conversations with the Staff, provided explanations in multiple data requests and provide technical analysis at every possible point in this case. I have attached data request number 0289 in Case No. ER-2012-0174 as Schedule MKH-4 as one example where we have tried to address the concerns of the Staff around these actions. In addition to data request number 0289, the Companies have received

approximately one hundred data requests related to this issue in KCP&L Case No. ER-2012-0174 or in prior cases. It is very frustrating and disturbing to me that the Staff continues to assert that we have not provided information to explain or address our actions as it relates to the Advanced Coal Tax Credits.

Q: On page 19 of his testimony, Mr. Featherstone refers to KCP&L's decision-making in this case as "self serving." Please address this comment.

A: KCP&L's position is that it will reallocate credits to GMO should the IRS approve of such treatment. Because KCP&L and GMO share a common parent, there is really no issue of which company will be better served. KCP&L's sole motivation is to avoid adverse tax treatment and avoid the significant risk of financial harm. Mr. Featherstone's testimony identifies no other motive for KCP&L's position in this case and does not explain what is meant by his comment that KCP&L's decision is "self serving." KCP&L appears to have an honest disagreement with Staff about how the IRS will treat an attempt to reallocate tax credits. KCP&L's position is based on the opinions of highly qualified outside professionals, while Mr. Featherstone's opinion appears to be based on his understanding of the "spirit of the normalization rules." *See* Featherstone Rebuttal at page 12. The prudent way to resolve this disagreement is by all parties coming together and seeking a PLR from the IRS, a ruling by which KCP&L will gladly abide.

CROSSROADS DEFERRED INCOME TAXES

Q: What is Staff's position regarding the accumulated deferred income taxes related to Crossroads?

A: Mr. Featherstone states on page 46 of his Rebuttal Testimony that "[d]eferred taxes should be consistent with the value of Crossroads the Commission determines should be

included in rate base for MPS" and that "[d]eferred taxes are directly related to the level of plant investment."

Q: Does GMO agree with the Staff position?

A: Yes. Generally speaking, GMO agrees that the deferred taxes should be consistent with the value of Crossroads the Commission determines should be included in rate base for MPS. However, GMO disagrees with how those deferred taxes are calculated if the value is set at full book value.

Q: What does the Staff recommend for deferred income taxes if the value of Crossroads for rate base purposes is set at full book value?

A: Mr. Featherstone states on page 48 of his testimony that "[i]f Crossroads is valued for rate base purposes at full book value, then it is Staff's position all the accumulated deferred income taxes generated by Crossroads since it was built should be included in MPS's rate base, regardless of when they were generated – prior to the transfer to regulated operations and after" or approximately $11.3 million of deferred income taxes.

Q: Does GMO agree with the Staff position for deferred taxes if the value of Crossroads is set at full book value?

A: No. GMO agrees the deferred taxes should be consistent with the value of Crossroads the Commission determines should be included in rate base for MPS. However, we do not believe that the deferred taxes generated prior to the transfer of Crossroads to MPS, as a regulated plant asset, should be included. GMO believes only the deferred taxes generated after the transfer of Crossroads to MPS, approximately $8.3 million, should be included.

Q: Why should the deferred taxes generated prior to the transfer of Crossroads to MPS be excluded?

A: As stated on page 3 of my Rebuttal Testimony, deferred income taxes are, in effect, a prepayment of income taxes by GMO's customers and are a source of cost-free funds to GMO to use in its utility operations. GMO believes it is appropriate to reduce GMO's rate base by deferred income taxes to avoid having customers pay a return on funds that are provided cost-free to GMO. However, since the deferred income taxes related to Crossroads prior to the transfer to GMO were never a prepayment of income taxes by GMO's customers or any other customer in a regulated environment, we do not believe that it is appropriate to reduce its rate base for these deferred income taxes. Additional detail is provided in my Rebuttal Testimony.

Q: What does the Staff recommend for deferred income taxes if the value of Crossroads for rate base purposes is set at $61.8 million at July 14, 2008 per the Commission's Order in Rate Case No. ER-2010-0356?

A: Mr. Featherstone recommends on page 49 of his Rebuttal Testimony that the amount of deferred taxes would be approximately $4.2 million.

Q: Does GMO agree with the Staff position for deferred taxes if the value of Crossroads is set at $61.8 million at July, 2008 per the Commission's Order in Rate Case No. ER-2010-0356?

A: Yes. We do.

Q: If the value of Crossroads is determined to by the Commission something other than the full book value or $61.8 million as of July 14, 2008, should the deferred taxes be recomputed?

A: Yes. The deferred taxes should be recomputed if the value of Crossroad is changed in this case to be consistent with the new value.

Q: Does that conclude your testimony?

A: Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of KCP&L Greater Missouri Operations Company's Request for Authority to Implement General Rate Increase for Electric Service	)))	Case No. ER-2012-0175

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 Senior Director of Taxes.

2. Attached hereto and made a part hereof for all purposes is my Surrebuttal Testimony on behalf of KC&PL Greater Missouri Operations Company consisting of ten (10) 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 10th day of October, 2012.

Nicole A. Wehry
Notary Public

My commission expires: Feb. 4, 2015

NICOLE A. WEHRY
Notary Public - Notary Seal
State of Missouri
Commissioned for Jackson County
My Commission Expires: February 04, 2015
Commission Number: 11391200

SCHEDULE MKH-3
THIS DOCUMENT CONTAINS HIGHLY CONFIDENTIAL INFORMATION NOT AVAILABLE TO THE PUBLIC

Verification of Response

Kansas City Power & Light Company
AND
KCP&L Greater Missouri Operations

Docket No. ER-2012-0174

The response to Data Request # 0289 is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: July 2, 2012

Company Name: KCPL
Case Description: 2012 KCP&L Rate Case
Case: ER-2012-0174

Response to Featherstone Cary Interrogatories – Set MPSC_20120524
Date of Response:

Question No. :0289
Identify any and rationale and provide documentation, including but not limited to any and all written communication including all correspondence, e-mails, studies, reports, detailed analyses, etc to support why Great Plains Energy Incorporated, Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company believes GMO is not entitled to and included as part of the allocation the Iatan 2 Advance Coal Tax Credits based on its ownership share of Iatan 2 in (a). late 2006 when KCPL requested the Advance Coal Tax Credits from the Internal Revenue Service (b). April 28, 2008 notice of acceptance by the IRS (c) August 2008 at the time of KCPL's memorandum of understanding with the IRS (d) at any time during the period of July 14, 2008 to present.

RESPONSE: (do not edit or delete this line or anything above this)

Before the acquisition of GMO by GPE, GMO did not apply for Section 48A Qualifying Advanced Coal Project Investment Tax Credits in the allocation round for 2006 or 2007. At this time, KCPL believed that income tax items, including tax credits, were the responsibility of each owner in accordance with the operating agreement and did not notify or file on behalf of the other joint owners for tax credits. In addition, KCPL believed that a taxpayer had to have 400 Megawatts or more of nameplate capacity of a qualifying facility to qualify per IRC Section 48A. GMO and the other owners did not meet this requirement. In addition, GMO would likely not have been able to utilize the credits since it was not paying income taxes due to significant net operating losses.

In October 2008, subsequent to the acquisition by GPE, GMO became aware that there was an additional $250 million of credits available to be awarded and did file an application for the advanced coal investment tax credits in 2008. The IRS denied GMO's application and indicated that the full $125 million of credits available for the Iatan 2 plant project had already been awarded to KCP&L in the 2007 allocation round. This was the first indication by the IRS that a definition of a project was not limited to the amount owned by a taxpayer, but included an entire project even if it was owned by multiple parties.

Shortly after the Company received the denial letter from the IRS for GMO's application, Empire began the arbitration proceedings to have credits reallocated to them by the panel. The Company did not include GMO in the arbitration proceedings since it felt strongly

that income taxes were the responsibility of each owner per the operating agreement and because GMO's application had just been denied. In December of 2009, the arbitration panel issued its order to allocate credits to Empire (via an amended Memorandum of Understanding by the IRS). The order does not require any credits to be reallocated or the monetary equivalent of its proportionate share of the credits to be paid to GMO.

Since the IRS denied GMO's application for credits and because GMO was not included in the arbitration order, the Company determined, in consultation with outside counsel, that it was likely that the IRS would not reallocate credits to GMO. In fact, the IRS requested document demonstrating that GMO would not request a reallocation.

Pursuant to the MPSC Order dated March 16, 2011, GPE, KCPL and GMO did request the IRS to reallocate credits to GMO during 2011. The IRS denied this request on September 8, 2011. The Company determined, again in consultation with outside counsel, that requesting a reconsideration of the IRS decision regarding GMO could jeopardize our previous agreement with the IRS regarding the Empire allocation. If this agreement was changed, then it is possible that a normalization violation could occur. A normalization violation would not be in the best interest of GPE, KCPL or GMO.

Since the IRS denied the request and no allocation has been made by the IRS, GPE, KCPL and GMO have not included any credits for GMO in the rate case proceedings due to the normalization rules outlined below.

Section 48A Qualifying Advanced Coal Project Investment Tax Credits (ITC) are subject to the normalization rules set forth in IRC Section 46(f). IRC Section 46(f)(2)(A) states that if the taxpayer's cost of service for ratemaking purposes or its regulated books of account is reduced by more than a ratable portion of the credit, then no credit is allowed. Since GMO has not been awarded any Section 48A credits, it is not allowed to include any Section 48A credit to reduce income tax expense for ratemaking purposes.

Regulation 1.46-6(b)(4) also states that the indirect reductions to cost of service of a taxpayer are also considered a violation. This includes any ratemaking decision intended to achieve an effect similar to a direct reduction to cost of service. Several private letter rulings have interpreted the restrictions against indirect reductions of cost of service related to ITC and have held that various ratemaking proposals would violate the normalization requirements. Most recently, PLR 200945006 addressed the sale of regulated gas distribution assets from one utility to another. At issue was whether the accumulated deferred ITC of the selling utility could be transferred to the buying utility to ultimately be used to reduce the rates of the buying utility. The IRS National Office held that the selling utility would violate the requirements of the investment tax credit normalization rules set forth in former section 46(f), if it directly or indirectly passes the accumulated deferred ITC balance to another taxpayer who did not claim such ITC tax benefits. Therefore any indirect allocation of credits to GMO would also be normalization violation under IRS regulations.

Per the Tax Reform Act of 1986 Section 211(b), the penalty for a violation of the ITC normalization requirements is the recaptured/repayment to the IRS the greater of ITC claimed in all open tax years as of the date of the violation or the amount of ITC tax credit remaining on the taxpayers' books of account. This would include all accumulated deferred ITC remaining on GMO for any other previous qualifying investment tax credit properties. Therefore, if GMO included benefits of Section 48A credits in violation of the normalization rules, GMO would be not only be including benefits of Section 48A credits that it never received on any tax return, it would have to pay the IRS for all outstanding ITC remaining on its books for previous investment tax credit properties.

KCP&L objects to the extent this request seeks attorney-client privileged information, attorney work product information, and/or accountant-client privileged information. A privilege log will be produced in a supplemental response.

A disc containing non-privileged materials responsive to data requests 0285, 0286, 0287, 0288, and 0289 will be provided to Staff. The materials are deemed **HIGHLY CONFIDENTIAL** pursuant to 4 CSR 240-2.135.

Additional documentation has also been provided as a response to Data Requests: 0289, 0294, 0295, 0307, 0309, 0310, 0313, 0314, 0315, 0317, 0321, 0322, 0324, 0330, 0331, and 0334.

Attachment:
Q0289 MO Verification.pdf