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Issue:	Revenue Requirement
Witness:	Michael L. Brosch
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Sponsoring Party:	Midwest Energy Consumer's Group
Case No.:	ER-2014-0370
Date Testimony Prepared:	April 2, 2015

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

	)	
In the Matter of Kansas City Power & Light	)	**Case No. ER-2014-0370**
Company's Request for Authority to	)	Tariff No. YE-2015-0195
Implement A General Rate Increase for	)	
Electric Service	)	

Direct Testimony and Schedules of

Michael L. Brosch

Revenue Requirement

On behalf of

Midwest Energy Consumers' Group

April 2, 2015

BEFORE THE PUBLIC SERVICE COMMISSION
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In the Matter of Kansas City Power & Light Company's Request for Authority to Implement A General Rate Increase for Electric Service	)))))	**Case No. ER-2014-0370** Tariff No.YE 2015-0195

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In the Matter of Kansas City Power & Light Company's Request for Authority to Implement A General Rate Increase for Electric Service	)))))	**Case No. ER-2014-0370** Tariff No. YE-2015-0195

Direct Testimony of Michael L. Brosch

Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A My name is Michael L. Brosch. My business address is PO Box 481934, Kansas City, Missouri 64148.

Q WHAT IS YOUR PRESENT OCCUPATION?

A I am the President of the firm Utilitech, Inc., a consulting firm engaged primarily in utility rate and regulation work. The firm's business and my responsibilities are related to special services work for utility regulatory clients. These services include rate case reviews, cost of service analyses, jurisdictional and class cost allocations, financial studies, rate design analyses and focused investigations related to utility operations and ratemaking issues.

Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A I am appearing on behalf of the Midwest Energy Consumer's Group ("MECG"). Utilitech, Inc. was engaged by MECG to review and address portions of the rate case revenue requirement and other matters raised by Kansas City Power & Light ("KCPL" or "Company"). Utilitech's work, as sponsored in this testimony, complements the work of other MECG witnesses who will address other elements of the revenue requirement and rate design, including Messrs. Maurice Brubaker, Michael P. Gorman and Lane Kollen.

Q WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A My testimony is responsive to KCPL's proposals for various cost tracking mechanisms or "trackers" for property tax expenses, vegetation management expenses and certain critical infrastructure and cybersecurity expenses. In addition, my testimony explains several income tax expense and accumulated deferred income tax issues associated with the KCPL revenue requirement. In this regard, I sponsor several ratemaking adjustments to the Company's test year rate base and income tax expenses that are necessary to establish just and reasonable rates. The individual ratemaking adjustments I sponsor have been incorporated into the Schedules that are attached to my testimony. In addition, I intend to submit Direct Testimony responding to KCPL's proposed new tariff to establish a Fuel Adjustment Clause ("FAC") when rate design testimony is scheduled for filing on April 16.

EDUCATION AND EXPERIENCE

Q WHAT IS YOUR EDUCATIONAL BACKGROUND?

A Appendix A to this testimony is a summary of my education and professional qualifications that also contains a listing of my previous testimonies in regulatory proceedings in Missouri and other states.

Q PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE IN THE FIELD OF UTILITY REGULATION.

A My professional experience began in 1978, when I was employed by the Missouri Public Service Commission as part of the accounting department audit staff. While with the Staff from 1978 to 1981, I participated in rate cases involving Kansas City Power and Light Company, Missouri Public Service Company (now part of KCP&L Greater Missouri Operations Company), Southwestern Bell and several smaller Missouri utilities. Since leaving the Commission Staff, I have worked as an independent consultant and have testified before utility regulatory agencies in Arizona, Arkansas, California, Florida, Hawaii, Illinois, Indiana, Iowa, Kansas, Michigan, Missouri, New Mexico, Ohio, Oklahoma, Texas, Utah, Washington, and Wisconsin in regulatory proceedings involving electric, gas, telephone, water, sewer, transit, and steam utilities. I have participated in many electric, gas and telephone utility regulatory proceedings, as listed and described in Appendix A.

EXECUTIVE SUMMARY

Q PLEASE SUMMARIZE YOUR DIRECT TESTIMONY.

A My testimony explains why KCPL does not need and should not be granted the extraordinary rate tracking treatment it has proposed for property taxes, vegetation management and certain critical infrastructure protection ("CIP") and cybersecurity expenses. I describe the generally applied regulatory criteria for such extraordinary regulatory mechanisms and show that the Company has not justified these requests.

My testimony also addresses KCPL's claimed income tax expense and describes the ratemaking adjustments that should be recognized in determining the Company's income tax expenses for the test year. The income tax expense adjustments I sponsor are set forth in my Schedule MLB-1 and have the effect of simplifying and correcting KCPL's flawed utilization of tax straight-line depreciation in several places within the calculation of income tax expenses.

The appropriate level of Accumulated Deferred Income Taxes ("ADIT") to be included in KCPL's rate base is also addressed in my testimony. The ADIT rate base adjustments I sponsor are to include ADIT associated with the Company's Construction Work in Progress investment (Schedule MLB-2), to exclude ADIT amounts where the associated liability accounts have not been included in the Company's rate base (Schedule MLB-3) and to adjust the Company's overstated ADIT estimates for Federal Net Operating Loss carryforwards (Schedule MLB-4).

It is my understanding that the Company's true-up filing will revise certain of the amounts addressed in my adjustments so, on behalf of the MECG, I reserve the right to respond to any KCPL-sponsored changes to income tax expenses and ADIT in rate base at the time true-up evidence is presented.

Q HOW DO THE RATEMAKING ADJUSTMENTS YOU SPONSOR IMPACT THE REVENUE REQUIREMENT BEING PROPOSED BY KCPL?

A. The following table summarizes the approximate revenue requirement impact of the adjustments set forth in Schedule MLB-1 through Schedule MLB-4:

Brosch Ratemaking Adjustments		Rate Base	Operating Income	Revenue Requirement
MLB-1	Income Taxes - Depreciation		$3,433,168	$ (5,572,420)
MLB-2	CWIP-related ADIT	$ (6,573,517)		(670,257)
MLB-3	ADIT Exclusions	(8,322,516)		(848,590)
MLB-4	Net Operating Loss ADIT	(11,323,198)		(1,154,550)

These amounts are based upon the Company's Direct Testimony filing and are subject to revisions when true-up recalculation of the revenue requirement occurs.

KCPL COST TRACKING PROPOSALS

Q PLEASE DESCRIBE KCPL'S PROPOSAL WITH REGARD TO TRACKING OF CHANGES TO CERTAIN EXPENSES THAT OCCURS BETWEEN RATE CASES.

A. The Company has selected several categories of expenses to receive preferential new regulatory treatment. KCPL proposes new "tracking" mechanisms for certain selected types of expenses that are believed to be growing, with deferral accounting that would translate into higher future rates whenever actual tracked expenses increase above the amounts being used to determine the revenue requirement in the pending rate case. Further, to the extent that these costs increase, the deferral of these higher costs will result in higher current earnings since any increased costs would be deferred and recovered in future periods. According to the Direct Testimony of Mr. Heitbrink, "…the Company is proposing four regulatory mechanisms: (1) an FAC which includes recovery of SPP-allocated transmission costs and reflects future volatility in OSS; (2) a property tax tracker; (3) a vegetation management cost tracker; and (4) a tracker for costs associated with critical infrastructure protection and cybersecurity efforts. According to the Company, these mechanisms will improve the Company's ability to address regulatory lag, which will in turn improve the Company's ability to earn the full and fair return authorized by the Commission in this case." Mr. Heitbrink claims that, "[t]he combination of a reasonable allowed return and authorization of our requested regulatory mechanisms to manage regulatory lag will provide the Company a realistic opportunity to earn a return closer to the return authorized by the Commission."[1]

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[1] Direct Testimony of Scott H. Heitbrink, pages 19-20.

Q ARE YOU RESPONDING TO THE COMPANY'S FAC PROPOSAL AT THIS TIME?

A. No. As noted previously, MECG's response to the Company's FAC tariff will be submitted when rate design Direct Testimony is filed on April 16. My testimony at this time will respond to the other three new expense tracking mechanisms being proposed by KCPL for:

- Property Tax Expenses
- Vegetation Management Expenses, and
- Critical Infrastructure Protection / Cybersecurity Expenses

Q IS THERE A COMMON THEME BEHIND THESE EXPENSE TRACKING PROPOSALS?

A Yes. In each instance, KCPL management has selected only specific categories of expense where spending is expected to increase in the future. For example, KCPL witnesses state the following regarding each of the proposed expense tracking mechanisms:

- The Company requests that a property tax tracking mechanism be authorized in this case to ensure the appropriate recovery of rising property tax expenses. Without such a mechanism, the Company expects to continue incurring significant regulatory lag due to increasing property taxes, which in turn impacts the Company's ability to earn returns reasonably close to returns authorized by this Commission.[2]

- Vegetation management expenses have been escalating over recent years as described more fully by Company witness Jamie Kiely. In addition, the Company is proposing to expand its tree trimming activities to address three specific areas that are not currently in the rules for vegetation management, but which will enhance customer reliability.[3]

- Security is a top priority for the Company. KCP&L is committed to and required to comply with the standards set out in CIP V5. The standards to be implemented in 2016 are much more aggressive in broader coverage of the Company's assets supporting the 5 BES. These cyber systems, as they are referenced in the V5, will require additional actions as well as resources for

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[2] Direct Testimony of Darrin R. Ives, page 26-27.
[3] Direct Testimony of Tim M. Rush, page 30.

> both physical and logical protection in support of reliability of the BES. The CIP standards represent only a portion of the Company efforts around strengthening physical and cyber security in protection of the Company's assets. This protection is necessary to ensure KCP&L is positioned to provide services to customers reliably given the emerging threats to the United States and her infrastructure. The cost to comply is undetermined, but is expected to be substantial. The Company has already committed significant resources toward compliance. Going forward, those efforts and resources will be increasing. The Company is asking the Commission to authorize it to establish a tracker for these costs.[4]

In each instance, the types of expense for which KCPL is now proposing continuous regulation through rate tracking mechanisms have historically been evaluated and quantified within traditional test year rate cases. These new tracking mechanism proposals should be carefully evaluated by the Commission to ensure that KCPL is not allowed to select only its increasing costs for tracking between test years, while other more favorable changes to the overall revenue requirement that may occur are ignored and allowed to contribute to the Company's earnings.

Q HAS THE COMPANY ACHIEVED ACCEPTABLE FINANCIAL RESULTS HISTORICALLY?

A Yes. While recently achieved return on equity ("ROE") has been somewhat below Commission-authorized levels for KCPL,[5] the Company has benefited from very supportive Missouri regulation that has approved six significant rate increases since 2006, allowing timely recovery of steadily increasing costs of service. In its Annual Report to Shareholders, Great Plains Energy states:

In 2014, we:

- Raised the dividend for the fourth year in a row;

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4 Id. Page 33.

5 According to KCPL's financial reports within Great Plain's Energy's 2014 SEC Form 10K at pages 54-56, the Company's Net Income was $162.4 million and $169 million in 2014 and 2013, respectively. When compared to average common equity throughout 2014 of $2,227 million, the ROE earned in 2014 was approximately 7.3 percent. Mr. Darrin Ives states in his Direct Testimony, at page 7, that "the earned ROE for KCP&L-Mo was 6.5% in 2013".

- Received credit rating upgrades from two major rating agencies;
- Entered the final stage of an ambitious environmental upgrade at our La Cygne generating station– on schedule and within budget;
- Completed a Kansas abbreviated rate case and filed a KCP&L Missouri general rate case;
- Launched a suite of energy efficiency programs that now benefit all Missouri customers;
- Expanded our renewable energy portfolio; and
- Responded to the greatest number of storms in our service territory in five years without compromising customer reliability.

While shareholders expect management to seek every available mechanism to more quickly increase rates and maximize reported earnings, I would note that these statements within the Company's Annual Report are indicative of a Missouri regulatory regime that is not broken or in need of significant reform and that is supportive of the financial and operational integrity of the State's utilities.[6]

Notably, Missouri regulation does not include the new trackers now being sought for KCPL. Nevertheless, KCPL's sister company Greater Missouri Operations ("GMO") achieved a 2013 ROE of 9.76% and 11.31% for MPS and Light & Power, respectively.[7] Furthermore, I note that there was a great deal of evidence provided in the recent Ameren case regarding Ameren's recent earnings being in excess of its authorized return on equity. Both of these utilities earned these healthy returns without the benefit of several of the trackers now sought by KCPL.

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[6] Along these lines, I note Moody's recent upgrade for GPE in which it noted "The stable outlook for each company incorporates our expectation that ongoing regulatory support of cost recovery and environmental capex ***will continue*** in Missouri and Kansas."

[7] KCPL response to Staff data request 491. This response did not provide ROE data for GMO operations in 2014.

Q HOW HAVE YOU ORGANIZED YOUR TESTIMONY RESPONDING TO THE COMPANY'S PROPOSED EXPENSE TRACKING MECHANISMS?

A My testimony will first explain the traditional treatment of utility operating expenses within test year rate cases as well as the rationale for consistent and internally matched accounting for changes in utility expenses, revenues, rate base investment and cost of capital (the "matching principle"). Then I will describe the policy criteria that should be applied whenever exceptions to traditional ratemaking are proposed, including piecemeal expense tracking proposals of the type recommended by KCPL witnesses. Then, after explaining the proper evaluative criteria for piecemeal cost-tracking mechanisms, I will apply these criteria to each of the Company's proposed cost tracking mechanisms in separate sections of this testimony.

REGULATORY POLICY CONCERNS RAISED BY TRACKERS

Q WHY DOES KCPL CLAIM TO NEED THE PROPOSED NEW TRACKERS FOR PROPERTY TAXES, VEGETATION MANAGEMENT AND CRITICAL INFRASTRUCTURE/CYBERSECURITY EXPENSES?

A As noted above, the Company desires new expense tracking mechanisms where its future expenses are expected to increase following this case. The proposed tracking mechanisms are intended to defer increased costs into a future rate case and, thus, secure incremental revenue increases in that case beyond the amounts available through normal rate case processes. Since these increased costs are not considered in the current period, this also has the effect of improving current earnings and increasing future revenues. Several KCPL witnesses explain the perceived need for the new tracking mechanisms by referring to earnings shortfalls experienced in prior years and the expectation of higher costs in the future, when the proposed trackers would be implemented.[8]

Q. WHAT IS THE PRIMARY STANDARD BY WHICH TRACKERS SHOULD BE JUDGED IN MISSOURI?

A. In its recent decision in Case No. EU-2014-0077, the Commission determined that trackers are only appropriate to address extraordinary costs; that is costs that are "unusual and infrequent" occurrences. As the Commission held:

> In Missouri, rates are normally established based off of a historic test year. The courts have stated than an AAO allows the deferral of a final decision on current *extraordinary* costs until a rate case and therefore is not retroactive ratemaking. Consistent with the language in General Instruction No. 7, the Commission has evaluated the transmission costs for which Companies seek an AAO to determine if they are an unusual and infrequent occurrence. The Commission concludes they are not.[9]

In any instances where a proposed tracking mechanism satisfies this primary standard established by the Commission, I describe in the testimony that follows additional regulatory policy criteria that should also be applied.

Q WHEN HAS THE COMMISSION TYPICALLY ALLOWED DEFERRAL ACCOUNTING?

A The Commission has granted deferral accounting, under a tracker or an accounting authority order, for costs that are incurred as a result of: (1) an Act of God or (2) new legislation or rules. For instance, in regards to the former, the Commission has allowed deferral accounting for costs incurred by the utility in responding to ice storms, tornadoes and floods. As to the latter, the Commission has allowed deferral

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8 See Direct Testimony of Scott Heidtbrink, pages 14-16; Direct Testimony of Darren Ives, pages 7, 10-12, 18 and 26-30 and Direct Testimony of Tim Rush, pages 5-8 and 27-34.

9 Case No. EU-2014-0077, *Report and Order*, issued July 30, 2014, at page 10.

accounting for costs associated with new legislation and rules, including gas pipeline replacement rules and the vegetation management rule promulgated about five years ago. In both cases, extraordinary costs were incurred that were otherwise not already included in the utility's cost of service.

Q. ARE PREDICTIONS OF HIGHER FUTURE EXPENSE LEVELS A REASONABLE BASIS FOR CREATING NEW REGULATORY TRACKING MECHANISMS BETWEEN RATE CASE TEST YEARS?

A No. The Missouri regulatory paradigm envisions that recurring costs, even those that are expected to increase, will be addressed in a rate case. While I am not an attorney, I understand that trackers and other deferral mechanisms, not explicitly authorized within the context of Section 386.266, are limited solely to extraordinary events.

Q. IS THERE ANOTHER REASON WHY COSTS THAT ARE EXPECTED TO INCREASE IN THE FUTURE SHOULD <u>NOT</u> BE SUBJECTED TO REGULATORY TRACKING AND FUTURE RECOVERY?

A Yes. The many diverse elements of electric utility revenue requirements are constantly changing between test years. Some utility costs increase while others decline. New investments are made to replace aging or obsolete utility plant assets, which can favorably impact maintenance costs or can inject new technologies and efficiencies into utility operations. Between test years, customers can be added or can modify their load and revenue levels significantly, particularly in times of economic growth.[10] In recent years, historically low interest rates have allowed

[10] The Company provided an update to its MWH load growth forecast in its Highly Confidential response to MECG data request 14-10.

electric utilities to refinance long term debt at attractive cost rates to reduce their overall revenue requirement. Any attempt to isolate and track selected costs that are expected to increase, while ignoring the other continuous changes in the utility's revenue requirement elsewhere that may offset such cost increases opens the regulatory system up to gaming and excessive rates. The isolation of only cost increases for regulatory tracking and future recovery creates a problem of "piecemeal ratemaking" that destroys the essential balance and "matching" of costs and revenues that is performed by measuring all of the elements of the test year revenue requirement at the same point in time and in a balanced manner in formal rate cases.

Q CAN YOU CITE ANY SPECIFIC EXAMPLES OF SIGNIFICANT COST REDUCTIONS THAT KCPL HAS EXPERIENCED HISTORICALLY AND EXPECTS TO EXPERIENCE IN THE FUTURE THAT HAVE HELPED TO OFFSET INFLATIONARY PRESSURES UPON THE BUSINESS?

A Yes. The Company has been able to refinance long term debt, achieving substantial savings in interest expense. Similarly, KCPL expects to realize future cost savings when certain currently outstanding debt matures and is refinanced. I have included in Schedule MLB-5 a copy of KCPL responses to MECG Data Requests 11-11 and 11-12 that provide information regarding cost savings from refinancing activities. Since 2008, according to MECG 11-11, a series of long term debt refinancing activities have produced interest savings for KCPL totaling more than $11 million annually. According to MECG 11-12, estimated annual interest expense savings of about $1.6 million could be achieved from identified future refinancing opportunities.

Other costs savings programs have been implemented by KCPL that have produced ongoing and significant realized savings in the past several years. These programs are explained within KCPL's Highly Confidential response to MECG 1-9, which is included within my Schedule MLB-6.

It is important to remember that, under the Missouri ratemaking paradigm and as explained below, KCPL kept all of these savings until a future case was completed to recognize the reduction in costs.

Q WHAT ARE THE PARTS OF TRADITIONAL TEST YEAR RATEMAKING THAT A UTILITY AVOIDS THROUGH PIECEMEAL RATEMAKING?

A. Traditional regulation of energy utilities involves the conduct of formal rate cases, in which the utility selects a test year and presents a calculation of its desired revenue requirement, including operating expenses, depreciation and taxes, plus a rate of return applied to a rate base measure of invested capital. The key characteristics of traditional rate case regulation include:

- A **test year**, in which all of the components of the revenue requirement are holistically analyzed and quantified in a balanced and internally consistent manner with appropriate "matching" of costs and revenues.
- Utilization of regulatory lag as an **efficiency incentive** which financially rewards the utility for achieved cost reductions, by allowing it to keep those savings until the next case, and punishes the utility, through reduced earnings, when costs increase more rapidly than revenues between test years.
- Application of **regulatory rules** to the analysis of revenue requirement components, including prescribed adjustments, minimum filing requirements, and adherence to past rate orders and policies.
- A detailed **formal filing** with testimony and exhibits supportive of the asserted revenue requirement.

- Updated quantification of input data, employing a **holistic measurement** of changing revenue requirements, which in Missouri includes a true-up of all individually significant elements of the revenue requirement,
- An opportunity for **prudence review** of management actions or inaction that may have contributed to unreasonable recorded costs.
- **Procedural provisions** for discovery and critical analysis of test year data submitted by the utility, and for litigation of disputed issues.
- **Comprehensive Review** of utility filings, discovery and submission of testimony and exhibits by Commission Staff and consumer intervenors.
- **Regulatory costs** are dedicated to support these more formal procedures.

The fundamental concept behind traditional utility regulation is that, in the absence of competitive markets to determine pricing for an essential public service, just and reasonable utility rates should be determined based primarily upon careful measurement of the utility's prudently incurred costs to provide such monopoly services.

Q DOES COST-BASED TEST-YEAR REGULATION CAUSE THE PUBLIC UTILITY TO BE COMPLETELY INDIFFERENT ABOUT ITS COST LEVELS?

A No. As mentioned, an important element of traditional test period regulation is the incentive created for management to control and reduce costs, so as to maximize the opportunity to actually earn at or above the authorized return level between rate cases. Traditional test year regulation is not continuous regulation, because prices established in a rate case are normally fixed for a period of years. Changes in actual costs or sales levels between rate cases can increase or decrease a utility's profit levels before such changes can be translated into revised prices after a “next” rate case. This passage of time between rate cases, commonly referred to as “regulatory lag,” serves as an efficiency incentive and moderates the counter-incentive that results when prices are based upon costs to serve.

Another beneficial characteristic of traditional test year regulation is the intensive focus upon utility operations and costs within a formal proceeding in which Commission Staff and other interested parties can carefully examine or audit the components making up the revenue requirement. The potential for regulatory disallowance of excessive or imprudently incurred costs in such formal proceedings represents another form of efficiency incentive to management.

Q HOW DOES USE OF A TRACKING MECHANISM FOR SPECIFIC TYPES OF UTILITY COSTS IMPACT THE INCENTIVES FOR MANAGEMENT TO CONTROL THE TRACKED COST?

A A tracking mechanism for a specific cost eliminates the regulated lag incentive that would normally serve to encourage efficiency and cost control between rate cases. If every dollar of a tracked type of cost is eligible for deferral and future rate recovery, management can afford to be less concerned about efficiency and the aggressive pursuit of cost containment for that type of cost and can be expected to focus attention on other areas of the business where earnings will be impacted by cost changes. In fact, if the pursuit of new efficiencies in connection with a tracked cost involves any significant risks or the incurrence of other costs that are <u>not</u> tracked, rational business behavior would discourage the pursuit of such efficiencies.

Q DOES THE INSTALLATION OF NEW COST TRACKING MECHANISMS ADD TO THE COMMISSION'S REGULATORY RESPONSIBILITIES AND RESOURCE COMMITMENTS?

A Yes. Each new cost tracking mechanism imposes additional regulatory burdens upon the Commission, its Staff, and concerned intervenors, through the creation of incremental monthly cost deferral accounting entries with carrying charges that should be rigorously analyzed for accuracy and prudence before being converted into incremental future rate increases. However, while increasing the burden, the incremental regulatory resources required for this needed critical analysis is often limited.

Q ARE THERE ANY SITUATIONS WHERE MISSOURI'S TRADITIONAL TEST YEAR RATEMAKING APPROACH TO THE REGULATION OF ELECTRIC UTILITIES SHOULD BE MODIFIED?

A Yes. There can be extraordinary circumstances where traditional test year ratemaking should be supplemented with cost tracking mechanisms. One instance can be for net energy costs, including fuel and purchased power costs less off-system sales, where the legislature has permitted the use of a Fuel Adjustment Clause ("FAC") mechanism to track and recover or return changes in net energy costs that occur between test years. The Commission has reviewed requests for FAC approval and, after applying certain evaluative criteria, has approved FACs for several Missouri electric utilities. As noted above, KCPL has requested an FAC tariff and my responsive testimony with regard to this proposal will be submitted in the rate design phase of this Docket.

Additionally, there can be unusual and infrequently occurring large and volatile costs, other than net energy costs, incurred by utilities where traditional test year ratemaking may be incapable of producing reasonable results that properly balance the interests of the utility and its ratepayers. For example, the Commission has granted expense tracking treatment for the extraordinary costs incurred by electric utilities in Missouri after the Commission implemented vegetation management rules and for the extraordinary costs incurred by gas utilities to comply with the Commission's gas safety rules.[11]

Q YOU HAVE IDENTIFIED THE PRIMARY CRITERIA USED BY THE COMMISSION IN GRANTING TRACKING MECHANISMS OUTSIDE OF RATE CASES FOR <u>ONLY</u> EXTRAORDINARY COSTS THAT ARE UNUSUAL AND INFREQUENTLY OCCURRING. ARE THERE ADDITIONAL POLICY CRITERIA THAT REGULATORY COMMISSIONS HAVE EMPLOYED TO EVALUATE THE NEED FOR TRACKING MECHANISM TREATMENT OF CERTAIN UTILITY COSTS?

A. Yes. Cost tracking mechanisms should be approved <u>only</u> in instances where compelling circumstances justify departure from traditional test period review of all test year costs and revenues within rate case proceedings in which the overall revenue requirement can be audited and considered in a balanced and synchronized manner. This concept is embodied in the Commission's decision in Case No. EU-

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[11] Regarding electric utilities, following extensive storm related service outages in 2006, the Commission promulgated new rules designed to compel Missouri's electric utilities to do a better job of maintaining their electric distribution systems. Those rules, entitled Electrical Corporation Infrastructure Standards 4 CSR 240-23.020 and Electrical Corporation Vegetation Management Standards and Reporting Requirements 4 CSR 240-23.030 became effective on June 30, 2008. In ER-2008-0318, the Commission allowed Ameren UE to recover $54.1 million in its base rates for vegetation management costs, and $10.7 million for infrastructure inspection costs. However, since the rules were new, the Commission found that Ameren UE had too little experience to reasonably know how much it would need to spend to comply with the vegetation management and infrastructure inspection rules. Because of that uncertainty, the Commission established a two-way tracking mechanism to allow Ameren UE to track its vegetation management and infrastructure costs. In ER-2010-0036, the vegetation management tracker for Ameren UE was continued until more experienced was gained under the Commission's new rule. See *Report and Order*, May 28, 2010, Ameren UE ER 2010-0036, 58-65.

2014-0077, quoted above. In addition to the Commission's primary criteria, I recommend that costs or revenue changes to be deferred or tracked through a rider should also have <u>all</u> of the following attributes to merit such exceptional and preferential rate recovery treatment:

1. Substantial enough to have a material impact upon revenue requirements and the financial performance of the business between rate cases.
2. Beyond the control of management, where utility management has little influence over experienced revenue or cost levels.
3. Volatile in amount, causing significant swings upward and downward in income and cash flows if not tracked.
4. Straightforward and simple to administer, readily audited and verified through expedited regulatory reviews.
5. Balanced, such that any known factors that mitigate cost impacts are accounted for in a manner that preserves test year matching principles.

In the testimony that follows, I will discuss the facts associated with each of KCPL's proposed new cost tracking mechanisms and subject the proposals to these criteria, to support my recommendation regarding whether the proposals should be approved by the Commission.

PROPERTY TAX TRACKER PROPOSAL

Q PLEASE DESCRIBE THE COMPANY'S PROPOSAL WITH RESPECT TO A TRACKING MECHANISM FOR CHANGES IN PROPERTY TAX EXPENSES BETWEEN TEST YEARS.

A KCPL argues that a tracker is appropriate for the Company's property tax expenses. According to Mr. Ives, "Property tax expenses have been escalating over the past five years as described more fully by Company witness Ronald Klote. Property taxes are determined by Missouri state assessors, are a significant component of the Company's cost of service, and amounts assessed are out of the control of the Company to manage."[12] Mr. Rush repeats these arguments and states, "We propose that annual property tax expenses, as defined in this tracker, be set in this rate proceeding at the expense level determined in the true-up in this case. The Company would then track its actual property tax expenses on an annual basis against this amount, with the Missouri jurisdictional portion of any excess treated as a regulatory asset (Account 182) and the Missouri jurisdictional portion of any shortfall treated as a regulatory liability (Account 254).[13]

Q IS KCPL'S PAYMENT OF PROPERTY TAXES AN UNUSUAL OR INFREQUENT OCCURRENCE?

A No. The Company pays property taxes every year in the normal course of business.

Q ARE THE COMPANY'S PROPERTY TAX EXPENSES AN INDIVIDUALLY LARGE COMPONENT OF TOTAL ANNUAL EXPENSES OR ANNUAL REVENUES?

A No. For the year 2014, a total of $88.4 million of Kansas and Missouri property taxes were billed to KCPL.[14] In relation to Total Operating Expenses, as reported by KCPL in SEC Form 10K for 2014 of $1,380.7 million, property taxes represented about 6.4 percent of overall expenses. In relation to total Electric Revenues, as reported by KCPL in SEC Form 10K for 2014 of $1,730.8 million, property taxes represented

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12 Direct Testimony of Darrin R. Ives, page 27.
13 Direct Testimony of Tim Rush, page 28.
14 KCPL response to Staff Data Request 104R, Part 4 Attachment.

about 5.1 percent of overall electric revenues.[15] These relationships illustrate the limited contribution of property taxes to the Company's overall costs and revenues are relatively unchanged in each of the last three years, 2012 through 2014. Even if five or six percent of the overall cost of service is viewed as significant, the complete absence of volatility in this expense argues against tracker treatment.

Q AT THESE LEVELS, ARE PROPERTY TAXES SUBSTANTIAL ENOUGH TO HAVE A MATERIAL IMPACT UPON REVENUE REQUIREMENTS AND THE FINANCIAL PERFORMANCE OF THE BUSINESS BETWEEN RATE CASES?

A No. Given the limited overall amount of expense involved, as a percentage of overall costs and revenues, property taxes in isolation would not be reasonably expected to adversely impact the Company's future financial stability or access to capital on reasonable terms. Moreover, given the predictable nature of when increased property taxes will occur, they can be reasonably addressed in traditional rate cases, where these taxes have been handled in previous Missouri rate case proceedings.

Q ARE THE LEVELS OF KCPL'S PROPERTY TAXES VOLATILE FROM YEAR TO YEAR?

A No. The following graph illustrates the Company's actual property taxes payable in both Kansas and Missouri from 2009 through 2014:

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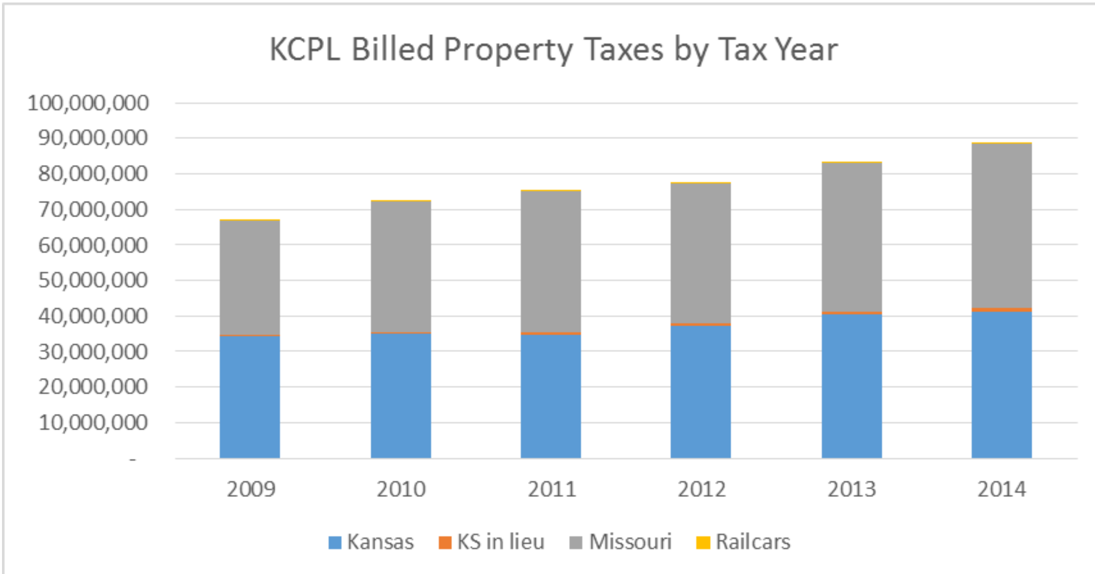
[15] Great Plains Energy Incorporated, Kansas City Power & Light Company SEC Form 10K for year ended December 31, 2014, page 54. Some of the Company's incurred property tax costs are recorded to accounts other than Operating Expenses.

Table 1: KCPL Property Tax Costs by Year [16]



This data clearly shows the relative stability and predictability of historical property tax levels experienced by KCPL. The Company has experienced gradual, single digit percentage increases in this expense from year to year, rather than any volatility or extreme levels of change in any recent year.

Q ARE KCPL'S PROPERTY TAXES BEYOND THE CONTROL OF MANAGEMENT, WHERE UTILITY MANAGEMENT HAS LITTLE INFLUENCE OVER EXPERIENCED COST LEVELS?

A Property tax assessments and mill levy rates are largely, but not completely beyond the control of utility management. There are a number of periodic filings and opportunities for property tax corrections and exemptions that KCPL management must prudently administer.[17] KCPL dedicates significant personnel time, including one full-time experienced tax accountant, to "…proactively ensure that the Company's property tax compliance is well managed and that the Company pays the

[16] Derived from KCPL responses to MECG 2-18 and Staff 104R. See Brosch Workpapers.
[17] Contracts governing Payments in Lieu of Tax ("PILOT") for wind facilities exempted from property taxation are discussed in the Direct Testimony of Ronald Klote at pages 74-75.

minimum amount of its legally owed property tax in conformity with current tax laws and regulations." Errors have been noted in property tax bills and, "[o]ver the past five years, KCPL has verbally communicated errors in tax bills significantly exceeding $1 million, for which all bills were subsequently re-billed correctly prior to payment." These management efforts to oversee and control property tax costs are described in additional detail within the Company's responses to MECG data requests 2-18 and 11-6, which are included within Schedule MLB-7 attached to this testimony. One would question whether KCPL would be willing to take such steps if it was guaranteed recovery of all property tax increases.

Q WOULD A TRACKING MECHANISM FOR KCPL'S PROPERTY TAXES BE STRAIGHTFORWARD AND SIMPLE TO ADMINISTER, READILY AUDITED AND VERIFIED THROUGH EXPEDITED REGULATORY REVIEWS?

A Yes. In isolation, a property tax tracking mechanism would not be particularly difficult to audit and verify, although some administrative cost would be incurred because of the large number of taxing jurisdictions that are involved and the potential for corrections and revisions to individual tax bills in each year. From an accounting perspective, property taxes represent discrete payments that can be readily isolated for verification and would therefore not require complex analysis to isolate any labor, benefits and other costs embedded in base rates to avoid double recoveries. However, the incremental costs to the utility and the Commission Staff, as well as the effort and cost involved if any disputes arise, argue against adding such a tracking mechanism to the Missouri regulatory regime unless a financial need for such a tracker is proven.

Q WOULD A TRACKING MECHANISM FOR CHANGES IN PROPERTY TAXES BETWEEN TEST YEARS BE APPROPRIATELY BALANCED, SUCH THAT ANY KNOWN FACTORS THAT MITIGATE COST IMPACTS ARE ACCOUNTED FOR IN A MANNER THAT PRESERVES TEST YEAR MATCHING PRINCIPLES?

A Yes. Property taxes do not, when paid, create any foreseeable opportunity for offsetting cost savings, operational efficiencies or other benefits to KCPL that must be identified and recognized as an offset to any recorded cost deferrals.

Q CONSIDERING EACH OF THE CRITERIA YOU HAVE RECOMMENDED FOR EXTRAORDINARY REGULATORY TREATMENT OF SPECIFIC TYPES OF COSTS, SHOULD KCPL'S PROPERTY TAX EXPENSES BE GRANTED THE TRACKING MECHANISM TREATMENT THAT IS PROPOSED BY THE COMPANY?

A No. As described above, property tax expenses incurred by KCPL are normal and ongoing annual expenses that are not sufficiently large and volatile to merit extraordinary expense tracking treatment. Additionally, KCPL management exercises some control over property tax expenses and the incentive for ongoing cost control efforts and costs would be blunted if expense tracker treatment was implemented.

VEGETATION MANAGEMENT TRACKER PROPOSAL

Q PLEASE DESCRIBE THE COMPANY'S PROPOSAL WITH RESPECT TO A TRACKING MECHANISM FOR CHANGES IN VEGETATION MANAGEMENT EXPENSES BETWEEN TEST YEARS.

A KCPL proposes in Mr. Rush's testimony that, "…a vegetation management tracking mechanism be authorized in this case to ensure the appropriate recovery of rising expenses and to help better manage the cyclical nature of tree-trimming throughout the service territory as well as in the Kansas and GMO rate jurisdictions, where we will also seek authority to implement vegetation management cost trackers. Use of a tracker for vegetation management costs will enable the Company to schedule and perform this work in the most efficient manner by, for example, concentrating resources and efforts on a particular portion of the service territory, while still meeting all requirements, without creating the perception that the Company is spending a vegetation management rate allowance for one rate jurisdiction on vegetation management efforts in a different rate jurisdiction. Without a vegetation management tracker, the Company would tend to spread the work ratably over each rate jurisdiction which is likely not the most efficient way to accomplish this work."[18]

The mechanics of the proposed vegetation management tracker would be similar to the property tax tracker proposal described above. According to Mr. Rush, "[w]e propose that annual vegetation management expenses, as defined in this tracker, be set in this rate proceeding at the expense level determined in the true-up in this case. The Company would then track its actual vegetation management expenses on an annual basis against this amount, with the Missouri jurisdictional portion of any excess treated as a regulatory asset (Account 182) and the Missouri jurisdictional portion of any shortfall treated as a regulatory liability (Account 254)."[19]

Q WHAT REASONS ARE STATED BY KCPL WITNESSES TO JUSTIFY IMPLEMENTATION OF EXTRAORDINARY TRACKER TREATMENT OF VEGETATION MANAGEMENT EXPENSES?

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[18] Direct Testimony of Tim Rush, page 29-31.

[19] Id.

A Mr. Rush argues that a Vegetation Management tracker is appropriate for KCPL because, "…[v]egetation management expenses have been escalating over recent years as described more fully by Company witness Jamie Kiely. In addition, the Company is proposing to expand its tree trimming activities to address three specific areas that are not currently in the rules for vegetation management, but which will enhance customer reliability."[20]

Q DOES KCPL INCUR VEGETATION MANAGEMENT EXPENSES ON A RECURRING BASIS EACH YEAR IN THE ORDINARY COURSE OF BUSINESS?

A Yes.

Q ARE THE COMPANY'S VEGETATION MANAGEMENT EXPENSES AN INDIVIDUALLY LARGE COMPONENT OF TOTAL ANNUAL EXPENSES OR ANNUAL REVENUES?

A No. For the year 2014, a total of $15.0 million of Kansas and Missouri vegetation management contractor charges were billed to KCPL.[21] In relation to Total Operating Expenses, as reported by KCPL in SEC Form 10K for 2014 of $1,380.7 million, vegetation management contractor costs represented about 1.1 percent of overall expenses. In relation to total Electric Revenues, as reported by KCPL in SEC Form 10K for 2014 of $1,730.8 million, vegetation management costs represented less than one percent of overall electric revenues.[22]

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[20] Id.page 30.
[21] KCPL response to MECG Data Request 2-19 and Staff Data Request 187 Attachments.
[22] Great Plains Energy Incorporated, Kansas City Power & Light Company SEC Form 10K for year ended December 31, 2014, page 54.

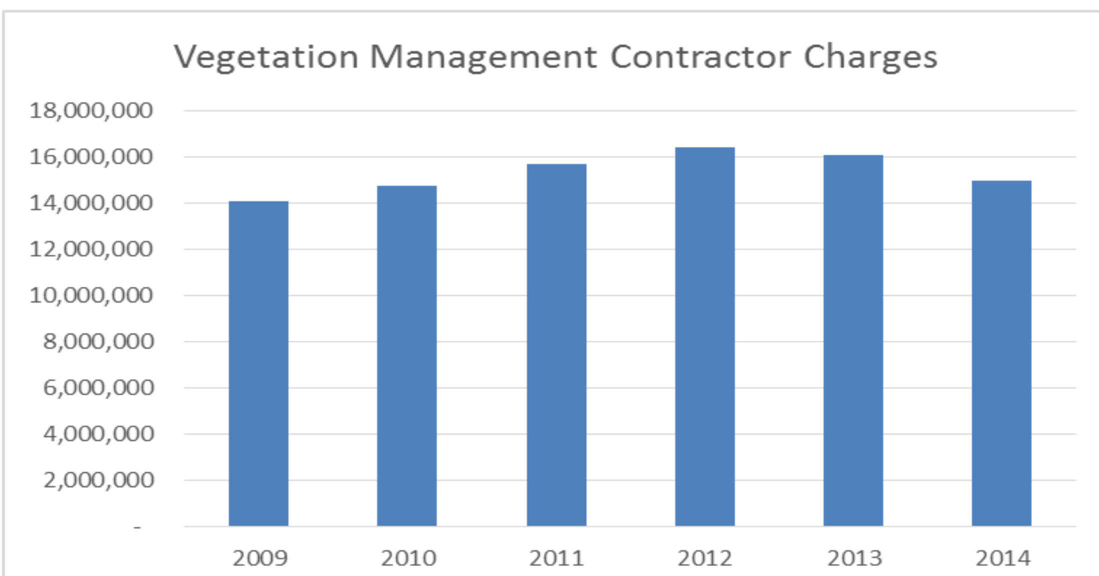
Q AT THESE LEVELS, ARE VEGETATION MANAGEMENT EXPENSES SUBSTANTIAL ENOUGH TO HAVE A MATERIAL IMPACT UPON REVENUE REQUIREMENTS AND THE FINANCIAL PERFORMANCE OF THE BUSINESS BETWEEN RATE CASES?

A No. Given the modest overall amount of expense involved, as a percentage of overall costs and revenues, vegetation management costs in isolation would not be expected to adversely impact the Company's future financial stability or access to capital on reasonable terms.

Q ARE THE LEVELS OF KCPL'S VEGETATION MANAGEMENT COSTS VOLATILE FROM YEAR TO YEAR?

A No. The following graph illustrates the Company's actual vegetation management charges from 2009 through 2014:

Table 2: KCPL Vegetation Management Costs by Year [23]



This data clearly shows the lack of variability within KCPL's historical vegetation management contractor costs. The Company has experienced modest amounts of

[23] Derived from KCPL responses to MECG 2-19 and Staff 187. See Brosch Workpapers.

fluctuation in this expense from year to year, rather than any volatility or extreme levels of change in any recent year.

Q ARE KCPL'S VEGETATION MANAGEMENT COSTS BEYOND THE CONTROL OF THE UTILITY, SUCH THAT MANAGEMENT HAS LITTLE INFLUENCE OVER EXPERIENCED COST LEVELS?

A No. Utility management has considerable control and discretion over vegetation management spending and can favorably impact such costs through efficient scheduling of work and the development of enhanced vegetation management programs. The ability to plan and control these costs is evident from points described in Mr. Kiely's testimony, where he provides, "…an overview of KCP&L's plan to ensure continued safe, efficient, and reliable supply of electric power by mitigating Vegetation Management ("VM") risk by: 1) implementing an ash tree mitigation plan due to Emerald Ash Borer ("EAB") infestation, 2) expanding the VM program to include triplex circuits, and 3) aligning trim cycles for the Urban and Rural areas to four years."[24] The details discussed throughout Mr. Kiely's direct testimony provide ample evidence of the ability and intention of KCPL management to carefully plan and control VM spending.

Q WOULD A TRACKING MECHANISM FOR KCPL'S VEGETATION MANAGEMENT COSTS BE STRAIGHTFORWARD AND SIMPLE TO ADMINISTER, READILY AUDITED AND VERIFIED THROUGH EXPEDITED REGULATORY REVIEWS?

A Yes. In isolation, a vegetation management contractor cost tracking mechanism that is limited to specific VM contractor charges would not be particularly difficult to audit and verify. However, the incremental costs to the utility and the Commission Staff, as

[24] Direct Testimony of James S. Kiely, page 2.

well as the effort and cost involved if any disputes arise in connection with the mechanism, argue against adding such a tracking mechanism to the Missouri regulatory regime unless a financial need for such a tracker is proven.

Q WOULD A TRACKING MECHANISM FOR CHANGES IN VEGETATION MANAGEMENT BETWEEN TEST YEARS BE APPROPRIATELY BALANCED, SUCH THAT ANY KNOWN FACTORS THAT MITIGATE COST IMPACTS ARE ACCOUNTED FOR IN A MANNER THAT PRESERVES TEST YEAR MATCHING PRINCIPLES?

A No. Systematically increased spending on vegetation management can be expected to produce operational benefits and savings. Reducing vegetation contact with distribution facilities can be expected to reduce outage frequency and response costs. Storm restoration costs can be reduced as a result of systematic vegetation clearing efforts that reduce the amount of tree limbs falling upon electric facilities during ice and wind events, while also simplifying restoration efforts by requiring less emergent vegetation work as part of storm outage restoration. Because there are economic benefits reasonably expected to result from more expansive vegetation management efforts, piecemeal tracking of only the changes in vegetation management costs incurred, while ignoring any resulting benefits, may not achieve a reasonable balancing of interest between ratepayers and shareholders.

Q IS KCPL FULLY ABLE TO PURSUE A MORE EXPANSIVE VEGETATION MANAGEMENT EFFORT IF NEEDED, WITHOUT AN EXTRAORDINARY COST TRACKING MECHANISM FOR ANY INCREASING COSTS THAT MAY BE INCURRED?

A Yes. Utility management has discretion to prioritize the allocation of its resources among competing opportunities to reduce cost and improve service quality. The Company can proceed with its plans for all new initiatives that are operationally and economically feasible. If such efforts involved added future costs, I am aware of no impediment to KCPL's ability to seek and recover its prudently incurred costs within future rate case proceedings.

Q CONSIDERING EACH OF THE CRITERIA YOU HAVE RECOMMENDED FOR EXTRAORDINARY REGULATORY TREATMENT OF SPECIFIC TYPES OF COSTS, SHOULD KCPL'S VEGETATION MANAGEMENT EXPENSES BE GRANTED THE TRACKING MECHANISM TREATMENT THAT IS PROPOSED BY THE COMPANY?

A No. Vegetation management expenses incurred by KCPL are normal, ongoing expenses for any electric utility. The Company's vegetation management expenses are also not sufficiently large and volatile that they merit extraordinary expense tracking treatment. Additionally, KCPL management exercises considerable control over vegetation management expenses and any increased spending in this area may produce efficiencies and cost savings that would be difficult to identify and quantify as a needed offset to tracked vegetation management expense changes.

<u>CRITICAL INFRASTRUCTURE / CYBER TRACKER</u>

Q WHAT IS PROPOSED BY KCPL WITH RESPECT TO A TRACKING MECHANISM FOR CRITICAL INFRASTRUCTURE AND CYBERSECURITY COSTS?

A According to Mr. Rush, "[t]he Company requests that a CIP tracking mechanism be authorized in this case to ensure recovery of costs necessary to address the government mandated requirements regarding security of cyber assets essential to the reliable operation of the electric grid." He explains some background information regarding the regulatory framework for Critical Infrastructure Protection ("CIP") and states that a new security standard identified as "CIP V5" is to be "effective April 1, 2016." Mr. Rush indicates that "the CIP standards represent only a portion of the Company efforts around strengthening physical and cybersecurity in protection of the Company's assets" and that "[t]he cost to comply is undetermined, but is expected to be substantial" and that the "Company has already committed significant resources toward compliance."[25]

Q HAS THE COMPANY DEFINED WITH ANY SPECIFICITY EXACTLY WHAT INCREMENTAL FUTURE COSTS WOULD BE ELIGIBLE FOR TRACKING THROUGH THE NEW MECHANISM THAT IS BEING PROPOSED?

A No. The proposed tracking mechanism is open ended and Mr. Rush simply states, "[t]he cost to comply is undefined at this time, but will be substantial" and that "KCP&L is working diligently to develop an overall plan….[t]he plan is to establish an amount reflecting personnel hired directly attributable to the CIP in the true-up and also include any defined costs that may have already been incurred."[26] In its supplemental response to MECG Data Request 2-20, the Company stated, "The CIP/Cyber tracker is for incremental O&M dollars, labor & non-labor, spent to meet regulatory requirements for protection of critical infrastructure, inclusive of NERC, DOE, NRC, etc. or Cyber Security needs. These regulatory obligations, such as NER CIP Standards, are publicly available, and subject to federal audits with potential civil penalties assessed or mandated actions ordered to achieve compliance. Cyber

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25 Direct Testimony of Tim Rush, pages 31-33.
26 Id. page 33.

Security needs are driven by many government entities as well as industry best practices."

Q HAS KCPL INCURRED ANY COSTS HISTORICALLY TO MAINTAIN PHYSICAL SECURITY AT ITS CRITICAL FACILITIES AND TO ENSURE THE SECURITY OF ITS AUTOMATIC SYSTEMS?

A Yes. The response to MECG data request 2-20S provided the Company's historical incurred CIP-Cyber costs. The highest level of annual spending in the past was in 2014, when non-labor expenses totaled $4.1 million, labor expenses totaled $1.0 million and cumulative capitalized costs exceeded $13.6 million.[27]

Q DOES THE COMPANY INCUR INFRASTRUCTURE PROTECTION AND CYBERSECURITY COSTS IN THE NORMAL COURSE OF BUSINESS?

A Yes. These types of costs are not unusual or infrequently incurred. The Company has incurred costs to secure its facilities and automated systems and to comply with established security standards for many years.

Q DOES THIS RATE CASE REPRESENT AN OPPORTUNITY FOR THE COMPANY TO RECOVER INCREASED STAFFING, CAPITAL INVESTMENT AND NON-LABOR EXPENSES TO COMPLY WITH RECENTLY EXPANDED CIP AND CYBERSECURITY NEEDS?

A Yes. The increased actual costs incurred in 2014 and the urgency regarding new efforts and costs expected to be incurred in 2015, in preparation for the April 1, 2016 V5 implementation deadline, should provide a meaningful opportunity for much of the Company's compliance efforts to be captured within the true-up of costs scheduled

[27] KCPL response to MECG data request 2-20B.

for this rate case proceeding. Additionally, any capitalized costs arising from expanded security requirements will be recorded within the Company's Plant in Service for consideration in rate base in the pending rate case and future rate cases.

Q RECOGNIZING THE SUBSTANTIAL UNCERTAINTY REGARDING FUTURE COMPLIANCE COSTS, HAS THE COMPANY PROVIDED ANY ESTIMATES OF ITS EXPECTED FUTURE EXPENSE LEVELS FOR CIP AND CYBER-SECURITY?

A Yes. The Company's response to MECG data request 2-20 part D provided cost projections for CIP and Cybersecurity activities that can be summarized as follows:

Table 3: KCPL Projected Critical Infrastructure Protection / Cybersecurity Costs

Forecasted Costs:	2015	2016	2017
Non-Labor O&M	$ 8,541,288	$ 8,295,878	$ 6,752,557
Labor O&M	3,152,125	4,603,025	4,929,085
Capital Investment	12,932,083	5,129,262	6,205,815
Total Estimate	$ 24,625,495	$ 18,028,166	$ 17,887,458

These projections reveal several facts that illustrate why a tracking mechanism is inappropriate for the Company's CIP and Cybersecurity costs:

- After ramping up hiring in 2015, the forecasted labor O&M expenses are relatively stable in subsequent years. Thus, the Company could hire any needed new employees and secure base rate recovery of the resulting labor costs within the May 31, 2015 true-up in this rate case, rather than attempting to isolate the future "new" employee and labor hours for these activities, versus other employee activities.
- Much of the planned spending is for new capital investment, which would fall outside the Company's proposed O&M tracking mechanism and would be includable in future test year rate base calculations, allowing recovery of return and depreciation expenses prospectively.

- The forecasted non-labor O&M expenses are not individually large or volatile, such that extraordinary regulatory tracker treatment is justified.

Q HOW DO THE COMPANY'S RECENT ACTUAL OR EXPECTED FUTURE CIP AND CYBERSECURITY EXPENSES COMPARE TO KCPL'S TOTAL ANNUAL EXPENSES OR ANNUAL REVENUES?

A No. As noted above, in the year 2014, a total of $4.1 million of non-labor expenses were incurred by KCPL., while in future years, non-labor O&M is projected to never exceed $8.5 million[28] In relation to Total Operating Expenses, as reported by KCPL in SEC Form 10K for 2014 of $1,380.7 million, this spending level is far less than one percent of overall expenses. In relation to total Electric Revenues, as reported by KCPL in SEC Form 10K for 2014 of $1,730.8 million, the actual and forecasted CIP and Cybersecurity non-labor expenses are similarly immaterial.[29]

Q AT THESE LEVELS, ARE THE COMPANY'S FORECASTED CIP AND CYBERSECURITY EXPENSES SUBSTANTIAL ENOUGH TO HAVE A MATERIAL IMPACT UPON REVENUE REQUIREMENTS AND THE FINANCIAL PERFORMANCE OF THE BUSINESS BETWEEN RATE CASES?

A No. Given the modest overall amount of historical and forecasted expenses involved, as a percentage of overall costs and revenues, these costs in isolation would not be reasonably expected to adversely impact the Company's future financial stability or access to capital on reasonable terms.

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[28] KCPL responses to MECG Data Request 2-19 and 2-20; Staff Data Request 187 Attachments.

[29] Great Plains Energy Incorporated, Kansas City Power & Light Company SEC Form 10K for year ended December 31, 2014, page 54.

Q ARE THE PROJECTED LEVELS OF KCPL'S CRITICAL INFRASTRUCTURE PROTECTION AND CYBERSECURITY COSTS EXPECTED TO BE VOLATILE FROM YEAR TO YEAR?

A No. The information in Table 3, above, clearly shows the stability and lack of variability within KCPL's forecasted CIP and Cybersecurity costs. Once hiring is completed and compliance programs are implemented in 2015, the Company has forecasted relatively stable O&M spending and declining capital investment levels, rather than any volatility or extreme levels of change in any future year.

Q ARE KCPL'S CIP AND CYBERSECURITY COSTS BEYOND THE CONTROL OF THE UTILITY, SUCH THAT MANAGEMENT HAS LITTLE INFLUENCE OVER EXPERIENCED COST LEVELS?

A Not completely. I would agree that the obligation to comply with security regulations is beyond the control of management. A number of policy directives and orders have been issued by the Federal Executive Branch and through reliability standards issued by the North American Electric Reliability Corporation ("NERC") that specify additional mandatory and enforceable protective and security measures.[30] However, utility management has responsibility and control over decisions regarding the hiring, testing, training, new capital investments and security modifications to facilities and automated systems that are made in order to achieve and maintain compliance. It would not be reasonable to approve a full recovery expense tracker covering any and all future labor and non-labor expenses that KCPL judges to have been incrementally incurred for CIP and Cybersecurity compliance, because such a tracker would

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[30] KCPL's Supplemental response to MECG 2-20 provided a number of voluminous documents explaining certain of the directives, orders and CIP statements applicable to the Company.

eliminate management incentives to implement cost-effective solutions to achieve compliance.

Q WOULD A TRACKING MECHANISM FOR KCPL'S CIP AND CYBERSECURITY COSTS BE STRAIGHTFORWARD AND SIMPLE TO ADMINISTER, READILY AUDITED AND VERIFIED THROUGH EXPEDITED REGULATORY REVIEWS?

A No. The Company has historically incurred labor and non-labor expenses and has made capital investments to maintain security at its facilities and to control access to information systems that are employed throughout the business. There are no clear lines of demarcation that would cleanly segregate the <u>new</u> labor hours for personnel who are dedicated to incremental CIP and Cybersecurity compliance work from the baseline level of historical activities and costs. If any existing employees are assigned from time to time to new CIP/Cyber efforts, double recovery of labor and benefit costs could occur, to the extent such employees were already included in the base revenue requirement determination. Similarly, if new employees are hired with the intention of dedicating them to incremental CIP/Cyber compliance efforts, there is nothing to prevent KCPL from reducing staffing in other areas while tracking and recovering the new employees' labor costs with no accounting for staff reductions elsewhere, or having the new employees also work on other activities while their labor costs are deferred for future recovery through the proposed tracker.

With a tracking mechanism in place, utility management would face a financial incentive to classify new spending as somehow related to CIP or Cybersecurity in instances where costs actually relate to more than just these needs. For instance, when a significant information technology system is being maintained or upgraded by KCPL employees or contractors, it may be necessary to subjectively determine what portion of upgrade time and labor could be characterized as for security enhancements, with only costs in these security-related costs qualifying for tracker recovery. A fundamental challenge with any regulatory tracking mechanism is the need to clearly specify includable costs using defined criteria that are administratively simple to apply and verify.

Q COULD A TRACKING MECHANISM FOR CHANGES IN CRITICAL INFRASTRUCTURE PROTECTION AND CYBERSECURITY BETWEEN TEST YEARS BE APPROPRIATELY BALANCED, SUCH THAT ANY KNOWN FACTORS THAT MITIGATE COST IMPACTS ARE ACCOUNTED FOR IN A MANNER THAT PRESERVES TEST YEAR MATCHING PRINCIPLES?

A Yes. If the cost segregation problem just mentioned could be solved, there should be no significant problems with unrecognized offsetting benefits or mitigating considerations.

Q IS KCPL FULLY ABLE TO PURSUE THE NEEDED CIP AND CYBERSECURITY INITIATIVE, WITHOUT AN EXTRAORDINARY COST TRACKING MECHANISM FOR ANY INCREASING COSTS THAT MAY BE INCURRED?

A Yes. The Company has been proceeding with its plans for continuing compliance with critical infrastructure and cybersecurity without any extraordinary cost tracking mechanisms in place. KCPL has developed a general CIP Milestone Schedule that provides for a series of implementation steps, including that all CIP Version 5 project to teams are forecasted to kick off their activities by 4/30/2015.[31]

As noted previously, in 2014 the Company's has already incurred more than $5 million in incremental expenses attributed to these efforts and any cost levels documented at time of true-up could be considered for prospective base rate

[31] KCPL response to Staff Data Request 465.

recovery. I am aware of no impediment to KCPL's ability to seek and recover its prudently incurred CIP and cybersecurity costs within the pending and any future rate case proceedings.

Q **DOES KCPL ROUTINELY UNDERTAKE MAJOR UPGRADES TO ITS AUTOMATED INFORMATION TECHNOLOGY SYSTEMS WITHOUT ANY SPECIAL REGULATORY TRACKER TREATMENT FOR THE INCREMENTAL COST OF EACH SYSTEM UPGRADE?**

A Yes. KCPL and other electric utilities must periodically undertake major technology initiatives to replace or upgrade installed systems that are used for enterprise accounting, asset management, human resources, outage management, customer billing/accounting and other critical business information systems. These technology upgrade programs often represent tens of millions in incremental expense and capital spending that are typically undertaken by KCPL and other electric utilities in the normal course of business and without any extraordinary cost tracking tariffs. Indeed, KCPL provided its Highly Confidential current view of such programmatic spending in response to Staff data request 331, which is contained in my Schedule MLB-8. In my view, the programmatic work required to design and install the new systems that are compliant with more expansive new CIP and Cybersecurity rules are comparable to these ongoing and planned major technology replacement projects and do not merit any extraordinary rate tracking treatment. I am concerned that if the Commission approves the Company's request for a CIP/Cybersecurity tracker in this case, it may be difficult to distinguish in future proceedings the many other discretely large Information Technology projects that are needed by KCPL and other Missouri utilities and that are potentially much more costly than the CIP/Cybersecurity initiative that is now under way.

Q CONSIDERING EACH OF THE CRITERIA YOU HAVE RECOMMENDED FOR EXTRAORDINARY REGULATORY TREATMENT OF SPECIFIC TYPES OF COSTS, SHOULD KCPL'S CIP AND CYBERSECURITY EXPENSES BE GRANTED THE TRACKING MECHANISM TREATMENT THAT IS PROPOSED BY THE COMPANY?

A No. Actual and planned CIP and Cybersecurity expenses incurred by KCPL are not unusual or infrequently incurred, but have been incurred historically in the normal course of business. Also, these costs are not sufficiently large and volatile such that they merit extraordinary expense tracking treatment. Additionally, there are no clearly defined eligibility criteria to reliably isolate any increased staffing and non-labor spending in this area, which encourage KCPL to judgmentally classify costs as recoverable CIP/Cybersecurity related, making it administratively difficult to properly administer the proposed expense tracker.

INCOME TAX EXPENSE ADJUSTMENTS

Q ARE YOU RECOMMENDING ANY ADJUSTMENTS TO THE COMPANY'S TEST YEAR INCOME TAX EXPENSE CALCULATIONS?

A Yes. An adjustment to KCPL's proposed income tax expense is needed to correct the Company's proposed net addition to taxable income for book depreciation amounts in excess of deductible tax straight line depreciation amounts. The Company's Schedule 11 calculation of income tax expense contains a number of complex entries that, when carefully analyzed, reveal several problems that overstate taxable income and, as a result, test year income tax expenses. The problems relate to differences between the amounts of depreciation and amortization expense that are recorded as book expense, compared to the corresponding amounts of depreciation and amortization that can be deducted in determining currently taxable test year income.

Q HOW IS DEPRECIATION AND AMORTIZATION TREATED IN DETERMINING TAXABLE INCOME?

A Different and much larger tax depreciation and amortization amounts are generally deductible in determining the Company's actual income tax liability, because of Internal Revenue Code ("IRC") provisions for accelerated and "bonus" methods available to calculate tax depreciation and/or amortization. Other depreciation and amortization differences arise between book and tax depreciation/amortization amounts because of the way the depreciable basis of property is quantified for book purposes, compared to tax purposes. For example, certain costs incurred by utilities for replacements of discrete units of property are capitalized for book purposes, but can be deducted currently as "repairs" expenses for tax purposes. Another example of a basis difference is Allowance for Funds Used During Construction ("AFUDC"), which is added to the book basis of self-constructed Plant in Service to recognize carrying costs while the asset is under construction. The income tax rules provide for capitalization of a different amount of interest during construction that includes no equity element of AFUDC.

Q ARE THE BENEFITS OF ACCELERATED AND BONUS DEPRECIATION FLOWED THROUGH TO BENEFIT RATEPAYERS WITHIN KCPL'S INCOME TAX EXPENSE CALCULATIONS?

A. No. The economic benefits of accelerated and bonus depreciation and the other basis differences arising from book and tax depreciation rules are deferred, through an accounting procedure often referred to as income tax "normalization" accounting. This accounting procedure involves the recognition of deferred income taxes on the books and the collection of deferred income tax expense from ratepayers. This procedure recognizes the fact that accelerating tax depreciation or modifying tax basis amounts generally delays the timing of when taxes are paid, rather than permanently reducing the total amount of taxes payable. I will discuss normalization accounting in greater detail later in this testimony.

In its filing, KCPL has calculated and included deferred income tax expenses within its asserted revenue requirement, so that the tax savings of accelerated or bonus depreciation are not flowed through to ratepayers. This normalization accounting adds $15.7 million of Jurisdictional net "Total Deferred Income Tax Expense" at line 52 of Mr. Klote's Schedule RAK-8. Instead of immediate income tax flow-through savings arising from tax depreciation, ratepayers are required to pay deferred income taxes in their rates. As a result, ratepayers then receive a rate base reduction for the accumulated amount of deferred income taxes they have paid the utility, that have not been paid in turn to the government. In KCPL's Direct Testimony, rate base is reduced by approximately $600 million for Accumulated Deferred Income Taxes.[32]

Q WHAT IS THE PROBLEM WITH KCPL'S CALCULATION OF INCOME TAX EXPENSES?

A The Company's calculations overstate income tax expense by adding back into taxable income much more book depreciation and amortization than is recognized when calculating deferred income tax expenses. This overstatement of income tax expense occurs because of errors in quantifying what KCPL calls its estimated "Tax

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32 Direct Testimony of Ronald Klote, Schedule RAK-9.

Straight Line" depreciation, amortization and nuclear fuel amortization. Tax Straight Line depreciation/amortization amounts are estimated values that are intended to represent book depreciation rates applied to tax basis investment amounts, but this is a ratemaking convention that does not mirror what actually occurs on the utility's books. On the books, the Company's full normalization income tax accounting procedures should cause all of the temporary book/tax timing differences associated with depreciation and amortization to net to a zero overall income tax expense impact. Unfortunately, in the Company's rate case calculations, the net increase to taxable income from depreciation/amortization add back calculations, after subtracting Tax Straight Line amounts, do not properly net to zero with respect to normalized temporary book/tax timing differences.[33]

This problem can be observed in Schedule RAK-8 sponsored by KCPL witness Mr. Klote in the "Total Company Balance" column. First, at line 3 of Schedule RAK-8, $216.2 million of per books "Depreciation Exp" is added into Net Income because book depreciation is not tax deductible. Then, at line 59, a calculated "Straight Line Tax Ratio" is applied to this book depreciation amount (included at line 56) to determine a much lower amount of "Straight Line Tax Depreciation" of $178.7 million. Then, at lines 61 through 63, this lower amount of "Straight Line Tax Depreciation" is compared to "IRS Tax Return Depreciation" of $284.1 million, yielding "Excess IRS Tax Depr over Tax SL Depr" of $105.4 million. The resulting $105.4 million book/tax timing difference is combined with similar amounts calculated

[33] Temporary book/tax differences will net to a zero income tax expense impact in any given year, because of provisions and reversals of deferred income tax expenses under normalization accounting. However, any permanent basis differences associated with AFUDC equity that is never taxable or differences that are associated with income tax credits that permanently reduce tax basis can create reconciling differences. See Schedule MLB-9 at "Reconciliation of Book and Tax Depreciation and Amortization" to see these effects at the lines labeled "AFUDC Equity" and "MO ITC Coal Basis Adj". Additionally, in the distant past KCPL did not practice full normalization accounting for certain book/tax basis differences, creating the "MO Miscellaneous Flow-Through" line item in the reconciliation performed by KCPL.

for Plant Amortization and Nuclear Amortization at lines 66 and 69 to yield the "Total Timing Differences" amount at line 70 that is multiplied by an Effective Tax Rate at line 71 to determine test year "Deferred Income Taxes – Excess IRS Tax over Tax SL" at line 72. Deferred Income Taxes are included within the asserted revenue requirement at line 46 of Schedule RAK-8.

The effect of including lower Tax Straight Line Tax Depreciation (at line 60) than the corresponding book Depreciation Expense added back at line 3 is to overstate taxable income and the resulting overall income tax expenses to be included in the revenue requirement. A similar problem arises from Plant Amortization Expense where the book amount added back of $27.9 million (at line 4) is much larger than the Tax Straight Line Amortization of $18.9 million (at line 65) that is used to calculate deferred tax expenses. Again with Book Nuclear Fuel Amortization, the add-back into taxable income at line 6 of $27.8 million significantly exceeds the corresponding "Tax Straight Line Nuclear Amort" amount at line 68 of $22.4 million.

Q WHAT IS THE PURPOSE OF THE NEGATIVE AMOUNT CAPTIONED "AMORT OF PRIOR DEFERRED TAXES – TURNAROUND OF BOOK/TAX BASIS DIFFERENCES" AT LINE 49 OF SCHEDULE RAK-8?

A This negative deferred tax expense amount should reflect the test year amount of overall reversals of previously recorded deferred income taxes for all vintages of property where book/tax basis differences were reversing during the test year. If the Company's ratemaking use of estimated Tax Straight Line amounts in place of book depreciation and amortization expense, as described above, were working correctly, one would expect to see this negative expense line completely offset the differences between book and Tax Straight Line depreciation and amortization, except for the value of any reconcilable permanent basis differences or any legacy effects of prior flow-through accounting. This should occur because KCPL should be recording deferred income taxes each year on all of the depreciation method and basis differences to accomplish no flowing through into test year income tax expense of any book/tax basis differences. However, the depreciation and amortization amounts included in the Company's Schedule RAK-8 cannot be reconciled.

Q DID YOU ASK THE COMPANY TO RECONCILE THE DIFFERENCES BETWEEN ESTIMATED BOOK VERSUS TAX STRAIGHT LINE DEPRECIATION AND AMORTIZATION AMOUNTS TO THE TEST YEAR TURNAROUND OF BASIS DIFFERENCES AMOUNT ON LINE 49?

A Yes. In its responses to MECG data requests 14-15, 14-17 and 14-18, the Company conceded that significant errors exist within the Schedule RAK-8 calculations. I have included these responses, without their highly confidential attachments, in Schedule MLB-9. According to KCPL's response to MECG 14-15(a), the Company inadvertently excluded a reclassification from its calculation of annualized Tax Straight Line Amortization of approximately $7.1 million. According to KCPL's response to MECG 14-17(a), after correction, the book nuclear fuel amortization and tax straight line nuclear fuel amortization are estimated to be the same amount per the December 2014 cutoff computation, rather than the different amounts used in the Company's filing. According to the MECG 14-18 response, "[t]ax straightline amortization and book amortization…should [be] equal and are based on the CS-24 workpapers for nuclear fuel."

Q AFTER CORRECTING FOR THE ADMITTED UNDERSTATEMENT OF TAX STRAIGHT LINE AMORTIZATION AND SETTING NUCLEAR FUEL BOOK AND

TAX STRAIGHT LINE AMOUNT EQUAL, IS THE COMPANY ABLE TO RECONCILE THE DIFFERENCES BETWEEN BOOK AND TAX STRAIGHT LINE AMOUNTS TO THE OFFSETTING AMORTIZATION OF PRIOR DEFERRED TAXES AS ONE WOULD EXPECT?

A No. There are still apparent inconsistencies in the numbers being used, as the Company's analysis still includes about $1.1 million of "Unreconciled Difference" with respect to the "Total Company Impact on Income Taxes."[34]

Q WHAT IS THE PURPOSE OF THE ADJUSTMENT SET FORTH AT MECG SCHEDULE MLB-1?

A This adjustment is necessary to revise the Company's test year income tax expense calculation. Because of the needless complexity introduced by the Company's flawed Tax Straight Line estimates and the Company's inability to reconcile its calculations even after making large corrections to such estimates, I have simplified Mr. Klote's Schedule RAK-8 to increase taxable income for only the reconciled differences between book and tax depreciation and amortization amounts, as set forth in the Company's response to MECG 14-15. These amount appear at lines 4,5 and 6 of my Schedule MLB-1, in a revised calculation template that is intended to replace Mr. Klote's Schedule RAK-8, making the entries originally contained at lines 3-7, 12-14, 46 and 49, as well as all of the deferred income tax expense calculations at lines 56-72 of the Company's Schedule RAK-8 no longer necessary. The revised income tax expense calculation I am proposing accurately determines total income tax expense, without regard to relatively unimportant distinctions between the currently payable and deferred portions thereof. This short form calculation is similar to that used in other regulatory jurisdictions and does not include the unreconciled adders to taxable

[34] See Schedule MLB-9, Reconciliation of Book and Tax Depreciation and Amortization.

income that KCPL's more complex Schedule RAK-8 calculation includes. Using the input data associated with the Company's direct testimony filing in my Schedule MLB-1, the effect of eliminating the Company's understated tax straight line estimates and un-reconciled additions to taxable income, while simplifying the calculation, is a reduction to test year tax expense of approximately $3.4 million (see line 55).

Q ARE ALL OF THE AMOUNTS WITHIN YOUR SCHEDULE MLB-1 SUBJECT TO UPDATING IN CONNECTION WITH THE TRUE-UP PHASE OF THIS PROCEEDING?

A Yes. I offer Schedule MLB-1 as a template to be used now and in the true-up for the purpose of eliminating the Company's inaccurate and un-reconcilable tax straight line depreciation and amortization estimates, and the resulting overstatement of total income tax expenses. If my proposed simplification of the calculation is not employed by the Commission, the Company should be held responsible for fully reconciling any proposed increases to taxable income in the true-up calculations that arise from differences between book and straightline tax depreciation entries. It is reasonable for the Commission to demand a complete reconciliation, given the normalization accounting that has been authorized for KCPL to account for all temporary book/tax timing differences.

Q USING THE SIMPLIFIED CALCULATION OF TOTAL INCOME TAX EXPENSE THAT YOU PROPOSE, SHOULD ANY OF THE RESULTING TOTAL INCOME TAX AT LINE 53 BE TREATED AS CURRENTLY PAYABLE IN CALCULATING CASH WORKING CAPITAL?

A No. As explained more fully in my testimony below, KCPL is in a Net Operating Loss Carryforward ("NOLC") position and does not expect to actually pay any income taxes in cash for the foreseeable future. Therefore, all of the test year income tax expenses in this rate proceeding should be treated as deferred income taxes, for which there would be no cash flows or cash working capital impacts.

<u>ACCUMULATED DEFERRED INCOME TAXES</u>

Q WHAT ARE ACCUMULATED DEFERRED INCOME TAXES ("ADIT")?

A ADIT are assets or liabilities that represent the cumulative amounts of additional income taxes that are estimated to become receivable or payable in future periods. Future income taxes are impacted by tax returns filed today because of differences between book accounting and income tax accounting regarding the timing of revenue or expense recognition. Book accounting, under Generally Accepted Accounting Principles ("GAAP"), requires the use of an accrual basis accounting method that must be used to recognize revenues, expenses and income within the publicly issued financial statements of public utilities such as KCPL. In contrast, the accounting methods and procedures specified to determine revenues and expenses (deductions) and taxable income for income tax purposes are defined by the Internal Revenue Code ("IRC" or "Code").

Differences in GAAP versus Code accounting cause what are characterized as book/tax differences. Many of these book/tax differences are temporary because they arise from <u>timing differences,</u> where a specific cost is deductible for tax purposes in a different year than for book purposes – the primary example being depreciation expenses that are recorded on a straight-line basis for book accounting, but are based upon accelerated lives and methods and/or "bonus" depreciation methods for income tax accounting and reporting purposes. Timing differences can also occur where the book basis of depreciable property includes different costs than the tax basis or whenever an anticipated expense is recognized on an accrual-basis for book purposes, but is deductible in a different year, when the expense is actually paid in cash by the taxpayer.

Specific provisions within GAAP[35] require recognition of income tax impacts from these book/tax timing differences, by recording ADIT assets or liabilities. ADIT assets generally occur when revenue taxation occurs prior to book recognition of the revenues or when the tax deductibility for expenses is subsequent to the book recognition of the expense. ADIT liabilities, on the other hand, represent delayed taxation of revenues or advance deduction of expenses, in relation to the timing of the same transactions on the books. ADIT balances exist to recognize that certain tax expenses are determinable today, but actually become payable in the future whenever book/tax timing differences ultimately reverse.

Q WHY IS ACCOUNTING FOR ADIT REQUIRED UNDER GAAP?

A Full and complete accounting for income tax expenses must recognize that filing tax returns and paying income taxes will impact tax expenses payable in more than one accounting period. The relevant GAAP requirements are stated within Accounting Standards Codification 740 ("ASC 740"). Under ASC 740, there are two primary objectives related to accounting for income taxes:

a. To recognize the amount of taxes payable or refundable for the current year, and

b. To recognize deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns.

[35] GAAP Accounting for Income Taxes is set forth within Financial Accounting Standards Board Accounting Standards Codification 740 ("ASC 740").

Recorded ADIT amounts arise from part (b) of this standard, where recognition is given on the books of the future tax consequences of transactions that are treated differently in financial statements than on tax returns.

Q WHY DO WE CARE ABOUT ADIT BALANCES IN DETERMINING UTILITY REVENUE REQUIREMENTS?

A Utilities are capital intensive businesses that invest continuously in newly constructed or acquired assets. These large annual capital investments generate persistently large income tax deductions for bonus/accelerated depreciation and other tax deductions and credits that must be normalized by recording deferred income taxes. Because deferred income tax expense accruals are included as part of total income tax expense in the revenue requirement, ratepayers are denied any immediate flow-through benefit from such tax deductions. From a ratemaking perspective, a utility's persistently large credit ADIT balances caused by the deferred payment of recorded tax expenses represent a significant source of capital to the utility. ADIT balances represent a form of zero-cost capital to the utility created by the income tax savings permitted under tax laws and regulations that are not immediately "flowed through" to ratepayers and would benefit only shareholders unless properly recognized as a rate base reduction. ADIT balances are normally included in rate base as reductions by regulators, so as to limit the utility to only a return on the <u>net</u> amount of investor-supplied capital to support rate base assets.

Q HAS KCPL INCLUDED ITS ADIT BALANCES IN THE DETERMINATION OF ITS RATE BASE?

A Yes. At Schedules RAK-2, line 25, and Schedule RAK-9, Mr. Klote has included certain of the Company's ADIT balances that were recorded at March 31, 2014, with pro forma adjustments to reflect estimated changes in these amounts that are expected to occur through the true-up date. By that date, Mr. Klote has estimated that KCPL's net ADIT balance for inclusion to reduce rate base will exceed $599 million.

Q DID THE COMPANY INCLUDE <u>ALL</u> OF THE ELEMENTS OF ITS ADIT BALANCES THAT ARE RECORDED ON ITS BOOKS WITHIN THE SCHEDULE RAK-9 AMOUNTS THAT ARE PROPOSED TO BE INCLUDED IN RATE BASE?

A No. The Company evaluated the dozens of individual elements of book/tax timing differences within a series of workpapers designated RB-125 DIT CS-125 Income Tax Exp-KCPL-MO-Direct-HC and has included many, but not all, elements of its recorded ADIT balances for rate base inclusion.[36] Generally, the ADIT items not recognized in calculating KCPL's proposed rate base are related to transactions or specific investments that are treated as non-jurisdictional or that are excluded in determining the Company's rate base.

Q HAVE YOU REVIEWED THE COMPANY'S ADIT DETAILED ACCOUNTS TO EVALUATE WHETHER THE PROPER ELEMENTS HAVE BEEN RECOGNIZED IN RATE BASE?

A Yes. I reviewed the referenced workpapers and the Company's responses to MECG data requests which contained descriptive details for many individual elements of the Company's recorded March 31, 2014 ADIT balances. In addition, I discussed income tax issues and information with Company tax department personnel and submitted

[36] These line items are designated with a column to either "Include" or "Exclude" within the referenced workpaper.

follow-up data requests to clarify the basis for KCPL's proposed inclusion or exclusion of specific elements of the ADIT balance.

Q DO YOU DISAGREE WITH ANY OF THE COMPANY'S PROPOSALS REGARDING ADIT AMOUNTS FOR SPECIFIC BOOK/TAX TIMING DIFFERENCES THAT KCPL HAS EITHER INCLUDED OR EXCLUDED IN DETERMINING RATE BASE?

A Yes. I am proposing three adjustments to the Company's ADIT calculations supporting amounts included in rate base, as more fully described in this and the following sections of my testimony. KCPL has inappropriately excluded all of the ADIT balances on its books that relate to plant assets within the Company's Construction Work in Progress ("CWIP") account. My first adjustment is to restore the CWIP-related ADIT to rate base. Then, for several discrete ADIT elements, the Company has improperly included its recorded ADIT balance in rate base even though the corresponding liability balance is not in rate base or otherwise recognized in determining the revenue requirement. I am recommending, in my second adjustment, several changes needed to exclude these ADIT elements that increase the Company's asserted rate base. In the next section of my testimony, I will explain adjustments that are needed to the Company's NOL deferred tax asset included within the ADIT amounts in KCPL's asserted rate base.

Q WHAT IS THE PURPOSE OF YOUR FIRST ADJUSTMENT TO ADIT BALANCES, AS SET FORTH AT MECG SCHEDULE MLB-2?

A MECG Schedule MLB-2 reflects my adjustment to include CWIP-related ADIT balances within rate base. KCPL has inappropriately excluded all CWIP-related ADIT amounts in assembling its proposed rate base, which overstates rate base significantly.

Q HOW DOES THE COMPANY EXPLAIN ITS PROPOSED EXCLUSION OF CWIP-RELATED ADIT BALANCES FROM RATE BASE?

A In response to MECG data request 9-6, the Company stated, "We believe the CWIP related ADIT should be excluded from rate base until the property related to CWIP ADIT has been included in rate base. We have tried to match the ADIT items included and excluded in rate base to items that are in the rate case as either a rate base item or a cost of service component." I have included a copy of this response within my Schedule MLB-10, including the Highly Confidential Attachment containing input values used in my adjustment.

Q IS THIS MATCHING CONCEPT VALID, SUCH THAT ADIT ITEMS SHOULD BE INCLUDED IN RATE BASE ONLY IF THE CORRESPONDING RECORDED ASSET OR LIABILITY IS ALSO IN RATE BASE?

A Generally, this approach is valid. However, in the case of CWIP assets, it is not valid because ratepayers are paying a return on CWIP investment, in the form of an Allowance for Funds Used During Construction ("AFUDC"). This AFUDC return is fully compensatory to KCPL and obligates ratepayers to repay in cash the full amount of all AFUDC that is reasonably recorded. If the Company's proposal to exclude CWIP-related ADIT balances from rate base is implemented, KCPL's AFUDC accounting will be excessive and will over-compensate for the Company's actual investment in newly constructed plant assets. This will occur because AFUDC calculations apply a carrying charge rate to the <u>gross</u> investment in such construction with no accounting for CWIP-related ADIT benefits that tend to reduce such investment.

Q DOES KCPL DISPUTE THE FACT THAT THE AFUDC RATE, THAT IS USED TO CALCULATE AND APPLY CARRYING CHARGES TO CWIP INVESTMENT, IS APPLIED TO THE GROSS AMOUNT OF THE INVESTMENT, RATHER THAN AN AMOUNT THAT HAS BEEN REDUCED TO RECOGNIZE CWIP-RELATED ADIT?

A No. This fact is not disputed. In its response to MECG 9-6(c), the Company acknowledged the fact that, "[t]he computation of AFUDC does not take into account ADIT related to CWIP."[37]

Q WHAT IS THE SIGNIFICANCE OF NOT REDUCING CWIP INVESTMENTS FOR RELATED ADIT WHEN CALCULATING AFUDC THAT WILL BE PAYABLE BY RATEPAYERS?

A It is necessary to fully account for CWIP-related ADIT balances to avoid an inflated rate base and excessive utility rates. CWIP-related ADIT balances must be included in rate base because AFUDC is applied to KCPL's <u>gross</u> investment in CWIP work orders, with no recognition given to the CWIP-related ADIT amounts that serve to reduce the Company's actual net capital requirements for CWIP.

Consider a simplified example, where a utility is assumed to be constructing a single asset costing $1 million over a construction period of one year that will be funded fully at the beginning of construction, but will remain in CWIP and earning AFUDC at an assumed 10 percent rate throughout the year of construction. Assume also that the utility has elected "repairs" tax accounting for this asset, allowing the full cost of the asset to be immediately deducted for income tax purposes in the current tax year. The value of the income tax deduction for this project being treated as a deductible "repair" at a 38 percent federal/state tax rate would result in an immediate $380,000 income tax deferral to the utility, requiring the accrual of

[37] See Schedule MLB-10.

CWIP-related ADIT that reduces the utility's actual out-of-pocket investment in the new asset to only $620,000 after taxes.

However, AFUDC will be accrued at 10 percent on the <u>gross</u> CWIP cost for the full year the asset is in CWIP. This results in Plant-in-Service added to rate base of $1.1 million ($1 million plus $100,000 of AFUDC) with no recognition given to the CWIP-related ADIT when accruing AFUDC. Clearly, when the AFUDC rate is applied to the entire $1 million of gross investment, with no reduction for CWIP-related AFUDC, the utility is fully compensated for its gross investment in this asset. In this example, the $100,000 of allowed AFUDC on a gross $1 million investment, when the utility's after-tax net investment is only $620,000, would significantly overstate AFUDC and future rate base. This is why CWIP-related ADIT balances must be recognized immediately in rate base, even though the CWIP investment not included in rate base earns an AFUDC return.

Q HOW IS CWIP-RELATED ADIT NORMALLY TREATED TO PROPERLY SYNCHRONIZE THE AFUDC ACCOUNTING PROCEDURES WITH RATEMAKING PROCEDURES?

A CWIP-related ADIT balances must be included in rate base in order for established AFUDC accounting procedures to work correctly.

Q ARE THE AFUDC ACCOUNTING PROCEDURES STANDARDIZED AND CODIFIED IN FEDERAL ENERGY REGULATORY COMMISSION ("FERC") RULES?

A Yes. The FERC prescribes that major electric utilities under its jurisdiction follow a Uniform System of Accounts that contains Plant Accounting Instructions including directives regarding accounting for AFUDC.[38]

Q WAS THE PROPER RATEMAKING TREATMENT OF CWIP-RELATED ADIT BALANCES RECENTLY ADDRESSED BY THE COMMISSION IN UNION ELECTRIC COMPANY (D/B/A AMEREN MISSOURI) CASE NO. ER-2012-0166?

A Yes. In the 2012 Ameren Missouri rate case, that utility proposed to change its previous practice and commence removing CWIP-related ADIT in determining rate base. Ameren Missouri's logic was similar to KCPL's argument; that CWIP is not yet in rate base so the CWIP-related ADIT balances should also not be in rate base. I testified on behalf of industrial intervenors in that proceeding and explained that CWIP is allowed to earn AFUDC on the gross investment, using the same example as stated above. In its Report and Order, the Commission stated:

> **Decision:**
>
> As fully explained in the findings of fact, Ameren Missouri must include CWIP-related ADIT balances as an offset to rate base to avoid overstating AFUDC and future rate base, to the detriment of both current and future ratepayers.[39]

The relevant facts are the same for KCPL as for Ameren Missouri regarding CWIP-related ADIT balances and the same outcome should apply to KCPL.

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[38] See 18 CFR 100 Plant Accounting Instructions at (17), "*Allowance for funds used during construction* (Major and Nonmajor Utilities) includes the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds when so used, not to exceed, without prior approval of the Commission, allowances computed in accordance with the formula prescribed in paragraph (a) of this subparagraph." AFUDC is applicable to the balance recorded in work orders within Construction Work in Progress with no reduction for related Accumulated Deferred Income Taxes.

[39] Report and Order; December 12, 2012, Union Electric Company File No. ER-2012-0166, pages 26-30.

Q PLEASE DESCRIBE YOUR NEXT ADJUSTMENT TO THE COMPANY'S ADIT BALANCES IN RATE BASE, AS SET FORTH IN MECG SCHEDULE MLB-3.

A This adjustment excludes from rate base certain of the Company's recorded debit March 31, 2014 balances in ADIT Account 283, because these ADIT amounts relate to accrued liability balances that have not been included in rate base. It is not reasonable to increase rate base for ADIT balances in instances where the associated liability is not being treated as jurisdictional or included in rate base for the benefit of ratepayers.

Q WHAT IS THE NATURE OF THE FIRST TWO ITEMS LISTED IN YOUR ADJUSTMENT AT SCHEDULE MLB-3?

A The Company occupies leased office space in downtown Kansas City in a building known as 1 KC Place and has received certain lease abatement benefits in connection with its lease agreement. On its books, KCPL has recorded a significant liability balance to recognize the delayed obligation to make additional lease payments.[40] In connection with this liability balance, a large and offsetting deferred tax asset was recorded to recognize that accrued but unpaid future lease costs are not currently deductible for income tax purposes. The Company proposes to include in rate base the debit ADIT item to increase rate base, but not the corresponding accrued lease liability balance that would reduce rate base if recognized. This is an unreasonable mismatch that must be corrected. In the Company's response to data request MECG 14-23, KCPL admits that the associated book liability balance for the 1 KC Place ADIT item has not been included in rate base. Therefore, this ADIT balance should also be excluded from rate base.

[40] A more detailed discussion of the 1 KC Place lease benefits and liability balances as of December 31, 2014 is set forth in the Company's response to Staff data request 501.

Q PLEASE EXPLAIN THE OTHER THREE DEBIT ADIT ITEMS THAT KCPL HAS INCLUDED TO INCREASE RATE BASE, THAT YOU PROPOSE TO ELIMINATE.

A Certain elements of employee compensation are paid much later than they are earned, requiring the Company to recognize an accrued liability for such deferred compensation and bonus pay that is owed to its employees. As with the 1 KC Place lease accruals, there is no recognition of the liability balance for deferred/bonus compensation in the Company's asserted rate base, yet KCPL has inexplicably proposed to include the associated debit ADIT balances for these accruals to increase rate base. This is an inappropriate mis-matching of rate base elements that must be corrected.

Q HAVE THE DELAYED CASH PAYMENTS FOR EITHER THE 1 KC PLACE LEASE OR FOR DEFERRED/BONUS COMPENSATION AMOUNTS BEEN RECOGNIZED EXPLICITLY WITHIN THE EXPENSE LEAD DAY CALCULATIONS OF KCPL'S LEAD LAG STUDY, WHICH MIGHT INDIRECTLY INCLUDE THE LIABILITY BALANCES FOR THESE ITEMS IN THE COMPANY'S RATE BASE?

A No. Mr. Klote's Schedule RAK-5 reveals no separately calculated expense lead day value for either the delayed lease payments or deferred/bonus compensation to employees. Therefore, absent a showing that KCPL's rate base has fully recognized these delayed cash payments, it is not appropriate to include the ADIT items arising from such delayed cash payments in rate base.

NET OPERATING TAX LOSSES

Q HAS KCPL INCLUDED IN RATE BASE A DEFERRED TAX ASSET BALANCE THAT RECOGNIZES THE EXISTENCE OF ITS NET OPERATING LOSS CARRYFORWARD ("NOLC") POSITION THAT WILL DELAY THE REALIZATION OF SOME TAX DEDUCTIONS AND CREDITS?

A Yes. KCPL has included certain Account 190 ADIT balances in rate base so as to recognize estimated NOLC deferred tax asset balances.[41] The amounts proposed for inclusion by the Company can be summarized as:

Account 190 ADIT Amounts in KCPL Schedule RAK-8	**Rate Base $(millions)**
Federal Net Operating Loss	$34.6
Missouri State Net Operating Loss	3.1
TOTAL RATE BASE IMPACT OF CUMULATIVE LOSSES	$37.8

Q ARE THERE PROBLEMS WITH THE COMPANY'S TREATMENT OF CUMULATIVE INCOME TAX LOSSES?

A Yes. The Company's NOL deferred tax asset calculation is calculated on a Consolidated Group basis, starting with recorded amounts on KCPL's books that are derived from application of the <u>Tax Allocation Agreement Among Great Plains Energy Incorporated and Affiliates</u> ("TAA"). The TAA is an affiliated interest contract entered into by Great Plains Energy and its subsidiaries, including KCPL. The TAA produces a higher NOLC amount for the KCPL utility business that results from calculation of the Company's NOLC on a stand-alone KCPL basis through tax year 2014. This result is contrary to ratepayers' interest and should be rejected by the Commission so

[41] See Direct Testimony of Ronald Klote, Schedule RAK-9, line 2.

as to not overstate the KCPL rate base with more NOLC amounts that can be attributed to the utility's own operations.

On a stand-alone basis, KCPL experienced its **________________________
____
____
____
____
____
____
____
____
__________________**[42]

Q PLEASE EXPLAIN THE PURPOSE OF YOUR NEXT ADJUSTMENT, WHICH IS SET FORTH AT SCHEDULE MLB-4.

A Schedule MLB-4 restates KCPL's test year NOLC deferred tax asset that is included in rate base, utilizing KCPL's stand-alone taxable income results in prior years. In my view, KCPL should not be allowed to include in rate base any Federal or State NOL deferred tax asset carryforward amounts that exceed what would have occurred if the Company's income taxes were calculated on a stand-alone basis in each applicable year through calendar 2014. This is essential to prevent the Company's rate base from being overstated because of income tax losses experienced in other parts of Great Plains Energy's consolidated business holdings. The input data used in preparing Schedule MLB-4 was provided in highly confidential attachments in the

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[42] See KCPL response to MECG 4-2 Highly Confidential Attachment.

Company's responses to MECG 4-2 and 14-21, which are included within Schedule MLB-11 to my testimony.

Q IS THERE ANY INFORMATION AVAILABLE TO SHOW THAT KCPL AND ITS RATEPAYERS HAVE EVER RECEIVED A FINANCIAL BENEFIT FROM INCLUSION IN THE GREAT PLAINS ENERGY, INC TAA?

A None of the information produced by the Company in response to discovery on this subject indicates any tangible financial benefits have ever been produced for KCPL as a result of the TAA. The adjustment I have calculated at Schedule MLB-4 clearly shows that KCPL is better off financially if its tax losses are quantified on a stand-alone, rather than consolidated group basis. In data request MECG 14-22 the Company was asked if it "…contend[s] that KCPL and its ratepayers have received any financial benefit from participation in Great Plain's energy, Incorporated's consolidated tax returns and Tax Allocation Agreement." The Company's response indicates that "[t]he Company believes that over time it does benefit KCPL to file as a part of Great Plains Energy Incorporated's consolidated tax group" but then indicates, "[w]e cannot quantify all of the potential benefits that KCPL has received since the election was made, nor is it fair to look at just the recent past to determine if there is an overall benefit." In that response, the Company does not quantify any benefit to KCPL or its ratepayers for any period of time, either historical or projected, arising from the TAA.

Q WHY ARE AFFILIATE AGREEMENTS, SUCH AS THE COMPANY'S TAA, POTENTIALLY HARMFUL TO REGULATED UTILITIES THAT ARE PART OF A LARGER CONSOLIDATED GROUP?

A Utility holding companies are free to invest in both regulated and non-regulated subsidiaries and to structure cost allocation and affiliate transaction arrangements between the controlled subsidiaries that may be more beneficial to its non-regulated subsidies and shareholders than its regulated subsidies and ratepayers. Great Plains Energy, Inc. oversees a portfolio of investments, some of which are regulated and others that are not regulated. This holding company structure introduces an opportunity for complex affiliated company transactions and intercompany allocations to unreasonably impact the costs borne by the regulated utility businesses within the portfolio. In particular, Great Plains' TAA produces persistently adverse consequences for KCPL's ratepayers in **________________________________ ____ ____ __________** It is entirely reasonable for the Missouri Public Service Commission ("Commission") and other regulatory agencies to employ affiliate transaction policies and safeguards that protect against unreasonable utility transactions with affiliated companies.

Q HAS THE THIS COMMISSION ADOPTED ANY POLICIES FOR AFFILIATE TRANSACTIONS THAT ARE APPLICABLE TO THE GREAT PLAINS ENERGY TAA?

A Yes. The Commission's rule governing affiliate transactions appears at 4 CSR 240-20.015 Affiliate Transactions and has as its stated purpose:

> PURPOSE: This rule is intended to prevent regulated utilities from subsidizing their nonregulated operations. In order to accomplish this objective, the rule sets forth financial standards, evidentiary standards and recordkeeping requirements applicable to any Missouri Public Service Commission (commission) regulated electrical corporation whenever such corporation participates in transactions with any affiliated entity (except with regard to HVAC services as defined in section

386.754, RSMo Supp. 1998, by the General Assembly of Missouri). The rule and its effective enforcement will provide the public the assurance that their rates are not adversely impacted by the utilities' nonregulated activities.

The Commission's rule adopts an asymmetric transfer pricing standard in regulating utility transactions with affiliated entities that is stated as follows:

> (2) Standards.
> (A) A regulated electrical corporation shall not provide a financial advantage to an affiliated entity. For the purposes of this rule, a regulated electrical corporation shall be deemed to provide a financial advantage to an affiliated entity if—
> 1. It compensates an affiliated entity for goods or services above the lesser of—
>   A. The fair market price; or
>   B The fully distributed cost to the regulated electrical corporation to provide the goods or services for itself; or
> 2. It transfers information, assets, goods or services of any kind to an affiliated entity below the greater of—
>   A. The fair market price; or
>   B. The fully distributed cost to the regulated electrical corporation.

Asymmetric pricing is intended to safeguard utility ratepayer interests when the regulated company is involved in transactions with affiliated companies. It ensures no self-dealing by insisting that the utility and its ratepayers always receive the lower of fair market value or cost-based pricing in affiliate arrangements.

Q DOES THE COMMISSION'S AFFILIATE TRANSACTION RULE AT 4 CSR 240-20.015 SPECIFICALLY ADDRESS AFFILIATE TAA MATTERS?

A No, but the scope of the Commission's rule is not limited to certain transactions. The stated purpose of the Rule and the asymmetric treatment of affiliate transfer pricing, however, clearly indicates a preference for affiliate arrangements that intentionally favor the utility and its customers, by providing the better of "market" or "cost-based" transfer pricing for affiliate transactions in order to safeguard the public interest. The specification in the Rule of a general standard that, "A regulated electrical corporation shall not provide a financial advantage to an affiliated entity" is directly applicable in concept to the income tax NOLC methodology issue. If the Great Plains Energy "consolidated group" method pursuant to the TAA is used, as proposed in the Company's filing, KCPL will be providing a "financial advantage to an affiliated entity" in a manner contrary to the general standard stated in 4 CSR 240-20.015.

Q IS YOUR PROPOSED USE OF A STAND-ALONE NOLC METHOD IN ADJUSTING KCPL'S NOLC DEFERRED TAX ASSET IN RATE BASE CONSISTENT WITH THE COMMISSION'S AFFILIATE TRANSACTIONS RULE?

A Yes. The method I propose would asymmetrically apply the better of "stand-alone" or "consolidated group" assignments of tax NOLC amounts in any given test year, in a manner entirely consistent with the Commission's Rule. This approach would ensure that no "financial advantage" is attributed to other non-utility Great Plains entities through affiliation with KCPL.

Q DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A Yes.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Kansas City Power & Light Company's Request for Authority to Implement A General Rate Increase for Electric Service	)))))	**Case No. ER-2014-0370** Tariff No. YE-2015-0195

STATE OF MISSOURI	)	
	)	**SS**
COUNTY OF JACKSON	)	

Affidavit of Michael L. Brosch

Michael L. Brosch, being first duly sworn, on his oath states:

1. My name is Michael L. Brosch. I am President of Utilitech, Inc., having its principal place of business at PO Box 481934, Kansas City, Missouri 64148. We have been retained by the Midwest Energy Consumer's Group in this proceeding on their behalf.

2. Attached hereto and made a part hereof for all purposes is my direct testimony and schedules which were prepared in written form for introduction into evidence in Missouri Public Service Commission Case No. ER-2014-0370.

3. I hereby swear and affirm that the testimony and schedules are true and correct and that they show the matters and things that they purport to show.

Michael L. Brosch

Subscribed and sworn to before me this 2nd day of April 2015.

FRANCISCO PACHECO
Notary Public - Notary Seal
State of Missouri
Commissioned for Jackson County
My Commission Expires: April 11, 2017
13372181

Notary Public

SCHEDULE MLB-1

Kansas City Power & Light Company
2015 RATE CASE - Direct
Missouri Jurisdiction
TY 3/31/14; Update TBD; K&M 4/30/15

Line No.	Income Tax - MECG Revised Schedule 11 Line Description A	Total Company Balance *	Juris Factor #	Juris Allocator *	Tax Rate B	(Jurisdictional) Adjusted with 7.938% Return C
1	Net Income Before Taxes (Sch 9)	327,853,666				158,987,801
2	***Add to Net Income Before Taxes:***					
3						
4	AFUDC Equity Flow-Through (MECG 14-15, Attachment)	8,025,991	PTD	54.2867%		4,357,046
5	Mo ITC Coal Basis Adjustment	427,672	PTD	54.2867%		232,169
6	Mo Miscelleneous Flow Through	602,300	PTD	54.2867%		326,969
7						
8	50% Meals & Entertainment	963,906	Sal&Wg	53.9740%		520,259
9	**Total**	10,019,869				5,436,442
10	***Subtract from Net Income Before Taxes:***					
11	Interest Expense	134,351,864				69,734,395
12						
13						
14						
15	Employee 401k ESOP Deduction	2,480,673	Sal&Wg	53.9740%		1,338,918
16	IRC Section 199 Domestic Production Activities	0	D1	53.5748%		0
17	**Total**	136,832,537				71,073,313
18	**Net Taxable Income**	201,040,998				93,350,930
19	**Provision for Federal Income Tax:**					
20	Net Taxable Income	201,040,998				93,350,930
21	Deduct State Income Tax @ 100.0%	10,925,578			6.25%	5,122,349
22	Deduct City Income Tax	0				0
23	Federal Taxable Income	190,115,420				88,228,581
24	Federal Tax Before Tax Credits	66,540,397			35.00%	30,880,003
25	Less Tax Credits:					
26	Wind Tax Credit	(12,333,612)	E1	57.4935%		(7,091,025)
27	Research and Development Tax Credit	(1,670,621)	E1	57.4935%		(960,498)
28	Fuels Tax Credit	(72,665)	E1	57.4935%		(41,778)
29	**Total Federal Tax**	52,463,499				22,786,702
30	**Provision for State Income Tax:**					
31	Net Taxable Income	201,040,998				93,350,930
32	Deduct Federal Income Tax @ 50.0%	26,231,750			17.50%	11,393,351
33	Deduct City Income Tax	0				0
34	State Jurisdictional Taxable Income	174,809,248				81,957,579
35	**Total State Tax**	10,925,578			6.25%	5,122,349
36	**Provision for City Income Tax:**					
37	Net Taxable Income	201,040,998				93,350,930
38	**Total City Tax**	0			0.00%	0
39	**Effective Tax rate before Tax Cr and Earnings Tax**	38.39%				38.39%
40	**Summary of Provision for Current Income Tax:**					
41	Federal Income Tax	52,463,499				22,786,702
42	State Income Tax	10,925,578				5,122,349
43	City Income Tax	0				0
44	**Total Provision for Current Income Tax**	63,389,077				27,909,051
45	**Deferred Income Taxes:**					
46						
47	Amortization of Deferred ITC	(1,073,314)	PTD	54.2867%		(582,667)
48	Amort of Excess Deferred Income Taxes (ARAM)	(1,150,742)	PTD	54.2867%		(624,700)
49						
50	Amortization of R&D Credits	0	100% MO	100.0000%		0
51	Amortization of Cost of Removal-ER-2007-0291	354,438	100% MO	100.0000%		354,438
52	**Total Deferred Income Tax Expense**	(1,869,618)				(852,929)
53	**Total Income Tax per MECG**	61,519,459				27,056,122
54	LESS: INCOME TAX EXPENSE CALCULATED BY KCPL AT SCHEDULE RAK-8					30,489,290
55	**MECG ADJUSTMENT TO INCOME TAX EXPENSE - BASED ON KCPL DIRECT FILED AMOUNTS**					**$ (3,433,168)**

<u>SCHEDULE MLB-2</u>

****<u>HIGHLY CONFIDENTIAL</u>****

<u>SCHEDULE MLB-3</u>

****<u>HIGHLY CONFIDENTIAL</u>****

<u>SCHEDULE MLB-4</u>

<u>HIGHLY CONFIDENTIAL</u>

SCHEDULE MLB-5

KCP&L
Case Name: 2014 KCPL Rate Case
Case Number: ER-2014-0370

Response to Woodsmall David Interrogatories - MECG_20150212
Date of Response: 03/04/2015

Question:11-11

Has the Company, since January 1, 2008, been able to refinance any of its outstanding long-term debt to achieve interest and overall cost of capital savings? Please explain each refinancing event and provide the approximate annual interest expense savings achieved through each event.

Response:

For this response "Company" has been defined as KCP&L. On January 1, 2008, KCP&L had five series of Environmental Improvement Revenue Refunding (EIRR) tax-exempt bonds in an auction rate mode meaning interest rates changed weekly. Due to conditions in the auction rate market, all of these bonds were converted to a fixed interest rate in 2008. A new tax-exempt bond series was also issued at a fixed interest rate in 2008. Each of these six series of bonds has subsequently been remarketed at lower interest rates in 2013. The annual interest expense savings from each of these six series of bonds is as follows:

Series 1992 EIRR bonds maturing 2017 totaling $31 million at a 2008 fixed rate of 5.25% through March 31, 2013 were remarketed at a fixed rate of 1.25% through maturity for an annual interest expense savings of $1,240,000.

Series 1993A bonds maturing in 2023 totaling $40 million at a 2008 fixed rate of 5.25% through March 31, 2013 were remarketed at a fixed rate of 2.95% through maturity for an annual interest expense savings of $920,000.

Series 1993B bonds maturing in 2023 totaling $39.5 million at a 2008 fixed rate of 5.00% through March 31, 2011 were remarketed in 2013 at a fixed rate of 2.95% through maturity for an annual interest expense savings of $809,750.

Series 2007B bonds maturing in 2035 totaling $73.25 million at a 2008 fixed rate of 5.375% through March 31, 2013 were remarketed at a floating interest rate. In order to obtain the lowest possible interest rate, these bonds are backed by a letter of credit. The current interest rate including the cost of the letter of credit is about 0.753% resulting in an annual interest expense savings of about $3,385,615 at current interest rates.

Series 2007A bonds maturing in 2035 totaling $73.25 million were split into two series in 2008 with Series 2007A-1 totaling $63.25 million having a fixed rate of 5.125% through March 31, 2011 and Series 2007A-2 totaling $10 million having a fixed rate of 5.00% through March 31, 2010. Both Series were recombined in 2013 as Series 2007A totaling $73.25 million and remarketed at a floating interest rate. In order to obtain the lowest possible interest rate, these bonds are backed by a letter of credit. The current interest rate including the cost of the letter of credit is about 0.753% resulting in an annual interest expense savings of about $3,189,990 at current interest rates.
Series 2008 State EIERA of the State of Missouri tax-exempt bonds maturing in 2038 totaling $23.4 million were initialing issued in 2008 at a fixed interest rate of 4.90% through June 30, 2013. These bonds were remarketed in 2013 at a fixed interest rate of 2.875% through June 30, 2018 resulting in an annual interest expense savings of $473,850.

On January 1, 2008, KCP&L had three Senior Note issues outstanding. Two of those Senior Notes are still outstanding today at the same interest rate. The 6.50% Senior Notes totaling $150 million matured on November 15, 2011. On September 20, 2011, KCP&L issued $400 million of 5.30% Senior Notes which had a stated use of proceeds that included “to repay all or a portion of the $150 million aggregate principal amount of KCP&L’s 6.50% Senior Notes due November 15, 2011 at maturity.” The annual interest expense savings on the $150 million of 6.50% Senior Notes refinanced in 2011 at 5.30% is $1,800,000.

Information provided by Gregg Clizer, Corporate Finance

Attachment: QMECG_11-11_Verification.pdf

KCP&L
Case Name: 2014 KCPL Rate Case
Case Number: ER-2014-0370

Response to Woodsmall David Interrogatories - MECG_20150212
Date of Response: 03/04/2015

Question:11-12

Does the Company anticipate being able, in 2015, 2016 or 2017, to refinance any of its presently outstanding long-term debt on terms that would reduce annual interest expenses and the overall cost of capital? Please explain each future refinancing opportunity and provide the best available estimates of the approximate annual interest expense savings that may be achieved (with stated assumptions).

Response:

For this response "Company" has been defined as KCP&L. KCP&L has two series of Environmental Improvement Revenue Refunding (EIRR) tax-exempt bonds that are callable at par in 2015. An analysis as of January 14, 2015 provided by Bank of America Merrill Lynch estimated both series of bonds could be refinanced at a new coupon interest rate of 3.50% subject to change with market conditions. The best available estimate of the approximate annual interest expense savings are as follows:

Series 2005 City of La Cygne, Kansas bonds maturing in 2035 totaling $21.94 million at a fixed interest rate of 4.65% and callable at par on September 1, 2015 if refinanced at 3.50% would result in annual interest expense savings of $252,310.

Series 2005 City of Burlington, Kansas bonds maturing in 2035 totaling $50 million at a fixed interest rate of 4.65% and callable at par on September 1, 2015 if refinanced at 3.50% would result in annual interest expense savings of $575,000.

There are no refinancing opportunities for KCP&L in 2016.

In 2017, the Series 1992 State EIERA of the State of Missouri bonds totaling $31 million at a fixed interest rate of 1.25% matures on July 1, 2017 and the 2007 5.85% Senior Notes totaling $250 million natures on June 15, 2017. The bond yield forecast on Bloomberg only goes out to Q2 2016 has the 10 year US Treasury rate at 3.01% which is a 83 basis point increase over the forecast for Q2 2015. Assuming another 83 basis point annual increase would result in a 10 year US Treasury rate of 3.84% for Q2 2017. The average indicative reoffer spread for KCP&L 10 year senior notes provided by various banks so far this year is about 121 basis points. Using these assumptions, an estimated coupon interest rate for new KCP&L 10 year Senior Notes in 2017 would be 5.05% resulting in an estimate of annual interest expense savings from refinancing the maturing tax-exempt bonds and senior notes of approximately $822,000.

Information provided by Gregg Clizer, Corporate Finance
Attachment: QMECG_11-12_Verification.pdf

Verification of Response

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

Docket No. ER-2014-0370

The response to Data Request # 11-11 is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: March 4, 2015

Verification of Response

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

Docket No. ER-2014-0370

The response to Data Request #_____11-12_____ is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: March 4, 2015

SCHEDULE MLB-6

****HIGHLY CONFIDENTIAL****

Verification of Response

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

Docket No. ER-2014-0370

The response to Data Request #____1-9____ is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: December 15, 2014

SCHEDULE MLB-7

KCP&L
Case Name: 2014 KCPL Rate Case
Case Number: ER-2014-0370

Response to Woodsmall David Interrogatories - MECG_20141201
Date of Response: 12/22/2014

Question:2-18

[Property Tax Tracker] Ref: Direct Testimony of Mr. Rush, page 28. Mr. Rush states, "Cost of service components, such as property taxes, that are out of Company management's control to contain or manage are significant contributors to regulatory lag and impact the Company's ability to earn returns reasonably close to returns allowed by this Commission." Please provide the following additional information:

a. Provide a detailed breakdown of KCPL's actual property tax payments, by taxing authority, for each of the past five years (2009 through 2013) in hard copy and electronic (excel) format.

b. Describe whether KCPL dedicates any significant personnel time or other resources to the critical review of property tax filings, billings, valuations or the resolution of disputes with taxing authorities, indicating the number of personnel and costs of resources involved in these efforts.

c. What, if any, disputes have been raised between KCPL and any taxing authorities regarding the property taxes being charged to KCPL in the past five years?

d. Provide the details regarding any property tax payments under protest, refunds of property taxes, or other instances where adjustments have been sought or approved with respect to KCPL's property tax costs.

e. Provide complete copies of all documents associated with each instance of disputed, protested or refunded property taxes in your responses to parts (c) and (d).

f. Provide the Company's best estimate of KCPL's property tax expenses that will be incurred in each future year for which a budget has been prepared.

Response:

Data Request to Kansas City Power & Light Company

From the Missouri Public Service Commission
Case Description: 2014 MO Rate Case
Case: ER-2014-0370
DR #2-18 (Q. b – e) dated Dec 2014

Q. Please provide the following additional information:

b. Describe whether KCPL dedicates any significant personnel time or other resources to the critical review of property tax filings, billings, valuations or the resolution of disputes with taxing authorities, indicating the number of personnel and costs of resources involved in these efforts.

c. What, if any, disputes have been raised between KCPL and any taxing authorities regarding the property taxes being charged to KCPL in the past five years?

d. Provide the details regarding any property tax payments under protest, refunds of property taxes, or other instances where adjustments have been sought or approved with respect to KCPL's property tax costs.

e. Provide complete copies of all documents associated with each instance of disputed, protested or refunded property taxes in your responses to parts (c) and (d).

Response prepared by Shannon Green and Steve Smith
Date of Response: Dec 2014

b. KCPL dedicates the appropriate amount of personnel time to proactively ensure that the Company's property tax compliance is well managed and that the Company pays the minimum amount of its legally owed property tax in conformity with current tax laws and regulations. This effort includes one Full Time Employee (FTE), dedicated to KCPL's property tax planning and compliance, who is an experienced tax accountant with state and local property tax experience in the Public Utility Sector. This person is a member of and attends numerous meetings annually of various utility tax associations, in addition to various other national and state utility tax conferences, including the annual Missouri Assessors Association meetings. It is this persons' responsibility to prepare all state and local property tax filings for KCPL, review for any tax-exempt property, review all tax valuations for fairness, handle and/or assist informal meetings with state and county tax assessors regarding such valuation, review all resulting tax bills for accuracy and ensure timely payment; all while maintaining expertise with all related property tax laws, regulations and current legislation. A tax manager, also experienced in public utility property taxation, dedicates a portion of their time to be involved in KCPL's property tax planning and compliance activities. These personnel are also supplemented by the Company's Director of Tax and consultations with external attorneys and consultants as warranted.

c. The proactive approach taken by KCPL has resulted in the avoidance of any disagreements that have elevated to a formal dispute that would require a payment of tax under protest during the past 5 years. The numerous annual meetings/informal hearings, both by phone and/or in person, with state and county tax assessors has led to final "fair" valuations. The tax bills have been reviewed in detail, confirming tax rates to independent published tax levy tables and the assessed valuations to the actual state or county assessments. Errors when noted, both under-billings and over-billings, are communicated to the taxing authority which then sends out corrected tax bills. Over the past five years, KCPL has verbally communicated errors in tax bills significantly exceeding $1 million, for which all bills were subsequently re-billed correctly prior to payment.

d. None. Due to our extensive communication with tax authorities and review of all property tax bills there have been no payments of tax under protest or refunds of tax in the past 5 years.

e. Not Applicable.

Verification of Response

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

Docket No. ER-2014-0370

The response to Data Request #____2-18_________ is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: December 21, 2014

KCP&L
Case Name: 2014 KCPL Rate Case
Case Number: ER-2014-0370

Response to Woodsmall David Interrogatories - MECG_20150212
Date of Response: 02/27/2015

Question:11-6

According to this response, "Over the past five years, KCPL has verbally communicated errors in tax bills significant exceeding $1 million, for which all bill were subsequently re-billed correctly prior to payment." Please respond to the following:

a. Explain the general nature of the errors being referenced, how they were discovered by KCPL and how communications occurred to achieve agreement with the taxing authorities to correct the errors.

b. Provide an itemized description for the errors that individually exceeded $1 million and the specific changes that were made to assessed values, mill levy rates or other (described) inputs to the determination of tax liability.

c. Explain whether and why it is necessary for the Company to remain vigilant in each year to ensure that only proper amounts of property taxes are paid?

Response:

a. The errors are generally clerical in nature. Most ad valorem property tax bills for electric public utilities in Missouri and Kansas are calculated by the County Treasurer/Collector with input from the County Assessor and/or County Clerk. These tax statements are often manually prepared, containing both the cumulative tax by taxing jurisdiction for locally-assessed property located throughout the County and for the tax on the state-assessed values allocated to various tax jurisdictions in the County. Different mill levies often apply for real v. personal property and for commercial v. agricultural designated property. Due to the history of occasional incorrect bills, and to better estimate its tax liability when mill levy rates become known (often well ahead of the receipt of the tax bills), KCPL has historically calculated the expected tax bill to be received from each County. This expected tax bill is then reconciled to the actual tax bill received to determine if there is a potential billing error. Any potential error noted above a diminutive threshold, regardless if over-billed or under-billed, is communicated to the applicable County taxing official, generally by phone, and is discussed until the KCPL representative is satisfied that there is no error or the County agrees to correct and issue a new tax bill.

b. The two largest single instances of tax billing errors noted in the past five years occurred in 2010 and 2011.

- In 2010, an initial tax bill from Clay County, MO, dated October 13, 2010, was issued in the combined amount of $1,873,152.02. However, a review determined that the County had applied the average school rate against the locally-assessed values instead of the state-assessed values which under-stated the tax bill. Following phone conversations with County personnel a corrected tax bill was issued on October 18, 2010 in the amount of $3,556,783.45, an increase of $1,683,631.43.
- The second instance occurred in 2011 in which KCPL received a tax bill from Platte County, MO on November 22, 2011 which incorrectly double billed most of the locally-assessed personal property, over-stating the total county tax bill by about $520,000. After discussions with the County, a corrected bill was received on December 1, 2011 in the amount of $7,767,005.97 fully reflecting the $520,000 decrease.

c. It is the mission of the KCPL tax department to provide value added tax services in order for management to make effective business decisions, maintain compliance with all regulatory and taxing agencies, enhance shareholder and customer value, and provide exemplary customer service. Reviewing property tax bills for accuracy to ensure that KCPL is in compliance with its legally required level of tax responsibility - paying its fair share but not overpaying - enhances value to taxing agencies, shareholders and rate-paying customers.

Information Provided By: Melissa Hardesty

Attachment: Q11-6_Verification.pdf

Verification of Response

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

Docket No. ER-2014-0370

The response to Data Request #___11-6___ is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: February 26, 2015

SCHEDULE MLB-8

****HIGHLY CONFIDENTIAL****

SCHEDULE MLB-9

KCP&L
Case Name: 2014 KCPL Rate Case
Case Number: ER-2014-0370

Response to Woodsmall David Interrogatories - MECG_20150306
Date of Response: 03/30/2015

Question:14-15

[Income Taxes] Income Tax Expense – Schedule 11; RB-125 CS-125 Income Tax Exp-KCPL-MO Direct HC MO Tax Basis F-7; KCPL Response to MECG 9-13 (Book vs. Tax SL Amounts). In its test year Income Tax Expense calculations within Schedule 11, the Company adds back book Amortization Expense on line 4 of $27.9 million, but then effectively deducts (after calculating deferred income taxes on Excess Tax Amortization) a calculated "Tax Straight Line Amortization" amount of only $18.9 million, resulting in additional taxable income of $9.0 million prior to any consideration of any relevant portions of the "Turnaround of Book/Tax Basis Differences" of $12.2 million on line 49. Please provide the following information:

a. State and explain why the Company is using only $18.9 million of Tax Straight Line Amortization within its ratemaking income tax expense calculation, given KCPL's utilization of full tax normalization accounting except for the "AFUDC Equity basis difference" that is referenced in your response to MECG 4-5(c).

b. Explain the calculations on workpapers F-7 that appear to isolate amortizable plant investment and then apply full year tax straight line rates to estimate Tax Straight Line Amortization.

c. Provide an itemization of the book/tax basis differences for 5-yr and 10-yr software recorded investments at March 2014 and in the RB-20 projected additions that make up the majority of the amortizable asset amounts, indicating each basis difference that is normalized and flowed through.

d. Provide a reconciliation of the $9.0 million difference between test year book and tax straight line amortization in Schedule 11, isolating the portion of this difference explained by AFUDC equity amounts for which normalization accounting does not exist and each other basis difference origination versus turnaround, to demonstrate the reasonableness of this difference.

e. Does the Company contend that any of the offset for estimated 2015 Turn Around Amortization of Basis Difference Deferred of $12.2 million in the income tax expense calculation (at Def. Amortization A-2.5), as referenced in response to MECG question 9-13(b) is believed to reasonably account for the effects of the much lower tax straight line amortization amount used within Schedule 11, compared to the Book Amortization add-back of $27.96 million on line 4.

f. What amount of previously capitalized AFUDC equity is being recovered through test year book amortization expense in the Company's filing?

g. Explain and provide calculations supportive of your response to part (f).

h. Does the Company contend that its test year estimated tax straight line amortization (that is less than book amortization) must provide recovery for any additional non-deductible cost than the amount of AFUDC equity in your response to part (f)?

i. Please explain and provide supporting documentation for any affirmative response to part (h).

j. Please supplement your response to parts (a) through (i) to address any changes in responding with regard to updated December 31, 2014 data recently provided to the Staff.

Response:

The attachments to this response are **HIGHLY CONFIDENTIAL** and contain private company financial information not available to the public and should be handled accordingly.

a. Within workpaper CS-125, Income Tax Expense the Company uses Schedule F-7 to estimate the tax straightline amortization for plant placed in service by taking the tax basis of amortizable accounts and multiplying them times the book recovery rate to estimate the tax-straightline amortization for the case. The $18.9 was calculated based on the accounts that were historically treated as amortizable for rate case purposes. However, General Plant depreciation for plant accounts 391, 393-395 and 397-398 was moved from Line 3 on Schedule 11 to Line 4 in the current case. This change was the result of being approved to use General Plant Amortization for these accounts in the last rate case. The company inadvertently excluded this reclassification from the tax computation in error. The estimated missing tax-straightline amortization of amortizable accounts at December 2014 is listed below:

Guideline Class	Items excluded from Depr Book/Tax Ratio Calc	Full yr TSL rates	Annualized 2014 TSL Amortization
G00.110 SERVICES-OFFICE EQUIP	16,954,413	5.00%	847,721
G00.120 INFO SYSTEMS – HARDWARE	21,022,242	12.50%	2,627,780
G48.320 7 YR MICROWAVE & MISC EQUIP	125,259,509	2.91%	3,648,057

Total missing amortization	163,236,164		7,123,558

b. Schedule F-7 explanation by column:

Guideline Class – List of Property Accounts listed by Tax Guideline Class within our Powertax software.

Tax Basis – [Date] – Provides the tax basis of the guideline classes at a certain date from our Powertax software.

Items excluded from Depr Book/Tax Ratio – Removes tax basis balances for amounts not depreciable for rate case purposes. Includes amortizable amounts, Land, non-utility property, future use, railcar leases, disallowed plant for rate cases, nuclear fuel and capital leases. It also adjust leases for certain equipment and vehicles to Powerplant balances

MO Depreciable Tax Basis – [Date] – Subtracts Items excluded from Tax Basis to arrive at MO Depreciable Tax Basis to be used in Book/Tax Ratio computation on schedule F-8, MO Book/Tax Ratio.

Amortizations Adds Projected per RB-20 – Adds amortizable amounts projected to be added since Tax Basis – [Date] and included in the Rate Case.

MO Amortizable Tax Basis Projected – [Date] – Adds Tax Basis of amortizable guideline classes to Amortization Adds Projected to get the estimated tax basis of amortizable accounts at the true up date in the case.

Full yr TSL Rates – The estimated book amortization % rates by guideline class

Annualized – [Date] - TSL Amortization – The MO Amortizable Tax Basis Projected is multiplied by the Full yr TSL Rate to compute the estimate tax straightline amortization used on Schedule 11, Income tax expense.

c. The book/tax basis differences related to the 5-year and 10-year software is not itemized separately. The cumulative basis difference for Software deducted for tax purposes but not for book purposes is $41,555,769. The estimated "turnaround of basis difference" for Software included in the direct filing was $13,484,231. The deferred tax on this amount at Missouri rates is $5,176,596 on a total company basis. All basis differences related to software are normalized.

d. As mentioned previously in part a., general plant amortization accounts were inadvertently excluded from the amortization calculation. This also impacted the book/tax ratio for tax straightline depreciation. We have revised the CS-125 worksheets using December 31, 2014 data and project May 31, 2015 data and have attached them in the file named "Q14-15_HC_CS-125 F-7 F-8 A-25 Updated.xlsx".

e. A portion of the $12.2 million of the “turn-around of basis differences” is related to amortization basis differences such as “capitalized software differences”. Please see the revised schedule A-2.5 in the file attached to part d. for the current estimate of “turnaround of basis differences” for 2015. The current estimate for the software related basis difference is $15,439,644. The deferred tax at Missouri rates is $5,927,279 on a total company basis.

f. The amount of total AFUDC Equity (including nuclear fuel AFUDC Equity) estimated to be recovered in the direct filing was $7,915,678 on a total company basis. This would create an adjustment of $3,038,828 at Missouri rates on a total company basis to total income taxes.

g. This amount was computed by our Powertax software as it allocated book depreciation to each existing book/tax basis differences. This schedule was provided as an attachment to data request MECG 9-13.

h. No.

i. N/A

J. We have estimated and updated all portions of book depreciation, book amortization, nuclear fuel amortization, book/tax basis ratio for depreciation, tax straightline depreciation, tax straightline amortization, and nuclear fuel tax straightline amortization in the file named “Q14-15_Reconciliation of Book-Tax Depr Amort Flow-through Updated.xlsx” attached. Due to estimates used in Powertax for additions, the allocation of book depreciation and amortization, and the book/tax ratio computations, we have been able to reconcile all but $1,093,334 of the adjustments to income tax expense.

Response prepared by: Melissa Hardesty, Tax

Files attached:
Q14-15_HC_CS-125 F-7 F-8 A-25 Updated.xlsx
Q14-15_Reconciliation of Book-Tax Depr Amort Flow-through Updated.xlsx
Q14-15_Verification.pdf

Verification of Response

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

Docket No. ER-2014-0370

The response to Data Request # 14-15 is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: March 30, 2015

KCP&L
Case Name: 2014 KCPL Rate Case
Case Number: ER-2014-0370

Response to Woodsmall David Interrogatories - MECG_20150306
Date of Response: 03/30/2015

Question:14-17

[Income Taxes] Income Tax Expense – Schedule 11; RB-125 CS-125 Income Tax Exp-KCPL-MO Direct HC MO Book Fuel Amort A-2.1.1; KCPL Response to MECG 9-13 (Book vs. Tax SL Amounts). In its test year Income Tax Expense calculations within Schedule 11, the Company adds back Book Nuclear Fuel Amortization Expense on line 6 of $27.8 million, but then effectively deducts (after calculating deferred income taxes on Excess Tax Return Nuclear Amortization) a calculated "Tax Straight Line Nuclear Amort" amount of $22.4 million, resulting in additional taxable income of $5.4 million prior to any consideration of any relevant portions of the "Turnaround of Book/Tax Basis Differences" of $12.2 million on line 49. Please provide the following information:

a. State and explain why the Company is using only $22.4 million of Tax Straight Line Nuclear Amortization within its ratemaking income tax expense calculation, given KCPL's utilization of full tax normalization accounting except for the "AFUDC Equity basis difference" that is referenced in your response to MECG 4-5(c).

b. Explain the calculations on workpaper A-2.1.1 that appears to calculate a Units of Production annualized fuel, less disposal costs, to estimate Tax Straight Line Nuclear Fuel Amortization.

c. Provide an itemization of the book/tax basis differences for each element of nuclear fuel costs, indicating each basis difference that is normalized versus flowed through.

d. Provide a reconciliation of the $5.4 million difference between test year book and tax straight line nuclear fuel amortization in Schedule 11, isolating the portion of this difference explained by AFUDC equity amounts for which normalization accounting does not exist and each other basis difference origination versus turnaround, to demonstrate the reasonableness of this difference.

e. Explain whether and how any of the offset for estimated 2015 Turn Around Amortization of Basis Difference Deferred of $12.2 million in the income tax expense calculation, as referenced in response to MECG question 9-13(b), is believed to reasonably account for the effects of the much lower tax straight line nuclear fuel amortization amount used within Schedule 11, compared to the Book nuclear fuel expense add-back of $27.8 million on line 6 of Schedule 11.

f. What amount of previously capitalized AFUDC equity is being recovered through test year book nuclear amortization expense in the Company's filing?

g. Explain and provide calculations supportive of your response to part (f).

h. Does the Company contend that its test year estimated tax straight line nuclear fuel amortization (that is less than book nuclear fuel amortization) must provide recovery for any additional non-deductible cost than the amount of AFUDC equity in your response to part (f)?

i. Please explain and provide supporting documentation for any affirmative response to part (h)

j. Please supplement your response to parts (a) through (i) to address any changes in responding with regard to updated December 31, 2014 data recently provided to the Staff.

Response:

The attachment to this response is **HIGHLY CONFIDENTIAL** and contains private company financial information not available to the public and should be handled accordingly.

a. The $22.4 million of tax straighline nuclear fuel amortization is per the calculation on Schedule A-2.1.1of the CS-125 Income Tax Expense workpapers in the Direct filing. This schedule took the total amount of book nuclear fuel amortization per CS-24 and subtracted disposal costs to compute the tax straightline amortization without disposal costs. The book amortization for nuclear fuel amortization on Line 6 of Schedule 11, Income Tax should have also been this same amount. We have corrected and estimated the "MO Update Projected" amounts and provided as part of the response to MECG 14-15. In the schedule attached to the MECG 14-15 data request, the Book nuclear fuel amortization and the tax straightline nuclear fuel amortization are estimated as the same amount per the December 2014 cutoff computation. This estimate will be updated when the "MO Update Projected" calculation is finalized. However, the amounts entered for book nuclear fuel amortization and tax nuclear fuel straightline amortization will equal each other whenever they are input into Schedule 11, Income Tax Expense.

b. The amounts included on Schedule A-2.1.1 are per the CS-24 workpapers.

c. The book/tax basis differences for nuclear fuel are AFUDC Debt and AFUDC Equity. AFUDC Debt is normalized and AFUDC Equity is flowed-through.

d. There should not have been a $5.4 million difference between test year book and tax straightline nuclear fuel amortization on Schedule 11, Income Tax Expense in the Direct Filing. See response to Part a. of this response.

e. No. Per Schedule A-2.5 AFUDC debt turnaround was estimated a $0. And, the AFUDC Equity for Nuclear Fuel is estimated at $415,014. This amount has already been included in the estimate of AFUDC Equity in the response to data request MECG 14-15 for the estimated "MO Update Projected" calculation.

f. $415,014 is the flow-through amount of the AFUDC Equity basis difference "turned around" included in the "MO Update Projected" estimate. Multiplied by the .3839 Missouri Rate, the total company income tax expense impact is $159,323.

g. See the Powertax file named " Q14-17_HC_Nuclear Fuel Basis Turnaround Powertax.pdf"

h. No.

i. N/A

j. Please see the response to data request MECG 14-15 for estimated and updated amounts.

Response prepared by: Melissa Hardesty, Tax

Files attached:
Q14-17_HC_Nuclear Fuel Basis Turnaround Powertax.pdf

Verification of Response

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

Docket No. ER-2014-0370

The response to Data Request #____14-17____ is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: March 30, 2015

KCP&L
Case Name: 2014 KCPL Rate Case
Case Number: ER-2014-0370

Response to Woodsmall David Interrogatories - MECG_20150306
Date of Response: 03/30/2015

Question:14-18

[Income Taxes] Income Tax Expense – Schedule 11; RB-125 CS-125 Income Tax Exp-KCPL-MO Direct HC MO Book Fuel Amort A-2.1.1 (Nuclear Fuel Tax Treatment). In its test year Income Tax Expense calculations within Schedule 11, the Company adds back Book Nuclear Fuel Amortization Expense on line 6 of $27.8 million, but then effectively deducts (after calculating deferred income taxes on Excess Tax Return Nuclear Amortization) a calculated "Tax Straight Line Nuclear Amort" amount of $22.4 million, resulting in additional taxable income of $5.4 million prior to any consideration of any relevant portions of the "Turnaround of Book/Tax Basis Differences" of $12.2 million on line 49. Please provide the following information:

a. Explain the book and tax treatment of nuclear fuel costs and amortization of such costs, indicating each basis, method and life difference arising from such accounting and the Company's accounting for same.

b. Provide a statement of assumptions and detailed calculations supporting the test year (and December 2014 cutoff period) amounts used for tax amortization, tax straight line amortization and book amortization for each element of nuclear fuel, including any disposal costs included in test year amounts.

c. State and explain each reason why all book/tax differences associated with the amortization of nuclear fuel are not fully normalized on the Company's books, such that flow-through income tax impacts arising from differences between book and tax straight line amounts should serve to increase test year revenue requirements.

d. Provide complete copies of all reports, analyses, workpapers and other documents supportive of your response to part (c).

Response:
The attachment to this response is **HIGHLY CONFIDENTIAL** and contains private company financial information not available to the public and should be handled accordingly.

a. Nuclear fuel is amortized under a units of production for book amortization and tax straightline amortization purposes. For tax IRS amortization purposes, the Company uses MACRS and units of productions depending on when the fuel is placed in service within a tax year.

b. Tax straightline amortization and book amortization are provided as Schedule A-2.1.1 in the CS-125, Income Tax Expense workpapers. The amounts should equal and are based on CS-24 workpapers for nuclear fuel. The tax IRS amortization is provided by Powertax. See the file named "Q14-18_HC_Nuclear Fuel tax IRS amort.pdf" attached for the estimated "MO Update Projected" filing amount for the tax IRS amortization for nuclear fuel.

c. Only AFUDC Equity for Nuclear Fuel is not normalized. See the response to data request MECG 14-17 for detailed information.

d. Workpapers for part c. were provided as part of the response to data request MECG 14-17.

Response prepared by: Melissa Hardesty, Tax

Files attached:
Q14-18_HC_Nuclear Fuel tax IRS amort.pdf

Verification of Response

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

Docket No. ER-2014-0370

The response to Data Request #____14-18____ is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: March 30, 2015

SCHEDULE MLB-10

****HIGHLY CONFIDENTIAL****

Verification of Response

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

Docket No. ER-2014-0370

The response to Data Request # 9-6 is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: February 26, 2015

SCHEDULE MLB-11

****HIGHLY CONFIDENTIAL****

KCP&L
Case Name: 2014 KCPL Rate Case
Case Number: ER-2014-0370

Response to Woodsmall David Interrogatories - MECG_20141219
Date of Response: 01/09/2015

Question:4-2

Ref: Accumulated Deferred Income Taxes in Rate Base, RB-125 DIT CS-125 Income Tax Exp-KCPL-MO HC.xls. The Company appears to have included calculated amounts of Federal and State Net Operating Loss ("NOL") deferred tax assets in its asserted rate base. Please provide the following additional information:

a. Provide a detailed discussion and a complete set of input documentation and workpapers supporting the methods and calculations employed to determine the Company's proposed rate base included amounts of federal and state NOL deferred tax asset balances.

b. Provide, for each legal entity included in the Company's consolidated group for federal income tax filing purposes, a reconciliation of each entity's stand-alone federal taxable income to the parent's consolidated federal taxable income as originally filed in each tax year 2007 to date (latest available returns, presumably through 2013). Taxable income and loss amounts for each entity in each year, summing to total consolidated taxable income is desired.

c. Provide, for each legal entity included in the Company's consolidated group for Missouri state income tax filing purposes, a reconciliation of each entity's stand-alone state taxable income to the parent's consolidated state taxable income as originally filed in each tax year 2007 to date (latest available returns, presumably through 2013). State taxable income and loss amounts for each entity in each year, summing to total consolidated taxable income is desired.

d. Updated information for parts (b) and (c) to show the effects of all audit and other adjustments to taxable income in each of the prior tax years, to date.

e. Using the information from your responses to parts (b),(c) and (d) as well as any additional required data, explain how the Company has determined the federal and state NOL balances recorded in Account 190 on KCPL books as of December 31, 2013 and provide calculations supportive of such per books NOL balances.

f. Provide complete copies of any tax allocation agreements applicable to Great Plains Energy entities for attribution of consolidated tax expense and liabilities among subsidiary entities.

g. Explain how the NOL deferred income tax provisions supported by the document(s) supplied in response to part (e) were employed in determining the amounts provided in response to part (a).

h. Has KCPL provided any reserves on its books for Uncertain Tax Positions ("UTPs") that impact test year amounts?

i. If your response to part (h) is affirmative, please describe and quantify each UTP and explain how it was treated in determining rate base deferred tax and NOL carryforward balances.

Response:

The attachments to this response are **HIGHLY CONFIDENTIAL** and contain private company financial information not available to the public and should be handled accordingly.

a, e & g. The Company has only included deferred taxes in rate base on net operating losses incurred by Kansas City Power & Light Company that have not been used by the consolidated group on its federal and state tax returns. The only year where this occurred was 2011. KCP&L incurred a loss of $186,521,122 on its separate company tax return. The GPE Consolidated Group had a loss of $313,761,508 for the same year. Under the consolidated tax return regulations, the consolidated group loss is allocated to all the loss companies on a pro-rata basis. This resulted in $182,259,412 of loss allocated to KCP&L. The loss from 2011 was also incurred for state tax purposes.

See the file named “Q4-2_HC_GPE Taxable Income.xlsx” for a detailed computation of the loss allocated to KCP&L.

Federal deferred tax assets were then computed at 35% of the loss allocated to KCP&L or $63,790,794. State deferred tax assets were computed at the appropriate state rates and recorded to the ledger. This amount is $6,646,589 at December 31, 2013. The State deferred tax asset was then modified to reflect only the Missouri state rate (net of federal taxes) of 3.9%. The result was State deferred tax asset for NOLs of $5,777,420. The total combined deferred tax asset was $69,568,214 before jurisdictional allocations included in rate base.

See the file named “Q4-2_HC_GPE Taxable Income.xlsx” for a detailed computation of the deferred tax assets included in ledger and rate base for KCP&L.

b, c & d. See the file named “Q4-2_HC_GPE Taxable Income.xlsx” for a detailed computation of taxable income for federal and state purposes from 2007-2013.

f. See the file named “Q4-2_HC_Tax Sharing Agreement for GPE and Subs.pdf” for a copy of the current tax allocation agreement.

h. No.

i. N/A

Response prepared by: Melissa Hardesty, Tax

Files Attached:
Q4-2_HC_GPE Taxable Income.xlsx
Q4-2_HC_Tax Sharing Agreement for GPE and Subs.pdf
Q4-2_Verification.pdf

Verification of Response

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

Docket No. ER-2014-0370

The response to Data Request #____4-2___________ is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: January 8, 2014

KCP&L
Case Name: 2014 KCPL Rate Case
Case Number: ER-2014-0370

Response to Woodsmall David Interrogatories - MECG_20150306
Date of Response: 03/25/2015

Question:14-21

[Deferred Income Taxes] Ref: KCPL Response to Staff Question 225; MECG 9-12(d) (Aquila Acquired NOLs). The attachment to Staff Question 225 sets forth detailed historical data for the Aquila Preacquisition NOLs recorded by GPE. Please provide the following additional information:

a. Provide a complete statement of GPE's consolidated NOL deferred tax and deferred tax credit NOL balances, as of December 31, 2013 and December 31, 2014 by entity, indicating the intended sequencing of future utilization of such amounts against future consolidated taxable income.

b. In response to MECG 9-12(d), the Company references "significant losses acquired with the merger of Aquila in 2008 that precede the KCPL net operating losses and those will be used first in accordance with IRS regulations." Does Great Plains Energy intend to utilize all of the Aquila Preacquisition NOLs prior to utilization of any KCPL NOL carryforward balances?

c. If your response to part (b) is affirmative, please provide illustrations showing the impact of sequenced early utilization of Aquila NOLs upon the recorded KCPL carryforward balances, indicating how the consolidated tax allocation agreement would account for such impacts.

d. Does Great Plains Energy intend to utilize all of the Aquila Preacquisition NOLs prior to utilization of GMO's more recent NOL carryforward balances?

e. If your response to part (d) is affirmative, please explain and provide illustrations showing the impact of sequenced early utilization of Aquila NOLs upon the recorded GMO carryforward balances, indicating how the consolidated tax allocation agreement would account for such impacts.

f. Explain whether and how the Company's intended utilization of Aquila Preacquisition NOLs prior to KCPL and GMO NOL realization is reasonable from the perspective of KCPL and GMO ratepayers.

Response:

The attachments to this response are **HIGHLY CONFIDENTIAL** and contain private company financial information not available to the public and should be handled accordingly.

a. See attached file named "Q14-21_HC_ADIT NOLs Credits Fed MO.xlsx" for the deferred tax assets by legal entity for Great Plains Energy and subsidiaries for federal net operating losses, Missouri net operating losses, federal tax credits and Missouri tax credits at December 31, 2013 and December 31, 2014. The order of items used is all NOLs first, all general business credits, and then all minimum tax credits. For each item the oldest vintage (tax year) will be used first. The consolidated group has additional tax benefits for various other states, including Kansas. However, they are not relevant to this proceeding and have not been provided.

b. Yes. Great Plains Energy is required to utilize the NOLs in the same order that they were created. So, the pre-acquisition NOLs will be used prior to NOLs generated after the acquisition, including KCPLs.

c. KCPL's ADIT for net operating losses will not change (other than for audit or other potential future amended returns) until the consolidated group utilizes the 2011 and 2014 NOLs. The tax allocation agreement pays each subsidiary when its allocated NOLs are used. Therefore, KCPL will be paid for its allocated 2011 and 2014 NOLs when they are used by the consolidated group.

d. Yes. See the response to part b.

e. GMO's ADIT for net operating losses will be reduced as the NOLs are utilized by the consolidated group. The oldest vintage will be used first. The tax allocation agreement pays each subsidiary when its allocated NOLs are used. Therefore, GMO will be paid for its allocated NOLs when they are used by the consolidated group.

f. Great Plains Energy must follow the IRS ordering rules for utilization of NOLs. There is no option for later NOLs first. If the Company was not allowed to utilize the Aquila Pre-acquisition NOLs, it would cause significant financial harm to GPE and GMO. GMO would be required to write off over $340 million of Federal and Missouri tax benefits available to the company just to use the post-acquisition NOLs. This is a cash benefit that GMO ratepayers will receive in future years. If we must write them off, GMO would be required to borrow additional cash to cover this shortfall in the future.

Response prepared by: Melissa Hardesty, Tax

<u>Files attached</u>
Q14-21_HC_ADIT NOLs Credits Fed MO.xlsx

Verification of Response

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

Docket No. ER-2014-0370

The response to Data Request #___14-21___ is true and accurate to the best of my knowledge and belief.

Signed: Tim Rush

Date: March 24, 2015