Exhibit No.: 13-NP
Issue: Income Taxes
Witness: Melissa K. Hardesty
Type of Exhibit: Surrebuttal Testimony
Sponsoring Party: Great Plains Energy Incorporated; Kansas City Power & Light Company; and KCP&L Greater Missouri Operations Company
Case No.: EM-2017-0226, et al.
Date Testimony Prepared: March 27, 2017

MISSOURI PUBLIC SERVICE COMMISSION

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

SURREBUTTAL TESTIMONY

OF

MELISSA K. HARDESTY

ON BEHALF OF

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

Kansas City, Missouri
March 2017

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

SURREBUTTAL TESTIMONY

OF

MELISSA K. HARDESTY

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

Q: Please state your name and business address.

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

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

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

Q: What are your responsibilities?

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

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

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

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

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

Q: What is the purpose of your Surrebuttal Testimony?

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

Q: Please identify the two issues,

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

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

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

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

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

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

[2] Gorman Rebuttal, p. 24.

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

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

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

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

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

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

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[3] Gorman Rebuttal, pp. 20-21.

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

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

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

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

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

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

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

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

Q: Do you agree with Mr. Gorman's proposal?

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

Q: Please explain why Mr. Gorman's proposal is unnecessary.

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

Q: How may Mr. Gorman's solution harm customers?

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

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[4] Gorman Rebuttal, p. 2.

Q: What are those examples?

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

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

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

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

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

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

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

Q: Does that conclude your Rebuttal Testimony?

A: Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

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

AFFIDAVIT OF MELISSA K. HARDESTY

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

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

1. My name is Melissa K. Hardesty. I work in Kansas City, Missouri, and I am employed by Kansas City Power & Light Company as Senior Director of Taxes.

2. Attached hereto and made a part hereof for all purposes is my Surrebuttal Testimony on behalf of Great Plains Energy Incorporated, Kansas City Power & Light Company, and KCP&L Greater Missouri Operations Company consisting of seven (7) pages, having been prepared in written form for introduction into evidence in the above-captioned docket.

3. I have knowledge of the matters set forth therein. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded, including any attachments thereto, are true and accurate to the best of my knowledge, information and belief.

Melissa Hardesty
Melissa K. Hardesty

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

Nicole A. Wehry
Notary Public

My commission expires: Feb. 4 2019

NICOLE A. WEHRY
Notary Public - Notary Seal
State of Missouri
Commissioned for Jackson County
My Commission Expires: February 04, 2019
Commission Number: 14391200

SCHEDULE MKH-1

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