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September 28, 2015

The Honorable Robert Godshall  
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House Consumer Affairs  
P.O. Box 202053  
Harrisburg, PA 17120-2053

The Honorable Peter Daley  
Chairman  
House Consumer Affairs  
P.O. Box 202049  
Harrisburg, PA 17120-2049

RE: House Bill 1436 – “Stand-alone” Calculation of Federal Tax  
Expense of Utilities in Rate Proceedings

Dear Chairmen:

The National Association of Water Companies (NAWC) [www.nawc.org/](http://www.nawc.org/) represents all aspects of the private water service industry including ownership of regulated drinking water and wastewater utilities and the many forms of public-private partnerships and management contract arrangements offered by unregulated subsidiary companies. The Pennsylvania Chapter consists of 8 member companies that provide safe and reliable drinking water service to approximately 3.1 million Pennsylvanians in 485 communities over 39 counties. In addition, four of our member companies provide wastewater service to over 155,000 Pennsylvanians in 25 communities over 8 counties.

The NAWC, PA Chapter supports [House Bill 1436](#) (Godshall-R), which is the subject of a September 29, 2015 public hearing of the House Consumer Affairs Committee. The Chapter respectfully requests the committee’s consideration of this legislation in the near future.

House Bill 1436 amends Title 66 (Public Utilities) requiring that a public utility’s federal income tax expense must be calculated separately, on a “stand-alone” basis, from any gains or losses of an unregulated affiliate in rate proceedings before the Public Utility Commission. Specifically, tax must be based on the utility’s own operations, expenses, and investments, and not those of the utility’s unregulated affiliates or parent company.

While section 1501 of the Federal Internal Revenue Code allows affiliated companies to file income tax returns on a consolidated basis, Pennsylvania’s state appellate courts have mandated a policy requiring the Public Utility Commission to make a “consolidated tax adjustment” (CTA) so that the rates of the utility are reduced to reflect the tax benefits arising from the business activities of its unregulated affiliate.

However, the Chapter believes that a utility's tax expense should be based on its own operations, investments and expenses, and not on those of its unregulated affiliates. Since utility rates may not be increased to recover losses of an unregulated affiliate, it is only fair that the utility's rates should not be decreased based on tax losses arising from the activities of unregulated affiliates.

The "stand-alone" approach proposed under House Bill 1436 fairly allocates the benefits and burdens whereby utility customers that bear the burden of an expense would also receive the benefit of a tax deduction related to that expense, but they would not receive the benefit of a tax deduction that arose from an expense borne by the shareholders of an unregulated affiliate.

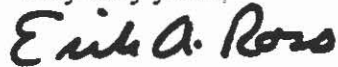
Due to the current CTA, an unregulated affiliate of a Pennsylvania utility is at a competitive disadvantage relative to other companies that do not have utility affiliates in the Commonwealth. This occurs because the unregulated affiliate of the Pennsylvania utility is forced to give back to utility customers some of the tax benefits related to its activities, while a competing company that does not have a utility affiliate in Pennsylvania can retain and reinvest those tax benefits.

Pennsylvania is one of a small and shrinking minority of jurisdictions that impose a CTA in setting utility rates. For example, Virginia passed legislation barring the CTA in 2007, Texas passed legislation that eliminated the CTA for electric utilities effective September 2013, and the New Jersey Board of Public Utilities ("BPU") entered an Order on October 22, 2014, modifying its CTA policy and greatly reducing the subsidy to ratepayers.

Therefore, to encourage investment in Pennsylvania and align the Commonwealth with the policy followed in a strong majority of other states<sup>1</sup> and the federal government, the NAWC, PA Chapter respectfully requests that the General Assembly enact House Bill 1436 to require a "stand-alone" approach and eliminate the CTA in rate proceedings.

The Chapter thanks you for considering our comments on this legislation. If you should need any additional information or have any questions, please do not hesitate to contact me.

Very truly yours,



Erik A. Ross  
Governmental Relations

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<sup>1</sup> States and other jurisdictions that have adopted the standalone approach and rejected the CTA are Arizona, Arkansas, California, Colorado, Hawaii, Idaho, Kentucky, Maryland, Minnesota, Nebraska, Nevada, New Mexico, New York, North Carolina, Virginia, Washington, Wyoming, the District of Columbia, and the Federal Energy Regulatory Commission.