

BEFORE THE
House Consumer Affairs Committee

Hearing on House Bill 1436

**Legislation requiring “standalone” calculation of federal tax
expense of utilities in rate proceedings**

Testimony of

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Good morning Chairman Godshall, Chairman Daley and members of the Consumer Affairs Committee. My name is Mark Kaplan and I am Senior Vice President Chief Financial Officer and Treasurer for Duquesne Light Holdings (“Duquesne Light”). Duquesne Light’s utility serves about 600,000 customers covering 817 square miles in Allegheny and Beaver Counties. We have over 1,400 employees spread across nine locations in our service territory. I am here today to talk about House Bill 1436 and discuss why the consolidated tax adjustment (“CTA”) should not be included in the computation of income tax expense for ratemaking purposes.

By way of background, the Internal Revenue Code permits companies to join together in filing a consolidated income tax return. In arriving at a consolidated tax return, each affiliated company reports their separate income and expenses from their separate books and records. The separate company income and losses are then added together to arrive at a combined or consolidated group taxable income or loss. In this consolidation, tax losses from one company may reduce the tax burden of the consolidated group. Duquesne Light does file a federal consolidated return for its electric utility and non-regulated affiliates. For Pennsylvania ratemaking purposes, the CTA mechanism reduces the utility’s separate company income tax expense by the tax losses of non-regulated affiliates.

In our consolidated group, we have a nonregulated affiliate, DQE Communications, which has added nearly 50 new employees over the last 5 years. DQE Communications has been named to Pittsburgh’s Top 100 fastest growing companies in the area. We have plans to further expand this business, which will require significant capital. When computing the taxable income for this affiliate company, we are permitted to take a tax deduction for a large portion of this capital spend, which will reduce the cash paid to the IRS when we file our consolidated tax return. DQE Communications will use this cash tax savings to invest in capital, expand the business and create jobs. However, the current CTA imposed by the appellate courts, results in Duquesne Light’s customers receiving a portion of DQE Communications tax benefits. Through the CTA mechanism, any tax loss from DQE Communications will ultimately reduce the utility customer rates even though its customer’s did not pay for the DQE Communication investment nor take on any risk associated with the nonregulated business. By flowing a tax benefit

associated with the affiliate's tax loss to the utility in the form of lower rates, the communication business is denied the use of the tax benefit in its own operations. The affiliate is financially handicapped by the CTA because of its relationship to the regulated utility, whereas another communications business without a PUC regulated affiliate suffers no such detriment and would be able to fully utilize any tax benefits generated from its own separate company operations. The utility is not permitted to increase rates to recover losses of its nonregulated affiliates; however the CTA operates to only decrease rates based on the tax losses arising from the nonregulated affiliate. This situation demonstrates the fundamental flaw in the CTA and respectfully, why it must be fixed through this legislation.

In Duquesne Light's last few distribution rate cases, on average the CTA impact in the rate case filings was less than \$0.50 per month per residential customer.

In summary, for reasons stated in the testimony of Terry Fitzpatrick, President and CEO of Energy Association of Pennsylvania and the other members of the industry panel, we support HB 1436 to eliminate the CTA as approved by the FERC and nearly every state. This will allow rates to be based on the stand alone revenues and expenses of the regulated utility. We believe this bill is fair and will allow our nonregulated affiliate to maintain a competitive balance as we expand and create jobs in Pennsylvania.

I want to thank you for the opportunity to present this testimony and would be happy to entertain any questions that members of the Committee may have.