McCARTER &ENGLISH
ATTORNEYS AT LAW

May 23, 2016

VIA ELECTRONIC FILING

Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: *Definition of Political Subdivision,* REG-129067-15:
Submission of Comments and Request to Speak

James R. Choukas-Bradley
Partner
T. 202-753-3410
F. 202-354-4642
jchoukasbradley@mccarter.com

Dear Sir or Madam:

On behalf of the American Public Gas Association (APGA), I hereby submit for filing the attached comments of APGA regarding the proposed regulations issued in the above-referenced docket.[1]

I also respectfully request permission for David Schryver, Executive Vice President of APGA, to speak on behalf of APGA at the public hearing scheduled for June 6, 2016, at 10:00 a.m. The following is the outline of the topics Mr. Schryver will discuss, along with the time to be devoted to each topic:

1. The nature and purpose of APGA: *1 minute*.
2. The public services and public benefits that APGA members provide: *3 minutes*.
3. How APGA members are governed as public entities: *3 minutes*.
4. How the proposed regulations regarding the definition of "political subdivision" would adversely affect APGA members: *3 minutes*.

Thank you for your consideration and assistance.

Respectfully submitted,

/s/ *James R. Choukas-Bradley*
James R. Choukas-Bradley

Attorney for the American Public Gas Association

Attachment

McCarter & English, LLP
1015 15th Street, NW
12th Floor
Washington, DC 20005
T. 202.753.3400
F. 202.296.0166
www.mccarter.com

[1] *Definition of Political Subdivision,* Notice of Proposed Rulemaking, 81 Fed. Reg. 8,870 (Feb. 23, 2016), *corrected*, 81 Fed. Reg. 13,305 (Mar. 14, 2016).

BEFORE THE
UNITED STATES DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE

Definition of Political Subdivision	)	REG-129067-15

COMMENTS OF THE
AMERICAN PUBLIC GAS ASSOCIATION

I. Introduction

The American Public Gas Association ("APGA") submits these comments pursuant to the Notice of Proposed Rulemaking ("NOPR" or the "Proposed Rule") issued in the above-referenced proceeding by the Internal Revenue Service ("IRS" or the "Service") and published in the Federal Register on February 23, 2016, as corrected by publication on March 14, 2016.[1] The NOPR sets forth proposed regulations regarding the definition of political subdivision for purposes of determining eligibility to issue tax-exempt bonds under Section 103 of the Internal Revenue Code (the "Code").[2]

APGA opposes the Proposed Rule and urges the IRS to withdraw it and terminate the captioned proceeding. If the Service withdraws the pending NOPR and issues new proposed regulations, APGA requests that the Service target the problem it has identified concerning certain development districts in a way that does not harm APGA members, which uniformly provide significant benefits to the public in the geographic areas they serve, as described in detail in these Comments. APGA members depend on access to tax-exempt funding for the construction of necessary infrastructure to ensure their ability to continue to provide safe and reliable natural gas service in their communities and to acquire long-term gas supplies at

---

[1] *Definition of Political Subdivision,* Notice of Proposed Rulemaking, 81 Fed. Reg. 8,870 (Feb. 23, 2016), *corrected*, 81 Fed. Reg. 13,305 (Mar. 14, 2016).

[2] 26 U.S.C. § 103.

reasonable and competitive prices for the benefit of the consumers they serve. Loss of access to tax-exempt financing would cause market disruptions and hardships for many APGA members to the detriment of the gas-consuming public.

II. Description of APGA and Its Members' Role in the Natural Gas Industry

APGA is the national association of publicly-owned natural gas distribution systems. Natural gas heats about half the homes in the United States. It is a dominant fuel for water heating and cooking. It is a widely used fuel for manufacturing in the Unites States, and is an essential component of the manufacturing process of certain products, such as agricultural fertilizers. Increasingly, natural gas is the fuel of choice for generating electricity.[3] Reductions in carbon emissions in the United States in the last ten years are in large part a result of the increasing use of natural gas to generate electricity.

While most gas consumers and businesses in the United States are served by investor-owned distribution systems, as are consumers in metropolitan Washington, DC, that is not the case in many smaller cities and towns in non-metropolitan areas and in rural regions, particularly in the South and the Midwest. There are approximately 1,000 public gas systems in 37 states out of a total of approximately 1,200 gas distribution systems throughout the country. Over 720 of these public gas systems are APGA members.

Publicly-owned gas systems are not-for-profit, retail distribution entities owned by, and accountable to, the communities and the citizens they serve. They include gas distribution systems in many legal forms: those owned by cities and towns; gas and other public utility districts; county and multi-county gas districts; gas districts created by multiple municipalities; publicly-owned gas boards; and other public agencies that own and operate natural gas

[3] Energy Information Administration, Natural Gas Explained: *Use of Natural Gas*, http://www.eia.gov/energyexplained/index.cfm?page=natural_gas_use.

distribution facilities. All are political subdivisions either created directly by state or local law or organized under state or local enabling legislation. None exists or operates for the benefit of private parties. Their retail customers are served as members of the general public under generally available tariffs and rate schedules.

In addition, APGA's membership includes, as agency members, a number of governmental entities that do not own retail distribution systems but rather have been formed by municipalities under state law as joint action gas supply agencies, for the purpose of acquiring long-term gas supplies for municipal gas distribution systems and managing those systems' transportation and storage contracts with the federally regulated interstate pipelines to which they are connected.

APGA members regularly benefit from the issuance of tax-exempt bonds, both directly and through their participation in governmental entities that have been formed and operate for the benefit of natural gas consumers. For many, access to tax-exempt funding was the reason they were able to bring natural gas service to rural parts of the country in the first place, beginning over 60 years ago, stimulating their economies through the attraction of industry and jobs, and providing safe, reliable, and affordable energy to keep people warm in the winter and fuel other appliances that vastly improved the quality of peoples' lives.

The importance of access to tax-exempt financing to APGA's members is as great today as ever, especially in view of new pipeline safety regulations being issued by the Pipeline and Hazardous Materials Safety Administration. Any threat to their continued access to it, whether intended or unintended, will be strongly opposed, both in the regulatory process and politically. Elected officials, whether at the local or state level, are acutely attuned to the needs of public gas

systems in their areas to build new and updated infrastructure and to acquire long-term gas supplies.

III. The "Governmental Control" Portion of the Proposed Rule Should Be Eliminated

A. First, Do No Harm.

APGA finds the heart of the Proposed Rule to be the "governmental control" section, § 1.103-1(c)(4). Though perhaps intended to be targeted and narrowly focused, in fact the provisions of that section are not. The first principle of any proposed rule should be "first, do no harm." The Proposed Rule either would or could terminate the status of scores of public natural gas distribution systems and their joint action gas supply agencies as "political subdivisions" for purposes of issuing tax-exempt bonds. These are systems and agencies that unequivocally provide significant public benefits to the people, businesses, industries and economies of the states and communities that have established them or authorized their organization. They provide a necessary fuel and do so on a safe, reliable, and affordable basis. They do not operate for profit. Included in the group of APGA members that either would or could fall within the penumbra of the adverse impacts of the Proposed Rule are scores of systems and agencies that have been tax-exempt since their formation as long as 65 years ago, and which indeed owe their existence to the ability to issue tax-exempt bonds.

B. The Proposed Rule Would or Could Do Significant Harm to the Nation's Public Gas Distribution Network.

The Proposed Rule would or could adversely affect APGA members in terms of both infrastructure and gas supply. Most APGA members serve small communities in predominantly rural areas of our country, many of which are economically disadvantaged. APGA members also serve a number of major cities, including Philadelphia, San Antonio,

Memphis, Omaha, Long Beach, Colorado Springs, Pensacola, Richmond, and Charlottesville. Many of the consumers they serve are economically disadvantaged as well.

Natural gas was first brought to many rural areas following the construction of the long-line interstate gas transmission pipelines that were built after World War II to bring new discoveries of natural gas from major producing areas in Texas, Oklahoma, Louisiana, and other states to major market areas in the Northeast and Midwest.[4] The pipelines traversed rural regions of the country, but in many cases the pipeline companies were not interested in serving them. Investor capital was not available to construct new distribution systems in these areas. But community and business leaders throughout the South and Midwest solved their problem by aggregating the requirements of small towns and potential consumers and issuing tax-exempt bonds to finance the construction of transmission and distribution systems to serve them. The continuing need for expansions, and for replacements required by safety requirements, make access to tax-exempt financing for public gas systems of ongoing importance.

The availability of natural gas made the siting of manufacturing industries possible, and, following their location in such areas, brought to reality the direct employment of thousands of people in productive and important occupations and enterprises and the indirect employment of many times more. This is still true today, and it is of growing significance in light of the revitalization of domestic manufacturing that the nation is witnessing, in large part because of the abundant supply and reduced cost of natural gas in the United States.

Access to tax-exempt financing to acquire long-term gas supplies is also crucial for public gas systems. Following the deregulation of the commodity portion of the gas industry that

[4] *See* John P. Gregg, *Regulation of the Gas Industry*, § 42.01 ("Rates And Service Obligations Of Municipally Owned Gas Distributors") (LexisNexis Mathew Bender 2015).

began over 30 years ago, many APGA members use tax-exempt financing to meet the obligations thrust upon them by changes in federal law, which required them to purchase their own gas supplies and ship them through the interstate pipelines, rather than buying a bundled product from the pipelines. APGA members must acquire the gas supplies they need to serve their customers. Access to tax-exempt financing is an important tool in their tool box for acquiring that gas supply on a long-term basis at a reasonable and competitive price, despite their small size and lack of market power.

C. State Legislatures Have Found Serving These Needs To Be an Important Public Function, One That Serves an Important Public Purpose.

Decisions concerning the public purpose served by APGA members have been made where they should be made – at the state and local level, closest to the people, where the need, and the best means to meet the need, can most appropriately be identified. APGA asks: Once that decision has been made at the state and local level, how can it be prudent public policy to superimpose federal bureaucratic decisions, and the imposition of the federal taxation power, on APGA's members and the consumers they serve? If the Service finds it necessary to curb abuses that it has identified in other arenas, having nothing to do with natural gas supply and distribution, it should limit its proposed regulatory actions to those areas.

In summary, APGA respectfully urges the Service to withdraw the NOPR with respect to the "governmental control" provisions, § 1.103-1(c)(4) of the Proposed Rule.

IV. A Few Examples of the Types of Governmental Entities That Exist in the Public Gas Industry, and of the Harm, or Potential Harm, That Would Be Inflicted on APGA's Members by the Proposed Rule

A. Public Gas Distribution Systems and Joint Action Agencies Have Been Organized Under a Variety of Statutory Structures.

The governmental structures under which public gas systems and their joint action gas supply agencies have been organized and established under state law are numerous and nuanced – too much so for APGA, with over 700 members, to comprehensively detail in these Comments. To be sure, many APGA members which own and operate natural gas distribution systems in the communities they serve are incorporated municipalities that have all three of the sovereign powers (taxation, eminent domain, and police) and therefore meet the "governmental control" test within § (c)(4)(ii)(A) of the Proposed Rule. But many do not. Under the Proposed Rule, those that do not must meet the "electorate" test under § (c)(4)(ii)(B). That test would or could deny many public gas systems and joint action agencies the ability to issue tax-exempt bonds. While not "municipalities" holding *all* of the sovereign powers, these governmental entities nonetheless have been granted at least one of those powers and meet every reasonable standard of providing a public benefit under powers expressly granted by the people of the states through their elected representatives.

B. The Proposed Rule Is at Best Ambiguous.

Some who have a compelling interest in the proposed regulations, including some of APGA's members and others with whom APGA has consulted, believe that the Proposed Rule as written would eliminate future tax-exempt financing for any entity that is not controlled by a single city, town or county's elected governing body. And even if that is not their intent, certain key provisions of the governmental control section of the Proposed Rule are inscrutable.

1. The State or Local Governmental Unit Test.

The Proposed Rule requires, in § (c)(4), that: "A State or local governmental unit exercises control over the entity." What does that phrase mean? Does that language intend to draw a distinction between the "State or local governmental unit" exercising control and the "entity"? If it does, it is specious as a matter of policy. If it does not, it is confusing.

Take the example of a gas district formed under a state law authorizing two or more municipalities to organize a new public corporation to provide natural gas distribution service to consumers living in cities and towns and unincorporated areas in a rural part of a state, with powers that include eminent domain but not tax or police powers. Once the entity has been organized and incorporated in the manner prescribed by the state law, the entity has the legal (and real-world) status as a stand-alone governmental entity. The gas district is not an instrumentality of its members or an "on behalf of" entity. It *is* the "entity." And, once organized, it *is* the state or local governmental unit. But the Proposed Rule suggests that a distinction exists, or must exist, and that some *other* state or local governmental unit must exercise control over the gas district.

Under the Proposed Rule, what is the "state or local governmental unit" that exercises control over the gas district in our example, as required for the entity to be a "political subdivision" qualified to issue tax-exempt bonds for required infrastructure and long-term gas supplies? Obviously, that "unit" is not any single municipality, and it is not any state agency. By definition, because the gas district has been organized and created by actions of more than one municipal or other governmental entity, it will not be controlled by any single municipality. Under the state law, it is controlled by *its* board of directors, which under that law is made up of representatives of the member municipalities. Thus, the "state or local governmental unit" that

exercises control over the entity is its board of directors. Does the language of the Proposed Rule mean that the governing body of the entity is the "state or local governmental unit"? APGA submits that it must be. That is the only reading that makes sense. Yet it certainly is not stated in a way that makes sense on its face.

Any other interpretation would bar scores of governmental entities that have been established pursuant to the will of state legislatures, to provide public benefits determined by those legislatures to be important to the well-being of the state and its people, from issuing tax-exempt bonds in the future. APGA suggests such a result cannot reasonably be the intent of the Proposed Rule.

That APGA's reading must be correct is buttressed by the alternative categories for vesting of control set forth in § (c)(4)(ii) of the Proposed Rule. Under § (c)(4)(ii)(A), a state or local governmental unit that has all three sovereign powers acting through its governing body or its officials acting in their official capacity qualifies. This category embraces states or municipalities, basically. For APGA members which are cities and towns that own and operate the gas distribution system serving their community, this works. Obviously, however, this category is not intended to, and will not, embrace any governmental entity, such as the gas district in our example, that has been granted authority to provide natural gas service as a public function, but not governmental functions of all types.

Take another example, that of a joint action agency. In the public natural gas world, a joint action agency is a governmental entity that has been created by or organized pursuant to a law enacted by the legislature in a state.[5] APGA agency members are found in many states. These joint action agencies were formed following (or in conjunction with) the deregulation of

[5] Interlocal cooperation state statutes permit governmental entities to form a new governmental entity that serves them all with energy, public health, police, fire and many other services.

the commodity portion of the natural gas industry. That deregulation process took place in the 1980s and 1990s through both Congressional action and regulatory action by the Federal Energy Regulatory Commission. Those actions required gas distribution systems, including APGA's members, to begin buying the gas supplies they needed in order to serve their customers *on their own* in a deregulated natural gas market instead of purchasing their needed supplies from interstate pipelines in a fully regulated environment under permanent certificates of public convenience and necessity and regulated long-term contracts. This daunting – indeed, frightening – prospect, thrust upon them over their strenuous objections and opposition in the regulatory process, prompted many APGA members to pool their resources, obtain any necessary state legislative authorization, and begin aggregating their municipal members' demands so they could successfully purchase necessary supplies and have them delivered to their communities at reasonable and affordable prices.

Under a typical joint action agency statute, public gas systems (municipalities, gas districts, utility districts, gas authorities, and other forms of governmental organizations, different in different states) are empowered to join together to form a new governmental entity that can purchase gas, manage transportation needs on the interstate pipelines, manage storage, and undertake all of the scheduling, balancing, and other operational functions required in the deregulated natural gas industry, on behalf of all of the members. For many small municipal systems, this joint action made operating in the deregulated world possible, on a basis that could ensure reliability of service and reasonable costs.

The joint action agency is governed by a board of directors or commissioners made up of representatives of the member governmental entities. The board is not controlled by any individual member entity. The directors may be government officials. They may also be

citizens who are neither elected or appointed municipal officials. But once they are elected or appointed to the board they are officials of a governmental entity – the joint action agency *itself*.

2. The Electorate Test.

The second qualifying category under the Proposed Rule, § (c)(4)(ii)(B), is "an electorate established under applicable State or local law of general application, provided the electorate is not a private faction" (as that latter term is defined in the Proposed Rule). Setting aside for now a discussion of the "private faction" tests set out in the Proposed Rule, the "electorate" category raises two fundamental questions.

First, what is an "electorate"? It is not defined in the NOPR. As a practical matter, is the use of that term simply a confusing way of describing a governing body? It would seem so to APGA as we read the NOPR. Is there a reason for the Proposed Rule not to say so, or least not to say, even parenthetically, "for example, a governing body, such as a board of directors"? That clarification should be made.

Second, what does the phrase "of general application" mean? It is not defined. Does it include or exclude a gas district or authority or utility district created by action of a state legislature through a private act, not a public law, such as one authorizing the merger of two existing, publicly-owned gas systems and defining the powers and governance structure of the new entity? What policy difference can it make to the status of a governmental entity as a political subdivision whether the applicable law establishing the "electorate" is a generally applicable enabling law or a specifically applicable private act? That distinction in the language of the Proposed Rule should be eliminated by deleting the words "of general application" from § (c)(4)(ii)(B).

3. The Private Faction Test.

Section (c)(4)(ii)(B) states that an "electorate" that otherwise qualifies under the "governmental control" test cannot be a "private faction." Section (c)(4)(iii) defines "private faction." The Proposed Rule states that if the exercise of control "is determined solely by the votes of an unreasonably small number of private persons," then the electorate does not meet the § (c)(4)(ii)(B) test. But what is a "private person" for purposes of the private faction test? That term is not defined in the Proposed Rule, and the meaning of the term is not self-evident. Is a "private person" a natural person who is a citizen but is not an elected official or an official acting in his or her official capacity? Is the Proposed Rule intended to isolate, and then count, members of the entity's governing body that are not already public officials?

We can't tell. But we submit that such a distinction makes no sense in any event. A member of the governing body (assuming that is what is meant by the term "electorate," as discussed above) of a governmental entity becomes a public official as soon as he or she is named to the governing body pursuant to the provisions of the applicable state or local law, whatever those provisions may be. What policy difference does it make if the person who is selected, in the manner established or authorized by the legislature in the applicable law, to serve on the board is a member of a city council on the one hand, or a resident of the service area of the public gas system on the other? Once on the board, the person is a representative of the public on that board, not a private individual acting in his or her own interest.

APGA submits that the "private faction" portion of the Proposed Rule should be eliminated if the governmental control section in its entirety is not. If the private faction test is retained, then at a minimum the meaning of "private person" must be defined, and it should be defined narrowly to only include (i) corporations, (ii) individuals who serve on a governing

body as representatives of a corporation pursuant to the provisions of the applicable state or local law, or (iii) individuals whose appointment to a governing body is not determined by state or local law *and* whose appointment to the governing body is not made, recommended, confirmed, affirmed or ratified by either (a) an elected state or local official, (b) the governing body of a city, town, county or other governmental entity, or (c) the public.

V. As a Legal Matter, Governmental Control Has Been Determined by the State Legislatures, and the IRS Has No Business Usurping the Power of the States To Make Those Determinations

Under current Federal law, the determination of whether a governmental entity is a "political subdivision" for purposes of Section 103 of the Code and is eligible to issue tax-exempt bonds is made by the States (or, by delegation, by local governments; we will refer in the paragraphs below only to the States). That has been the case since the beginning. If a State grants a governmental entity one or more of the three sovereign powers, then the entity is a "political subdivision." On what authority is the Service to second-guess or override such a determination made by a State with respect to its governmental entities? APGA submits that there is no established legal basis on which it could properly do so. And even if there were, APGA suggests that it would be imprudent for the Service to exercise such authority in the vague and far-reaching way that would or could eliminate from the powers of many public gas systems and their joint action agencies the ability to issue tax-exempt bonds for the furtherance of their governmental missions, as embodied in the NOPR.

VI. The "Governmental Purpose" Section of the Proposed Rule Should Be Amended To Eliminate the "Incidental Private Benefit" Provision

All of APGA's members serve a public purpose and a governmental purpose. Their purpose is to provide, safe, reliable and reasonably priced natural gas supply, transmission and distribution services to the public within the areas they serve, on a not-for-profit basis. No

member of the governing body of a public gas system participates in the "profits" of a public gas system. There are no "profits." Net margins are returned to the municipality or the member municipalities or counties, or are used for capital or other infrastructure improvements to enhance the safety, reliability and breadth of the services offered, or are used to reduce rates to the gas consuming public, depending on the provisions of applicable state or local law. APGA members depend on their ability to issue tax-exempt bonds. They only do so to serve important public purposes and to provide important and significant public benefits.

The IRS would muddy the waters and create regulatory uncertainty by adding the requirement that a governmental entity operate in a manner that provides "no more than incidental private benefit" in § 1.103-1(c)(3). The private use rules already place strictures on the private use of the proceeds of tax-exempt bonds. What is this additional test intended to add? Why is it appropriate to add *anything*? What does "incidental" mean? And what is "private benefit" intended to mean? Are governmental entities now to be forced to worry if the per diems paid to their directors pursuant to the applicable state law are more than an "incidental private benefit"? Are they to be forced to worry if the companies they do business with, and enter into contracts with, are receiving more than an "incidental private benefit" under those contracts within the meaning of the regulations? These potentially expansive and alarming ambiguities should be put to bed by eliminating the "incidental private benefit" provision from the Proposed Rule.

WHEREFORE, for all of the foregoing reasons, APGA urges the IRS to withdraw the Proposed Rule.

Respectfully submitted,

AMERICAN PUBLIC GAS ASSOCIATION

By: /s/ *Bert Kalisch*
Bert Kalisch
APGA President and CEO
Dave Schryver, Executive Vice President
Richard Worsinger, Chairman
www.apga.org

By: /s/ *James R. Choukas-Bradley*
William T. Miller
James R. Choukas-Bradley
John P. Gregg
Jeffrey K. Janicke
McCarter & English, LLP
General Counsel to APGA

May 23, 2016