

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

New England Power Company

ER03-793-002

ORDER CONDITIONALLY ACCEPTING REVISED INTERCONNECTION
AGREEMENT AND REJECTING COMPLIANCE FILING

(Issued July 2, 2007)

1. New England Power Company (NEP) submitted a filing in compliance with the Commission's May 7, 2004 Order. That order required NEP to explain why the security amount for the tax gross-up associated with the lump sum pre-payment by the generator under the AES Londonderry, L.L.C. (Londonderry) revised Interconnection Service Agreement (Revised Agreement) should remain constant over time and not be reduced or eliminated due to depreciation or the expiration of the Internal Revenue Service (IRS) statute of limitations.¹ In this order, the Commission conditionally accepts NEP's Revised Agreement, rejects the compliance filing and directs NEP to make a further compliance filing consistent with the security requirements of Order No. 2003.

I. Background

2. On April 30, 2003, NEP filed the Revised Agreement, which gives Londonderry the option to pay for its share of certain costs with a lump sum pre-payment.² This raised the question as to whether that lump sum pre-payment would qualify as income upon which NEP might be required to pay taxes. To address the risk that the lump sum payment would become taxable, the Revised Agreement requires Londonderry to maintain for twenty years security of approximately \$2.7 million to cover a possible tax gross-up associated with the lump sum pre-payment. Londonderry protested this provision, arguing that it was unjust for NEP to impose a security requirement where there was no current tax liability.

¹ *New England Power Company*, 107 FERC ¶ 61,127 (2004).

² The Revised Agreement reflects Londonderry's transfer of ownership of a newly constructed switchyard located at Londonderry's generating plant in Londonderry, New Hampshire, to NEP.

3. On June 27, 2003, the Commission ruled in favor of Londonderry, finding that the tax gross-up and related security requirements were unjust and unreasonable, given the mere possibility that the lump sum payment would be taxable as income to NEP.³

4. NEP filed a request for rehearing. It argued that the Commission did not recognize the business risks that NEP will face if circumstances change, resulting in a tax liability, and if Londonderry becomes bankrupt and is thus unable to pay such tax liability. NEP also argued that the security amount should remain constant and should not be reduced over time because if the pre-payment becomes taxable, NEP would be taxed on the fair market value of the facilities pursuant to IRS Notice 90-60. NEP argued that it should not be required to accept these risks.

5. Upon reconsideration, the Commission agreed with NEP that it would be inappropriate to reduce the security amount based upon a private letter ruling (PLR) from the IRS. We noted that the IRS PLR does not eliminate the risk to NEP; the pre-payment may still become taxable due to either the IRS changing its policy or a “subsequent taxable event.”⁴

6. The Commission noted that since the purpose of the security is to cover the tax risk, to the extent the risk associated with the potential tax becomes less over time, the security should become proportionately less, as well. The Commission directed NEP to explain on compliance “why the security amount should remain constant over time and not be reduced or eliminated due to depreciation or the expiration of the IRS statute of limitations.”⁵

II. Compliance Filing

7. NEP explains that the security amount should remain constant and should not be reduced over time. First, in the event the pre-payment becomes taxable, NEP would be taxed on the fair market value of the facilities. NEP states that under IRS Notice 90-60, fair market value is the depreciated replacement cost, which reflects the remaining economic useful life of the property. In addition, NEP claims that depending upon the timing of when a taxable event could occur, the calculation of replacement cost has a tendency to cancel out any accumulated depreciation on the original book value and can result in values higher or lower than the original book value. Therefore, according to NEP, the replacement cost and, consequently, the amount of the tax gross-up liability cannot be calculated prior to the time the pre-payment becomes taxable. Therefore, for

³ *New England Power Company*, 103 FERC ¶ 61,364 (2003).

⁴ *New England Power Company*, 107 FERC ¶ 61,127, at P 7 (2004).

⁵ *Id.* at P8.

ease of administration NEP states that it has traditionally calculated the security amount on the original book value of plant asset at issue. NEP also claims that the IRS statute of limitations does not protect it.

III. Notice of Filing and Comments

8. Notice of the filing was published in the *Federal Register*, 69 Fed. Reg. 34,150 (2004), with interventions and protests due on or before June 28, 2004. A timely motion to intervene was filed by Duke Energy Corporation (Duke). Duke's pleading also included comments. NEP filed an answer to Duke's comments.

9. Duke is a transmission provider, through its Duke Power division, and a developer, owner, and operator of numerous independent power facilities throughout the United States, through its Duke Energy North America, LLC subsidiary. Duke states that it filed its intervention because the Commission's policies with respect to security requirements for tax gross-ups will significantly and directly affect the interests of Duke Energy, with respect to its rights as a transmission provider and the obligations of its subsidiaries as interconnection customers of any jurisdictional transmission provider.

10. Duke states that the question presented by the compliance filing is whether some future change in the facts might constitute a "disqualification event" within the meaning of section 4 of IRS Notice 88-129. According to Duke, potential disqualification events include: (1) violating the 5 percent test specified in section 4(A) of IRS notice 88-129; (2) a termination of the power purchase agreement under section 4(B) of IRS Notice 88-129 or the termination of the interconnection agreement, in the case of a merchant plant relying on the safe harbor of IRS Notice 2001-82; (3) the sale of, and transfer of title to, power on the transmission grid at a location beyond the point of interconnection (the "busbar test"), in violation of the safe harbor of IRS Notice 2001-82; and (4) failing to capitalize and amortize the cost of interconnection facilities on a straight-line basis over twenty years.

11. Duke comments that requiring a generator that is the beneficiary of an IRS PLR, or which comes squarely within the safe harbor provisions of IRS Notice 2001-82, to maintain security for possible future tax consequences throughout the useful life of transferred equipment based on the original cost of that equipment would violate Order No. 2003-A⁶ and is not supported by any current or foreseeable tax rules. Duke comments that the Commission should make clear that transmission provider's tax exposure should be subject to periodic reassessment over the twenty-year term and the security requirement should be adjusted accordingly.

⁶ See Order No. 2003-A, FERC Statutes and Regulations ¶ 31,160 at P 343; section 5.17.3 of the LGIA.

12. In its response, NEP notes that Duke is not a party to the Revised Agreement, and that Londonderry, the customer under the Revised Agreement, did not respond to NEP's compliance filing.

13. NEP states that Duke's request that tax exposure be subject to periodic reassessment over the term of the agreement is generic in nature, and thus beyond the scope of this proceeding, in which NEP and Londonderry are the only other parties. NEP argues that if the Commission desires to make such a policy call, it should do so in the Generator Interconnection Rulemaking proceeding under Order No. 2003.

IV. Discussion

A. Procedural Matters

14. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2006), the timely, unopposed motion to intervene serves to make the entity that filed it a party to this proceeding.

15. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2006), prohibits an answer to a comment unless otherwise ordered by the decisional authority. We will accept NEP's answer because it has assisted us in our decision-making process.

B. Commission Ruling

16. Order No. 2003-A concluded that it was unreasonable to allow the Transmission Provider to require security for the maximum amount of potential tax liability.⁷ Because the potential tax liability will change over time, the Commission concluded that the required level of security should also change over time. The Commission noted in Order No. 2003-B that the possibility that the potential tax payment may be based on fair market value of the property instead of some other measure does not justify allowing a security requirement to be imposed in excess of the cost consequences of the potential current tax liability determined as of January 1 of each year. In Order No. 2003-B, the Commission reiterated that it is excessive to require that an Interconnection Customer maintain security equal to the maximum theoretical tax liability calculated at the outset of the agreement.⁸ The same reasoning applies here.

⁷ FERC Statutes and Regulations ¶ 31,160 (Order No. 2003-A) at P 343 (2004).

⁸ FERC Statutes and Regulations ¶ 31,171 (Order No. 2003-B) at P 95 (2004).

17. We agree with Duke's comments and find that while NEP's compliance filing supports its initial security requirement at the time of filing, this requirement should be reviewed on an annual basis to determine if it continues to be reasonable. At this time we have no basis to conclude, as NEP has, that the fair market value of the asset will remain relatively constant over the life of the facility.

18. We reject NEP's compliance filing because, as explained above, it would keep the same level of security over time; instead, we will require annual reassessment of the amount consistent with the security requirements of Order No. 2003.

19. We direct NEP to make a new compliance filing, within 30 days of the date of this order, to demonstrate that the proposed security requirement is consistent with the current fair market value of the interconnection facilities. We will also require NEP to modify the Interconnection Service Agreement to provide for the annual assessment and review of its security requirement.

The Commission orders:

(A) NEP's compliance filing is rejected, as discussed in the body of this order.

(B) NEP is directed to make a compliance filing revising the Revised Agreement as discussed in the body of this order, within 30 days of the date of this order.

(C) NEP is directed to file annually justifying the security requirement associated with the Interconnection Agreement.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.