

127 FERC ¶ 61,128
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Cottonwood Energy Company LP,

Docket No. EL09-35-000

v.

Entergy Gulf States, Inc.

ORDER DISMISSING COMPLAINT

(Issued May 8, 2009)

1. On February 6, 2009, Cottonwood Energy Company LP (Cottonwood) filed, pursuant to sections 206 and 306 of the Federal Power Act (FPA),¹ a complaint against Entergy Gulf States, Inc. (Entergy Gulf States)² seeking recovery of an amount Cottonwood claims is an overpayment to Entergy for construction of certain interconnection facilities (Complaint). In this order, the Commission dismisses the Complaint.

I. Complaint

2. Cottonwood owns an approximately 1,200 MW combined cycle electric generating facility, located in Newton County, Texas, that is interconnected to Entergy's

¹ 16 U.S.C. §§ 824e and 825e (2006).

² In December 2007, Entergy Gulf States split into two separate public utilities, Entergy Gulf States Louisiana, L.L.C. and Entergy Texas, Inc. (Entergy Texas). As a result of that split, Entergy Texas became the successor to Entergy Gulf States for the Interconnection Agreement. Entergy Services, Inc. (Entergy Services), a registered public utility holding company, acts as agent for the Entergy Operating Companies, including Entergy Texas (as well as Entergy Gulf States), with respect to the execution and administration of certain contracts and in proceedings before the Commission. As noted below, Entergy Services filed a response on behalf of Entergy Texas. For the sake of clarity, we will refer to these entities as Entergy.

transmission system. Cottonwood takes service pursuant to an interconnection and operating agreement with Entergy (Interconnection Agreement). Under the Interconnection Agreement, Cottonwood is responsible for the costs of constructing the required and optional system upgrades to interconnect its facility to Entergy's transmission system.

3. Cottonwood claims that Entergy owes it \$2,251,679, plus interest, for an "overpayment" it made to Entergy in connection with the construction of certain interconnection facilities.³ Cottonwood explains that, under the terms of the Interconnection Agreement, it is only responsible for the "actual costs"⁴ of constructing the interconnection facilities. Consistent with the Interconnection Agreement, Cottonwood previously remitted \$66,012,474 to Entergy to cover the estimated costs of the required and optional system upgrades to connect its generating facility to the Entergy transmission system. According to Cottonwood, the actual cost of constructing the interconnection facilities, however, was \$63,760,795. Cottonwood claims that Entergy owes it the difference between the amount it paid, \$66,012,474, and the actual costs of the interconnection facilities, \$63,760,795, plus interest. Cottonwood states that Entergy has yet to remit to Cottonwood this amount and that, once interest is factored into the overpayment, it is due more than \$3 million from Entergy. Cottonwood claims that it is entitled to either an immediate: (1) refund the \$2,251,679 overpayment, plus interest; or (2) inclusion by Entergy of the \$2,251,679 in monthly transmission credits to Cottonwood, with interest.

4. Cottonwood states that, prior to filing the Complaint, it attempted to resolve its dispute with Entergy through correspondence. In November 2008, Cottonwood sent a letter to Entergy explaining that Cottonwood was entitled to the refund, and asking that Entergy either refund the amount due as a lump sum or resume providing transmission

³ Complaint at 1.

⁴ Appendix B (System Upgrades) of the Interconnection Agreement provides that:

[A]s used in this Appendix B, "Actual Costs" shall mean all dollar amounts incurred by Company for the Company's acquisition or construction of said Interconnection Facilities, including estimated Tax Cost.

Appendix B at 65. Tax Costs include all taxes and interest related to those taxes imposed or required to be collected by Entergy on acquisition of ownership of the interconnection facilities, plus taxes imposed on or with respect to payments made by Cottonwood to Entergy to indemnify Entergy for the Tax Cost. *Id.* at 69.

credits to Cottonwood until Cottonwood was fully reimbursed for all amounts relating to the interconnection facilities.⁵

5. In a letter in response to Cottonwood, Entergy explained that the disputed amount represents the tax gross-up portion of Cottonwood's payment for the interconnection facilities. Pursuant to new guidance issued by the United States Internal Revenue Service (IRS), which changed the tax treatment of up-front payments utilities receive from generators for upgrades to utility transmission systems, Entergy had filed an amended tax return seeking a refund or credit from the IRS for the tax gross-up amount. Entergy stated that, under Appendix B of the Interconnection Agreement, it was not required to remit the tax gross-up amount, the approximately \$2.25 million, unless and until the IRS ruled on Entergy's amended tax return.⁶

6. In the Complaint, Cottonwood contends that Entergy cannot delay payment of the disputed amount until the IRS completes its review of the amended tax return and issues Entergy a refund. Cottonwood asserts that Entergy appears to rely solely on Appendix B of the Interconnection Agreement to support its position. Cottonwood argues that, when viewed in light of the other Interconnection Agreement provisions that expressly require Entergy to provide transmission credits as transmission service is taken, Appendix B is "intended as a mechanism to accelerate – not delay – payments to the interconnection customer."⁷ Cottonwood argues that the Interconnection Agreement sets out several alternative, not mutually exclusive, mechanisms through which Cottonwood may be reimbursed for amounts paid for network upgrades, and that these other provisions require Entergy to pay immediately the tax gross-up.

7. More specifically, Cottonwood maintains that section 8.3 (System Upgrades) and Appendix B of the Interconnection Agreement require Entergy to refund the difference between the amounts generators pay on an estimated basis, and the actual amounts Entergy paid for the interconnection facilities (i.e. the actual costs). According to Cottonwood, this mechanism applies to all interconnection facilities that are funded by generators, and requires that refunds are due as soon as actual costs are known. Cottonwood contends that Appendix B also provides a second alternative. Under Appendix B, Entergy must refund tax gross-up amounts for all interconnection facilities that are funded by generators for which a tax gross-up payment is made and which

⁵ Complaint, Exhibit B, November 4, 2008 letter from Cottonwood to Entergy at 2 (November 2008 Letter).

⁶ Complaint, Exhibit C, December 9, 2008 letter from Entergy to Cottonwood (December 2008 Letter).

⁷ Complaint at 6.

amounts are later subject to refund or credit by the IRS. Cottonwood states that these amounts are due when Entergy receives the monies from the IRS. Finally, according to Cottonwood, section 8.3.1 provides a third alternative. Under section 8.3.1, Entergy is required to refund all amounts paid for upgrades, including tax gross-up amounts, plus interest. Cottonwood believes that this section applies to all facilities that are eligible for transmission credits, and the refund is due as soon as transmission service is taken, on a dollar-for-dollar basis.

8. Based on its interpretation of the Interconnection Agreement, Cottonwood concludes that the conflict Entergy perceives between section 8.3.1 and Appendix B with respect to the timing for reimbursement under the Interconnection Agreement is non-existent. According to Cottonwood, if its interconnection facilities were not eligible for transmission credits, as Entergy claims, Cottonwood's refunds might be limited to the tax gross-up amount, and the timing of the refunds might be determined by IRS refunds or credits. Cottonwood asserts, however, that just because the Interconnection Agreement grants Cottonwood the right to repayment of tax gross-up amounts that are refunded by the IRS for all facilities, even those that are not eligible for transmission credits, the Interconnection Agreement cannot be read to preclude Cottonwood from receiving refunds based on the same tax gross-up costs which are "unambiguously" due on an earlier date.⁸ Since section 8.3.1 requires that dollar-for-dollar refunds be remitted until the cost of the upgrades has been fully offset, Cottonwood asserts that the timing for repayment of these funds is not affected by the fact that Cottonwood might have an alternative, and less timely, mechanism for refunds based on other provisions of the Interconnection Agreement.

9. Cottonwood further argues that Entergy "routinely" uses transmission credits to remit tax-gross up amounts.⁹ Cottonwood states that Entergy has remitted \$13,531,858 to the IRS for income tax gross-up, but has remitted to Cottonwood through transmission credits only \$11,280,179 of this amount.¹⁰ Citing section 8.3.1 of the Interconnection Agreement, Cottonwood argues that Entergy must provide transmission credits for all amounts related to network upgrades – Entergy may not exclude amounts that interconnection customers overpay for network upgrades or amounts for which Entergy has not yet received an IRS refund or credit. Cottonwood asserts that providing

⁸ *Id.* at 8.

⁹ *Id.* at 5.

¹⁰ *Id.*

transmission credits on a dollar-for-dollar basis, including any tax gross-up amounts, is consistent with Entergy's transmission service credit policy.¹¹

10. Finally, Cottonwood contends that remittance of the approximately \$2.25 million is required by the Commission's interconnection policy – since all costs associated with Network Upgrades are recoverable through transmission rates, including amounts related to funding tax liability, Transmission Providers should refund to customers through transmission credits tax gross-up and other related tax payments initially funded by the customer.¹²

II. Notice of Filing and Responsive Pleadings

11. Notice of Cottonwood's complaint was published in the *Federal Register*, 74 Fed. Reg. 7,424 (2009), with interventions and protests due on or before February 26, 2009. Entergy filed an answer to the Complaint on February 26, 2009 (Answer). On March 13, 2009, Cottonwood filed a motion for leave to reply and reply to Entergy's answer.

12. Entergy argues that the Complaint should be dismissed because, while there is no dispute about the amount of money Cottonwood is owed, there is no support for an immediate payment to Cottonwood. Entergy does not dispute that Cottonwood is entitled to the approximately \$2.25 million, including any interest, paid by the IRS to Entergy. Entergy claims, however, that Cottonwood's characterization of the disputed amount as an "overpayment" as the result of the difference between estimated and actual costs is inaccurate. Entergy states that, once Cottonwood's mischaracterization of the approximately \$2.25 million is corrected, immediate refund of the disputed amount is not required by the Interconnection Agreement, the Commission's interconnection policy, or IRS guidance.

13. Entergy explains that, in 2005, the IRS issued Revenue Procedure 2005-35 (IRS 2005-35), which changed the tax treatment of up-front payments utilities receive from generators for upgrades to utility transmission systems. By the time IRS 2005-35 issued, Cottonwood had paid the tax gross-up amount to Entergy and Entergy had paid the higher (but appropriate at the time paid) amount of income tax to the IRS. A few months following the issuance of IRS 2005-35, Entergy notified Cottonwood that IRS 2005-35 applied to the tax gross-up that Cottonwood had previously paid to Entergy, and stated

¹¹ *Id.*

¹² *Id.* at 6.

that, once it received an income tax refund from the IRS, Cottonwood would be entitled to receive the refund from Entergy, along with any interest provided by the IRS.¹³

14. Entergy argues that Cottonwood misinterprets the Interconnection Agreement. Because Cottonwood properly paid Entergy the Actual Costs for the interconnection facilities at the time the companies entered into the Interconnection Agreement, and because Entergy properly paid taxes on those funds to the IRS at the time they were due, with the IRS subsequently revising its rules, Entergy believes that Appendix B of the Interconnection Agreement is directly on point. Appendix B provides:

If Company has collected estimated federal income taxes from Customer as part of Actual Costs and thereafter the Internal Revenue Service issues a private letter ruling to Company or issues guidance in any other form on which Company may rely, and such private letter ruling or other guidance clearly relieves Company from any or all of said tax liability, Company agrees to and shall...(2) if Company has already paid the tax, file an amended tax return seeking a refund of federal income taxes paid pursuant to this Appendix B and remit to Customer the Excess, if any, provided Company will remit such amounts to Customer *only after* Company has received a tax refund or credit from the Internal Revenue Service for any applicable overpayment of federal income tax as related to the transaction described in this Appendix B.[¹⁴]

Entergy points out that, since it had already paid the income taxes on Cottonwood's payments to the IRS, it properly filed an amended tax return to obtain a refund or credit for the tax gross-up pursuant to IRS 2005-35. Entergy reaffirms that, pursuant to Appendix B, once it receives the refund from the IRS, it will provide Cottonwood with the tax gross-up amount to which it is entitled.¹⁵

15. Entergy rejects Cottonwood's argument that applying Appendix B would negate the effect of other provisions of the Interconnection Agreement. According to Entergy, Cottonwood would be entitled to transmission credits under section 8.3.1 of the Interconnection Agreement only if the funds which Entergy had collected were not

¹³ Answer, Exhibit B, October 17, 2005 letter from Entergy to Cottonwood.

¹⁴ Answer at 6 (*quoting* Interconnection Agreement, Appendix B at 65-66).

¹⁵ Answer at 6-7.

Actual Costs under Appendix B. Entergy concludes that, since the tax gross-up amounts were included as part of Actual Costs, section 8.3.1 does not apply. Entergy also contends that Cottonwood has received the appropriate amount of transmission credits under section 8.3.1, and that nothing in that provision negates the language in Appendix B which expressly addresses the facts in this case.

16. Entergy also responds to Cottonwood's argument that section 8.3 of the Interconnection Agreement requires Entergy to refund the difference between the amounts Cottonwood paid on an estimated basis and the actual amounts paid. Entergy maintains that it is disingenuous for Cottonwood to argue that this tax issue is now a matter of transmission credit eligibility when it has nothing to do with transmission credits but everything to do with tax treatment of actual costs, which is prescribed by Appendix B.¹⁶ Entergy agrees that it usually refunds to customers the difference between estimated and actual costs. Nevertheless, according to Entergy, in the present case the approximately \$2.25 million amount is not a true-up between estimated and actual costs. Rather, "[t]he approximately \$2.2 million is the [tax gross-up] associated with prepayments for facilities that were later determined by [Entergy] to be non-taxable income to [Entergy] pursuant to favorable tax guidance issued by the IRS in 2005...."¹⁷

17. Finally, Entergy argues that, in order for Cottonwood to succeed in this proceeding, Cottonwood would have to show that the existing Interconnection Agreement is no longer just and reasonable. According to Entergy, the Complaint does not support such a finding, so the Commission would have to independently review the Interconnection Agreement and find, pursuant to its own FPA section 206 authority, that the Interconnection Agreement is unjust and unreasonable.

III. Discussion

18. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2008), prohibits an answer to an answer unless otherwise ordered by the decisional authority. We are not persuaded to accept Cottonwood's answer and will, therefore, reject it.

19. We will dismiss Cottonwood's complaint requesting an immediate refund of the approximately \$2.25 million or, alternatively, for immediate transmission credits in lieu of a refund. We find the language of Appendix B excerpted above to be dispositive. Appendix B clearly contemplates the facts presented in this case. Entergy collected estimated federal income taxes from Cottonwood as part of Actual Costs before the IRS

¹⁶ *Id.* at 8.

¹⁷ *Id.*

issued guidance, IRS 2005-35, which relieved Entergy from tax liability. Since Entergy had already paid the federal income taxes to the IRS, pursuant to Appendix B, Entergy was required to file an amended tax return seeking a refund or credit for the tax paid. Entergy did so. Appendix B expressly provides that, in these circumstances, Entergy must remit that amount to Cottonwood “only after” Entergy has received the refund or credit from the IRS for any overpayment of taxes by Entergy. Thus, Appendix B squarely addresses Cottonwood’s request for immediate refund of the approximately \$2.25 million.

20. We also find that sections 8.3 and 8.3.1 of the Interconnection Agreement do not negate or provide alternatives to Appendix B. Section 8.3, System Upgrades, states:

Company shall perform, and Customer shall bear the reasonable cost of, any System Upgrades. The Parties agree that the cost of any such System Upgrades shall reflect the tax effects to the Company of Customer’s payment for the System Upgrades.

Section 8.3.1, Credits for System Upgrades, provides in relevant part:

Customer, Customer's marketing agent, or Customer's power purchaser(s) will be responsible for arranging transmission service necessary for deliveries from the Facility across the Company Transmission System. For each kW produced from the Facility and delivered onto the Company Transmission System under a transmission service agreement under the Entergy Transmission Tariff, Company shall credit Customer in an amount equal to the equivalent Point-To-Point transmission service rate, on a dollar-for-dollar basis applied to Customer's total monthly bill for services, until such time as the cost of the Required System Upgrades and Optional System Upgrades (that have been previously paid by Customer), has been fully offset, after which time such offset or credit shall no longer apply. The Required System Upgrades and Optional System Upgrades are identified in Appendix B. Total estimated costs of the Required System Upgrades and Optional System Upgrades that qualify for credits are identified in Appendix B.

21. Both sections 8.3 and 8.3.1 must be read in conjunction with Appendix B, which explicitly addresses the tax treatment of actual costs paid by a customer. Specifically, “System Upgrades,” the subject of section 8.3, are defined in section 1.23 as “modifications or improvements to the Company Transmission System required in order to interconnect the Facility with the Company Transmission System, as identified as ‘Required System Upgrades’ in Appendix B.” Further, section 8.3.1 notes that “Required

System Upgrades and Optional System Upgrades are identified in Appendix B. Also, total estimated costs of the Required System Upgrades and Optional System Upgrades that qualify the credits are identified in Appendix B.” Thus, neither of the provisions cited by Cottonwood defines the “actual costs” as independent of the actual, existing tax treatment.

22. We also note that Cottonwood has provided no support for its claim that Appendix B “intended as a mechanism to accelerate – not delay – payments to the interconnection customer.”¹⁸ We do not think the plain language of the Interconnection Agreement supports such a reading; as Entergy points out, Appendix B prescribes the payment of actual costs. Therefore, in the absence of any supporting evidence by Cottonwood, we reject this interpretation.

23. Finally, we note that dismissal of the Complaint is consistent with Commission precedent.¹⁹ In *Wrightsville*, the Commission found that a generator was entitled to interest on all tax gross-up amounts that were not paid to the IRS. Nevertheless, once those funds were remitted to the IRS, the generator was only entitled to the tax refund provided by the IRS (including any interest provided by the IRS) and only when the tax refund was issued. We reject Cottonwood’s alternative request for transmission credits for the same reasons. Once Entergy provided the tax gross-up amount to the IRS, Cottonwood was only entitled to the tax refund Entergy received from the IRS.

The Commission orders:

Cottonwood’s complaint is hereby dismissed, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

¹⁸ Complaint at 6.

¹⁹ See e.g. *Wrightsville Power Facility, L.L.C. v. Entergy Arkansas, Inc.*, 117 FERC ¶ 61,294 (2006) (*Wrightsville*).