Raquel J. Webster
Senior Counsel

July 7, 2015

BY HAND DELIVERY AND ELECTRONIC MAIL

Luly E. Massaro, Commission Clerk
Rhode Island Public Utilities Commission
89 Jefferson Boulevard
Warwick, RI 02888

RE: Docket 4483 – Wind Energy Development, LLC (WED) and ACP Land, LLC Petition for Dispute Resolution Relating to Interconnection National Grid's Private Letter Ruling Compliance Filing

Dear Ms. Massaro:

For the Rhode Island Public Utilities Commission's (PUC) review, I have attached a final version of a request by The Narragansett Electric Company d/b/a National Grid (the Company) to the United States Internal Revenue Service seeking a private letter ruling (PLR) on the issue of whether certain in-kind contributions and payments received by the Company for an interconnection are taxable under federal law. The Company submitted an earlier draft of this request to the PUC on June 8, 2015. As required by the PUC at its December 29, 2014 Open Meeting, the Company has worked with Wind Energy Development, LLC (WED) to develop the request based on one of WED's projects, in an effort to reach consensus language. Although the Company and WED agreed on several changes to the attached document during the drafting process, the parties were unable to agree on the following issues:

- Whether to include in the PLR request the procedural history of this dispute at the PUC, per WED's request. The Company has omitted this history from the attached PLR request because, based on the Company's experience in other proceedings before the IRS, the procedural history of this docket (or other state regulatory dockets) is not relevant to the IRS in the context of its review of requests for PLRs;

- Whether to include information regarding the right of a party to terminate the interconnection agreement. The Company has concluded that the ability of a Generator to terminate an interconnection service agreement upon 60 days' notice is a relevant fact for consideration by the IRS that cannot be excluded (see pages 3-4 of the PLR request);

- Whether to include certain language regarding the definition of the term "intertie." Although WED has requested certain language for this definition, the Company has concluded that certain language regarding the definition of "intertie" should not be included in the request because the definition, when read on its own and when read in context of the IRS notices in their entirety, only supports application of the notice exemption to transmission interconnections and not to distribution interconnections, as WED suggests; and

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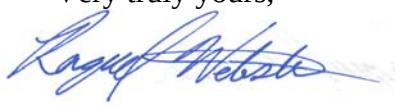
- Whether, per WED's request, to include a reference to a May 2000 letter from a senior IRS attorney to a Congressman, who, in the letter, states that generators are not customers for purposes of IRC Section 118(b). The Company has determined that it already makes this point in Section B of the enclosed PLR request, where the Company cites Notice 88-129. The Company has also concluded that the letter does not constitute an official IRS statement that can be cited as either binding or persuasive authority. Finally, the Company notes that the views expressed in the letter do not support a view that a transaction is eligible for tax exempt treatment under the notices unless the transaction is identical to the exempt transaction described in those notices.

The Company's internal and external federal tax experts agree that the attached version of the request represents the most appropriate means of presenting this issue to the IRS for its deliberation. As is demonstrated by the legal arguments included in the request, the Company has structured the request to strongly advocate the conclusion that WED is seeking, i.e., that certain in-kind contributions and payments received by the Company for an interconnection are not taxable under federal law. Accordingly, the PUC need not be compelled to require further deliberations between the Company and WED on this document. The Company is prepared to submit the attached request to the IRS without further revision.

The Company understands that the PUC will inform the Company regarding whether to file the attached PLR request or whether the Company can wait, per the Company's earlier request, for the IRS to rule on the pending Massachusetts PLR request on the same issue. To date, the IRS has not issued a ruling on the MA PLR request. Therefore, the Company is prepared to submit the attached request for a PLR to the IRS should the PUC direct the Company to do so during its next Open Meeting.

Thank you for your attention to this matter. If you have any questions, please contact me at 781-907-2121.

Very truly yours,



Raquel J. Webster

Enclosure

cc: Docket 4483 Service List
Leo Wold, Esq.
Steve Scialabba, Division

July __, 2015

BY HAND DELIVERY

Courier's Desk
Internal Revenue Service
Associate Chief Counsel (Passthroughs and Special Industries)
Attn: CC:PA:LPD:DRU, Room 5336
1111 Constitution Avenue, N.W.
Washington, DC 20244

RE: The Narragansett Electric Company: Request For Ruling Under Section 118 With Respect To Certain Payments Received For Construction of An Interconnection

Dear Sir or Madam:

On behalf of The Narragansett Electric Company ("NECo" or "Taxpayer"), we respectfully request the ruling set forth in Section III, hereof, under section 118, with respect to certain in-kind contributions and payments received by NECo for an interconnection.[1]

I. STATEMENT OF FACTS

A. Taxpayer information

NECo, tax identification number 05-0187805, is a regulated electric and gas distribution company providing service to approximately 493,000 electric customers and 260,000 gas customers in 38 cities and towns in Rhode Island. NECo's electric distribution properties consist of, primarily, substations and distribution lines that are located in the state of Rhode Island. NECo is a member of a group of corporations that join in filing consolidated U.S. federal income tax returns on an accrual method, March 31 year-end basis. The common parent of these corporations is National Grid North America, Inc. ("NGNA"), tax identification number

[1] Unless otherwise noted, all "section" references are to the Internal Revenue Code of 1986, as amended, (the "Code"), and all references to "Treas. Reg. §" are to the Treasury regulations promulgated under the Code.

04-3569631. All of the stock of NGNA is indirectly owned by National Grid plc, a company publicly traded on the London and New York stock exchanges.

NECo's principal place of business is 280 Melrose Street, Providence, RI 02907. NGNA's principal place of business is One Metrotech Center, Brooklyn, NY 11201. For purpose of this request, Taxpayer's contact person is Robert A. Ermanski at (781) 907-2393.

B. Description of relevant transactions

NECo will enter into an Interconnection Service Agreement (the "Interconnection Agreement") with WED Coventry One, LLC (the "Generator"), which will involve the Generator's electric generation facility (the "Facility") located in Coventry, Rhode Island. Pursuant to the Interconnection Agreement, (i) the Generator and NECo will be required to construct certain interconnection equipment (the "NECo Intertie"), (ii) the Generator will be required to construct or pay for the cost of the NECo Intertie, and (iii) NECo will own and be the sole operator of the NECo Intertie which will become a permanent part of Taxpayer's distribution system.

The Generator will enter into a municipal net metering finance agreement (the "MNMFA") with the Town of Coventry, Rhode Island (the "Town") for a public/private partnership under which Coventry will net meter the power generated by the turbine against consumption at its municipal accounts as authorized under Rhode Island law. The Generator will also enter into a distribution generation contract (the "DGC") with NECo providing for the sale of the rest of the electricity generated at the Facility.

NECo, NGNA, and their affiliates own no equity interest in the Generator or the Town. In addition, the Generator and the Town have no common ownership.

1. Facility

The Facility will generate electricity exclusively through the use of a Vensys SDL, 1,500 kW 690V, direct drive permanent magnet, synchronous, converter based, wind turbine generator, which will have a maximum installed nameplate capacity of approximately 1.5 megawatts ("MW"). Commercial operation of the Facility will commence in 2016. The Facility will produce a maximum of 1.5 MW of alternating current ("AC") at a voltage of 600 volts ("V"). The AC electricity produced by the Facility will be converted from 600V to 620V and then stepped up via an interface transformer to 23 kilovolts ("kV"), which corresponds to the voltage on the nearest existing NECo distribution line -- the 23 kV NECo distribution line # _2232_ (the "NECo Distribution Line").[2]

[2] The NECo Distribution Line is connected to NECo's Drumrock and Johnston substations, where it connects with the electric transmission system. The electricity delivery systems operated by utilities are typically classified into two broad categories: a transmission system and a distribution system. The NECo Distribution Line associated with the interconnection of the Facility is part of the electric distribution system.

All of the electricity generated by the Facility, other than that consumed by the Facility for its operations, will either be net metered to the Town or sold to NECo. The Town is a municipality and a NECo distribution customer that intends to net meter all of its electricity from the Facility. Following the net metering of electricity from the Facility to the Town the remaining electricity will pass through the NECo Intertie and will be delivered to the NECo Distribution Line -- *i.e.*, to NECo's electric distribution system pursuant to the DGC. There will be no direct interconnection between the Facility and any electric transmission system.

The Facility will be a "stand-alone" generating facility as contemplated under Notice 2001-82. The Facility is expected to consume only a *de minimis* amount of electricity from NECo's electric distribution system. The Generator submitted a self-certification to the Federal Energy Regulatory Commission ("FERC") in July 2013 that the Facility is a Qualifying Facility ("QF") under federal law.[3]

2. **Interconnection Agreement**

NECo and the Generator will enter into the Interconnection Agreement (copy attached as Tab A) to permit the Generator to connect the Facility to the NECo electric distribution system.[4] That agreement will have an indefinite term, but the Generator is permitted to terminate the agreement upon 60 days written notice. Pursuant to the Interconnection Agreement, NECo will agree to construct the NECo Intertie, and the Generator will be required to pay all costs of the NECo Intertie (the "Interconnection Payment"). NECo will hold legal title to the NECo Intertie, and such equipment will be a permanent part of NECo's electric distribution system. The NECo Intertie will not be included in Taxpayer's rate base and the Taxpayer will not take any depreciation deductions with respect to the Intertie. The NECo Intertie will be necessary for the safe, efficient, and reliable operation of the Facility with the NECo electric distribution system.

The NECo Intertie will be constructed primarily to net meter and deliver electricity from the Facility to the NECo electric distribution system and not to enable NECo to sell electricity to the Facility, as confirmed by an analysis prepared by Power Engineers LLC (the "PE LLC Report"; copy attached as Tab B). PE LLC is an independent company of power engineers unaffiliated with the Generator, NECo, NGNA, or any affiliate thereof. The PE LLC Report analyzed and calculated the power flow, in both directions, across the NECo Intertie and concluded that less than 5% of the power flowing through the interconnection will pass from NECo distribution system to the Facility.

The cost of the intertie will be capitalized by Generator as an intangible asset and recovered using the straight-line method over a useful life of 20 years.

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[3] "Qualifying Facilities" include qualifying small power producers and qualifying cogenerators, as defined in section 3 of the Federal Power Act, as amended by section 201 of the Public Utility Regulatory Policies Act of 1978 ("PURPA").

[4] The Interconnection Agreement is in a standard form that was approved by the Rhode Island Public Utilities Commission as part of NECo's interconnection tariff.

3. **Net Metering**

The Generator and the Town have entered the MNMFA (copy attached as Tab C). The term of the MNMFA is 25 years with the possibility of three five-year extensions. Pursuant to the MNMFA, the Town will take legal title and ownership of electricity generated by the Facility. Title and ownership of the electricity will pass to the Town at or prior to the busbar on the Facility's side of the intertie.

All the electricity purchased by the Town will be delivered to Town facilities through NECo's electric distribution system as allowed for public entity net metering facilities under Rhode Island law. Under certain Rhode Island state regulatory "net metering" rules, the Town will either be (i) charged by NECo, as a NECo customer, for the difference between the amount of electricity it consumes as a customer of NECo less the amount of electricity that it net meters from the Generator or (ii) issued credits for any amount of electricity net metered from the facility that exceeds the amount of electricity it consumes up to a maximum of 125 percent.[5]

4. **DGC**

The Generator and NECo will be parties to the DGC (copy attached as Tab D). The term of this agreement will be 15 years. Pursuant to the DGC, NECo will purchase all of the electricity generated by the Facility that is not used by the facility or net metered to the Town. This electricity will travel through the busbar at the NECo Intertie and onto the NECo Distribution Line.

II. REPRESENTATIONS

Taxpayer makes the following representations:

1. The Facility will be a Qualifying Facility ("QF").

2. The NECo Intertie will be used in connection with the distribution of electricity for net metering and sale to NECo.

3. The cost of the NECo Intertie will not be included in NECo's rate base.

4. The Interconnection Agreement will have an indefinite term, but the Generator is permitted to terminate the agreement upon 60 days written notice.

5. The term of the MNMFA is at least 25 years.

6. The term of the DGC will be 15 years.

[5] Rhode Island does not require public entities that are net metering customers under a municipal net metering financing arrangement to own the generating facility in order to be eligible for net metering benefits.

7. Title and ownership of the electricity generated by the Facility will pass from the Generator to the Town at or prior to the busbar on the Facility's end of the NECo Intertie.

8. Taxpayer will not claim depreciation or amortization deductions with respect to the NECo Intertie for U.S. tax purposes.

9. The amount of any Interconnection Payments will be capitalized by Generator as an intangible asset and amortized over 20 years.

10. No more than 5% of the electricity will flow from NECo over the NECo Intertie during the first ten years beginning on the date on which the NECo Intertie is placed in service.

11. There is no direct interconnection between the Facility and an electric transmission system; there is a direct interconnection between the Facility and an electric distribution system.

III. RULING REQUESTED

The transfer of the Interconnection Payment by Generator to Taxpayer will not constitute a contribution in aid of construction under section 118(b) and will be excludible from the gross income of Taxpayer as a non-shareholder contribution to capital under section 118(a), notwithstanding that the interconnection is between the Facility and the Taxpayer's electric distribution system and not with an electric transmission system.

IV. LAW AND ANALYSIS

A. Relevant statutory framework

Section 61 provides generally that gross income means "all income from whatever source derived." However, under section 118(a), "[i]n the case of a corporation, gross income does not include any contribution to the capital of the taxpayer." Section 118(a) applies to both shareholder contributions to capital and non-shareholder contributions to capital.[6]

The section 118(a) exclusion from gross income for amounts received by a corporation is limited by section 118(b). Section 118(b) provides that the term "contribution to the capital of the taxpayer" (as used in section 118(a) does not include any "contribution in aid of construction or any other contribution as a customer or potential customer."[7] Thus, any amounts received by a taxpayer that are described in section 118(b) are not excluded from gross income under section

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[6] *See* Treas. Reg. §1.118-1.

[7] *See also* Treas. Reg. Section 1.118-1 ("the [section 118(a)] exclusion does not apply to any money or property transferred to the corporation in consideration for goods or services rendered . . . .").

118(a) and, therefore, are treated as gross income under section 61 unless another exclusion applies.[8]

Prior to the Tax Reform Act of 1986 (the "1986 Act"),[9] section 118(b) generally provided that a corporate public utility that provides electricity, gas, water or sewage disposal services was allowed to treat a payment as a contribution to capital that was not included in gross income. Section 118(b) was amended by the 1986 Act because:

> The Congress believed that all payments that are made to a utility either to encourage, or as a prerequisite for, the provision of services should be treated as income of the utility and not as a contribution to the capital of the utility. The Congress believed that prior law allowed amounts that represented prepayments for services to be received by corporate regulated public utilities without the inclusion of such payments in gross income….
>
> A utility is considered to have received property to encourage the provision of services if the receipt of the property is a prerequisite to the provision of the services, if the receipt of the property results in the provision of services earlier than would have been the case had the property not been received, or if the receipt of the property otherwise causes the transferor to be favored in any way.[10]

Further explication of the scope of section 118(b) was provided through four Notices issued by the Service following the 1986 Act amendment to section 118(b): Notice 87-82, 1987-2 C.B. 389; Notice 88-129, 1988-2 C.B. 541; Notice 90-60, 1990-2 C.B. 345; and Notice 2001-82, 2001-2 C.B. 619.

B. Section 118(b) does not apply to interconnection equipment used exclusively for the purpose of allowing the flow of electricity from a generator to a utility

The IRS Notices confirm that section 118(b) does not apply to a generator's contribution in aid of construction, paid to a utility as reimbursement for the cost of interconnection equipment used exclusively for the purpose of allowing the flow of electricity from the generator to the utility.

The Service released Notice 87-82 shortly after the 1986 Act amended section 118(b).

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8 Section 118(c) provides special rules for the application of section 118(a) to water and sewerage disposal utilities; those rules are inapplicable here.

9 Pub. L. No. 99-514.

10 Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986*, May 4, 1987 (generally referred to as the "Bluebook").

That Notice "provides guidance with respect to the treatment of contributions in aid of construction after enactment of [the 1986 Act]." Notice 87-82 did not, however, address the treatment of payments or transfers of property made by QFs to utilities in connection with sales of power by the QF to the utility under PURPA.

PURPA and its implementing rules and regulations require that a utility interconnect with a QF for the purpose of allowing the sale of power produced by the QF. Under PURPA, a QF must bear the cost of the purchase and installation of any equipment required for the interconnection (also known as an intertie), notwithstanding that the utility generally receives title to such equipment. The IRS subsequently released Notice 88-129 to fill this gap and respond to numerous inquiries that followed the issuance of Notice 87-82 regarding whether transfers of interconnection equipment from a generator to a utility result in income to the utility.[11]

Notice 88-129 provides that section 118(b) is not intended to apply to the transfer of interconnection equipment constructed for the purpose of allowing the flow of electricity from a generator to the utility; rather, it is intended to apply where the purpose is to allow the flow of electricity from the utility to the generator. In that regard, Notice 88-129 states:

> The amendment of Code section 118(b) by the 1986 Act was intended to require utilities to include in income the value of any contribution in aid of construction [CIAC] made to encourage the provision of services by a utility to a customer. See H.R. Rep. No. 841, 99th Cong., 2d Sess. 324(1986 (Conference Report). In a CIAC transaction the purpose of the contribution of property to the utility is to facilitate the sale of power by the utility to the customer. In contrast, the purpose of the contribution by a Qualifying Facility to a utility is to permit the sale of power by the Qualifying Facility to the utility. Accordingly, the fact that the 1986 amendments to Code section 118(b) render CIAC transactions taxable does not require a similar conclusion with respect to transfers from Qualifying Facilities to utilities.
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> …. With respect to transfers of property made by a Qualifying Facility to a utility exclusively in connection with the sale of electricity by the Qualifying Facility to the utility, a utility will not realize income upon transfer of an intertie by the a Qualifying Facility. These nontaxable transfers are referred to herein as "QF Transfers."

[11] *See* Notice 88-129, "Background" section.

Notice 88-129 at §1. (Emphasis added.)

Notice 88-129 further provides that the same tax treatment applies whether the generator constructs and transfers "in-kind" the intertie to the utility or the utility agrees to construct and install the intertie on behalf of the QF, with the QF agreeing to reimburse the construction and installation costs. Id. In the latter case, the utility is effectively treated as constructing the equipment for the QF for a payment, and the QF is then treated as making an in-kind contribution of the intertie to the utility.[12]

In order for the IRS to treat QF Transfers (as referred to in Notice 88-129) as nontaxable, the following requirements must be met (i) the intertie is not included in the utility's rate base,[13] (ii) (a) the term of the power purchase agreement is 10 years or more[14] or (b) the intertie is transferred pursuant to a long-term interconnection agreement;[15] (iii) the ownership of electricity must pass to the purchaser at or prior to the busbar on the generator's end of the intertie;[16] (iv) the utility may not claim depreciation or amortization deductions with respect to the intertie;[17] and (v) the generator must recover its interconnection contributions over 20 years using the straight line method.[18] NECo has represented that each of these requirements will be met here. See Section II *supra*, Representation Nos. 3-7. Accordingly, the Interconnection Payment would not be subject to section 118(b), and would be treated as a nontaxable "QF Transfer," if the NECo Intertie is used exclusively for the flow of electricity from the Generator to NECo. As discussed below, the fact that in the instant case there is some *de minimis* flow of electricity from NECo to the Generator should not alter this conclusion.

C. A *de minimis* use of interconnection equipment for electricity flow from NECo to the Generator should not implicate section 118(b)

In Notices 88-129 and 2001-82, the Service recognizes that situations exist in which interconnection equipment is used almost exclusively for the purpose of allowing the flow of electricity from the generator to the utility. The Service has concluded that in such situations, section 118(b) would not apply to the transfer of interconnection equipment, and the transfer

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[12] Notice 90-60 amplified and modified Notice 88-129. The changes made by Notice 90-60 are not germane to the analysis herein. Notice 2001-82 further "amplified and modified" Notice 88-129 to extend the provisions of the earlier Notices to non-QFs. That change was necessitated by the deregulation of the electric power industry, which caused few new stand-alone generators to be QFs. As noted above, the Facility is a QF.

[13] Notice 88-129 at § 3.

[14] Notice 88-129 at § 3.

[15] Notice 2001-82.

[16] Notice 2001-82.

[17] Notice 88-129, at § 6.

[18] Notice 2001-82.

would qualify as a nontaxable QF Transfer, if only a *de minimis* amount of electricity is expected to flow from the utility to the generator. Those Notices provide that the amount of electricity flowing from the utility to the generator is *de minimis* for this purpose if:

> it is reasonably projected that during the first ten taxable years of the utility, beginning with the year in which the transferred property is placed in service, not more than 5% of the projected total power flows over the interties will flow to the [generator] (the "5% test"). Such a projection shall, if practicable, be supported by a report from an independent engineer. Total power flows means power flows to or from the [generator] over the intertie.[19]

NECO and the Generator expect that this 5% test will be satisfied here. The PE LLC Report (an independent engineering report) confirmed that less than 5% of the projected power flows over the NECo Intertie will flow to the Generator. Furthermore, Taxpayer represents that no more than 5% of the electricity will flow from NECo over the NECo Intertie during the first ten years beginning on the date on which the NECo Intertie was placed in service. See Section II *supra*, Representation No. 8.

Accordingly, notwithstanding that a *de minimis* amount of electricity will flow from the NECo electric distribution system to the Facility, under IRS Notices 88-129 and 2001-82, the receipt of the Interconnection Payment by Taxpayer should not be subject to section 118(b) since the 5% test is satisfied and, as discussed in section IV.C. above, the Interconnection Payment is not otherwise subject to section 118(b).

D. The Interconnection Payment received by NECo Is Not gross income under section 118(a).

The Interconnection Payments received by NECo should be excluded from gross income under section 118(a), and section 118(b) should be inapplicable. Under section 61, the definition of gross income is broadly defined; however, section 118(a) excludes from gross income any contribution to the capital of the taxpayer. As discussed above, the Interconnection Payment should be treated as a nontaxable QF Transfer under Notices 88-129 and 2001-82 and, therefore, should not in included in Taxpayer's gross income.

The legislative history of section 118 states offers the following guidance:

> Section 118 of the Code in effect places in the Code the Court

[19] Under certain circumstances where, ultimately, the 5% test is not satisfied, the transferred property may become taxable. Notice 88-129 at §4.

> decisions on the subject. It deals with cases where a contribution is made to a corporation by a governmental unit, chamber of commerce, or other association of individuals having no proprietary interest in the corporation. In many such cases because the contributor expects to derive indirect benefits, the contribution cannot be called a gift; yet the anticipated future benefits may also be so intangible as to not warrant treating the contribution as a payment for future services.

S. Rep. No. 1622, 83d Cong., 2d Sess. 18-19 (1954).

A few United States Supreme Court cases offer further guidance on this issue. In *Detroit Edison Co. v. Commissioner*, 319 U.S. 98 (1943), the Court held that payments by prospective customers to an electric company to cover the cost of extending the utility's facilities to their homes were part of the price of service rather than contributions to capital. *Detroit Edison Co.* involved customers' payments to a utility company for the estimated cost of constructing service facilities (primary power lines) that the utility company otherwise was not obligated to provide. The customers intended no contribution to the company's capital.

In *Brown Shoe Co. v. Commissioner*, 339 U.S. 583 (1950), the Court held that money and property contributions by community groups to induce a shoe company to locate or expand its factory operations in the contributing communities were non-shareholder contributions to capital. The Court reasoned that when the motivation of the contributors is to benefit the community at large and the contributors do not anticipate any direct benefit from their contributions, the contributions are non-shareholder contributions to capital.

Finally, in *United States v. Chicago, Burlington & Quincy Railroad Co.*, 412 U.S. 401 (1973), the Court, in determining whether a taxpayer was entitled to depreciate the cost of certain facilities that had been funded by the federal government, held that the governmental subsidies were not contributions to the taxpayer's capital. The Court recognized that the holding in *Detroit Edison Co.* had been qualified by its decision in *Brown Shoe Co.* In *CB&Q Railroad Co.*, the Court found that the distinguishing characteristic between those two cases was the differing purpose motivating the respective transfers. In *Brown Shoe Co.*, the only expectation of the contributors was that such contributions might prove advantageous to the community at large; thus, since the transfers were not made to receive direct services or recompense, they were held to be nontaxable contributions to capital.

In *CB&Q Railroad Co.*, the Court stated that a non-shareholder contribution to capital has the following five characteristics:

1. The contribution must become a permanent part of the transferee's working capital structure;

2. The contribution may not be compensation, such as a direct payment, for a specific, quantifiable service provided for the transferor by the transferee;

3. The contribution must be bargained for;

4. The asset transferred foreseeably must benefit the transferee in an amount commensurate with its value; and

5. The asset transferred will be employed in or contribute to the transferee's trade or business to produce income.

Here, the Interconnection Payment is a non-shareholder contribution to capital as described in *CB&Q Railroad Co.* because: (1) the NECo Intertie will become a permanent part of NECo's working capital structure; (2) the transfer is not compensation for services because, after the transfer, the NECo Intertie almost exclusively will export electricity to NECo's electric distribution system and not import electricity from NECo; (3) the transfer is made pursuant to the Interconnection Agreement, *i.e.*, it was contractually bargained for; (4) the Interconnection Payment will foreseeably result in a benefit to NECo commensurate with its value since the NECo intertie will become a permanent part of NECo's electric distribution system; and (5) the NECo Intertie will be used in NECo's business to produce income.

The IRS has issued numerous private letter rulings since the release of Notice 88-129 that address whether a contribution of interconnection equipment by an electric generator to a utility may be excluded from gross income under section 118.[20] Those rulings uniformly conclude, based on facts and representations substantially similar to those present in the instant case, that the contribution of the interconnection equipment is not a contribution in aid of construction under section 118(b) and is excludible from gross income under section 118(a). During the more than 25-year period since the release of Notice 88-129, the Service has continued to reaffirm this position and has not issued any private letter rulings or administrative pronouncement suggesting a contrary position.

In light of the substantially similar facts of those rulings with the facts herein, those rulings provide strong support for the conclusion that Taxpayer's receipt of the Interconnection Payment is not subject to section 118(b), but instead is excluded from gross income under section 118(a).

E. Section 118 does not distinguish between electric transmission and distribution interconnections

[20] *See, e.g.*, PLR 201005002 (Oct. 16, 2009); 200638002 (Sept. 22, 2006); 200552002(Dec. 30, 2005); PLR 200404002 (Jan. 23, 2004); PLR 200403086 (Jan. 14, 2004); PLR 200317009 (Apr. 25, 2003); PLR 200310012 (Mar. 7, 2003); PLR 9348017 (Dec. 3, 1993); PLR 9224054 (Mar. 19, 1992): PLR 9049007 (Aug. 31, 1990); PLR 8947026 (Aug. 25, 1989). Although private letter rulings may not be cited as precedent by anyone other than the taxpayer to whom it was addressed, they do provide insight as to the Service's interpretation of the Code and the Regulations thereunder. *Buckeye Power Inc. v. United States*, 38 Fed. Cl. 283 (1997); *Xerox Corp. v. United States*, 656 F. 2d 659 (Ct. Cl. 1981); *Est. of Reddert v. United States*, 925 F. Supp. 261, 267-68 (Dist. N.J. 1996); *Woods Investment Co. v. Commissioner*, 85 T.C. 274, 284 (1985).

It should be of no import in determining the application of section 118 whether or not there is a direct interconnection between a generation facility and an electric transmission system, as opposed to a direct interconnection between a generation facility and an electric distribution system. As noted above, the Facility will have no direct interconnection with an electric transmission system (as opposed to an electric distribution system).

Nonetheless, some uncertainty exists because in Notices 88-129 and 2001-82 and in certain private letter rulings, there are numerous references to the use of interconnection equipment in connection with "transmission." Therefore, this ruling request is necessary because of those numerous references to "transmission" and the dearth of references to "distribution."

The electricity delivery systems operated by utilities like NECo and its affiliates are typically classified into two broad categories: (1) a transmission system; and (2) a distribution system. While the transmission of electricity in interstate commerce is exclusively within federal jurisdiction, the Federal Power Act excludes from federal jurisdiction "facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter,"[21] and all such facilities are left to exclusive state jurisdiction.[22] Although the distinction between electric transmission and distribution systems is central in defining the scope of federal and state jurisdiction, FERC has noted that there is no "bright line test" for distinguishing between distribution lines and transmission lines.[23] Indeed, electricity flows through both sets of lines,

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[21] 16 U.S.C. § 824(b)(1) (2006). Section 201(b) of the Federal Power Act (the "FPA") grants FERC exclusive jurisdiction over the wholesale sale and transmission of electricity in interstate commerce, and FPA sections 205 and 206 empower FERC to regulate the rates, terms and conditions of such wholesale sales and transmission. *See* FPA §§ 201(b), 205 and 206, 16 U.S.C. §§ 824(b), 824d and 824e; *Pub. Util. Dist. No. 1 of Snohomish County Wash. v. FERC*, 471 F.3d 1053, 1058 (9th Cir. 2006) (recognizing FERC's exclusive jurisdiction over transmission and wholesale sales of electric energy in interstate commerce), *aff'd in part and rev'd in part sub nom. Morgan Stanley Capital Group, Inc. v. Pub. Util. Dist. No. 1 of Snohomish County Wash.*, 554 U.S. 527 (2008); *New England Power Co. v. New Hampshire*, 455 U.S. 331, 340 (1982) (same).

[22] *See, e.g.*, *New York v. FERC*, 535 U.S. 1 at 7 n.5 (2002); *Fed. Power Comm'n v. Florida Power & Light Co.*, 404 U.S. 453, 460 (1972).

[23] *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. ¶ 31,036, (1996), *clarified*, 76 FERC ¶ 61,009 and 76 FERC ¶ 61,347 (1996), *order on reh'g*, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048, *clarified* , 79 FERC ¶ 61,182 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in relevant part sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002). In Order No. 888, FERC provided a seven-factor test to determine whether facilities are transmission or distribution facilities on each individual power transaction they handle: (1) local distribution facilities are normally in close proximity to retail customers; (2) local distribution facilities are primarily radial in character; (3) power flows into local distribution systems, and it rarely if ever, flows out; (4) when power enters a local distribution system, it is not reconsigned or transported on to some other market; (5) power entering a local distribution system is consumed in a comparatively restricted geographic area; (6) meters are based at the transmission local distribution interface to measure flows into the local distribution system; and (7) local distribution systems will be of reduced voltage. Order No. 888 at 31,770-71. *See also* U.S.

and courts have previously determined that electrons in interstate commerce cannot be traced and move "effortlessly" through the interconnected transmission and distribution systems.[24] Because of their close interconnection, transmission and the distribution systems can be seen as subparts of the larger electricity delivery system. For purposes of determining the tax treatment to a utility of a contribution of interconnection equipment, there is no rational basis for differentiating between situations in which a utility directly interconnects with an electric transmission system versus with an electric distribution system.

Furthermore, notwithstanding the references to "transmission," neither Notice 88-129 nor Notice 2001-82 rely on the presence of a direct interconnection with an electric transmission system; rather those Notices simply are concerned with the direction in which electricity flows through the intertie -- *i.e.*, from the generator to the utility or from the utility to the generator. In that regard, Notice 88-129 states:

> In a CIAC transaction the purpose of the contribution of property to the utility is to facilitate the sale of power by the utility to the customer. In contrast, the purpose of the contribution by a Qualifying Facility to a utility is to permit the sale of power by the Qualifying Facility to the utility. Accordingly, the fact that the 1986 amendments to Code section 118(b) render CIAC transactions taxable does not require a similar conclusion with respect to transfers from Qualifying Facilities to utilities.

Notice 88-129 at § 1. (Emphasis added.) In other words, the application of section 118(b) primarily depends on the direction of the flow of electricity, without any consideration of where in the electric grid system such electricity is delivered.

Thus, although Notice 88-129, Notice 2001-82, and certain private letter rulings make numerous references to "transmission", none of those references are relevant to the ultimate conclusion that section 118(b) does not apply where all, or all but a *de minimis* amount of, the flow of electricity is from the generator to the utility, as is the case here. Accordingly, the Service has already confirmed in private letter rulings that the contribution of an intertie by a generator to a utility that allows electricity to be delivered to the electric grid was a fully non-taxable contribution to capital where the intertie was part of both the "Taxpayer's transmission *and distribution* system":

- PLR 201122005 (June 3, 2011) ("Generator submitted applications to Taxpayer for interconnection of Facility with the transmission and distribution system belonging to Taxpayer and Corp 2….")

CONGRESS, OFFICE OF TECHNOLOGY ASSESSMENT, ELECTRIC POWER WHEELING AND DEALING: TECHNOLOGICAL CONSIDERATIONS FOR INCREASING COMPETITION 10 (1989).

[24] *See, e.g., New York v. Fed. Energy Regulatory Comm'n*, 535 U.S. at 7 n.5 (2002); *Fed. Power Comm'n v. Florida Power & Light Co*., 404 U.S. 453, 460 (1972).

- PLR 940012 (Feb. 15, 1984) ("Also included in such upgrades are a number of improvements to the electric connections and switchyard equipment needed to transmit the electric output of the Generating Facility to a nearby substation and intertie such output with the Taxpayer's high-voltage transmission and distribution system.").
- PLR 200403084 (Oct. 6, 2003) (prior ruling issued to NECo's affiliate, Massachusetts Electric Company ("MECo") concluding that the contribution of an intertie by a generator to MECo was not a contribution in aid of construction under section 118(b) and was excludible from income under section 118(a) where the interconnection was to MECo distribution line #2286, the interconnection costs related to distribution equipment, and, among other reasons, "the intertie will be used in connection with Generator's sale of electricity wheeled over Taxpayer's transmission grid to third parties . . . Thus, we conclude that the transfer of the intertie by Generator to Taxpayer meets the safe harbor requirements of Notice 88-129, as amended and modified by Notice 90-60 and Notice 2001-82."

F. Conclusion

Based on the foregoing, and consistent with the section 118 authorities and numerous IRS Notices and rulings cited herein, the Interconnection Payment received by NECo from the Generator pursuant to the Interconnection Agreement should be treated as a non-taxable non-shareholder contribution to capital under section 118(a). Further, section 118(b) is inapplicable here because all but a *de minimis* percentage (*i.e.*, well under 5%) of the flow of electricity through the NECo Intertie will be from the Generator to NECo. It is of no significance that the Facility has no direct interconnection to an electric transmission system.

V. PROCEDURAL MATTERS

A. As required under section 7.01(4) of Rev. Proc. 2015-1, to the best of the knowledge of Taxpayer and the undersigned, the same issues are not in earlier returns of Taxpayer (or of any persons related to Taxpayer within the meaning of section 267 or of any members of an affiliated group of which Taxpayer is a member within the meaning of section 1504) that are currently, or were previously, under examination, before Appeals, or before a Federal court.

B. As required under section 7.01(5)(a) of Rev. Proc. 2015-1, to the best of the knowledge of Taxpayer and the undersigned, the Service has not ruled on the same or similar issues for Taxpayer or a member of an affiliated group of which Taxpayer is also a member within the meaning of section 1504.[25]

[25] Although PLR 200403084 (2004) was issued to an affiliate of the Taxpayer and concluded with respect to the transaction therein that the transfer of intertie by the generator to the affiliate would not constitute a contribution in aid of construction under § 118(b) and would be excludable from the gross income of the affiliate as a non-shareholder contribution to capital under § 118(a), that ruling considered a different transaction and did not precisely address the issues raised herein.

C. As required under section 7.01(5)(b) of Rev. Proc. 2015-1, to the best of the knowledge of Taxpayer and the undersigned, neither Taxpayer, a person related to Taxpayer, a predecessor, nor any representatives have previously submitted the same or a similar issue to the Service but withdrew the request before a letter ruling or a determination letter was issued.

D. As required under section 7.01(5)(c) of Rev. Proc. 2015-1, the Taxpayer and the undersigned acknowledge that an affiliate of the Taxpayer, Massachusetts Electric Company, has submitted a ruling request on December 12, 2014 for a similar transaction involving an interconnection with its distribution system. To the best of the knowledge of Taxpayer and the undersigned, neither Taxpayer, a person related to Taxpayer, nor a predecessor have previously submitted any other request involving the same or a similar issue that is currently pending with the Service.

E. As required under section 7.01(5)(d) of Rev. Proc. 2015-1, to the best of the knowledge of Taxpayer and the undersigned, Taxpayer is not presently submitting another request involving the same or a similar issue to the Service.

F. As required under section 7.01(8) of Rev. Proc. 2015-1, the law in connection with this request is uncertain and Taxpayer cannot be assured of the proper tax treatment of the Interconnection Payment without obtaining a private letter ruling.

G. Consistent with section 7.01(9) of Rev. Proc. 2015-1, to the best of the knowledge of Taxpayer and the undersigned, there are no authorities that could be considered contrary to the rulings requested herein.

H. Consistent with section 7.01(10) of Rev. Proc. 2015-1, to the best of the knowledge of Taxpayer and the undersigned, there is no pending legislation that may affect the ruling requested herein.

I. As required by section 7.01(11) of Rev. Proc. 2015-1, a deletions statement is submitted with this request for rulings.

J. As required by section 7.01(14) of Rev. Proc. 2015-1, a Form 2848 authorizing the undersigned to act in this matter on behalf of the Taxpayer is enclosed at Tab E.

K. As required by section 7.01(15) of Rev. Proc. 2015-1, enclosed at Tab F is a statement signed under penalties of perjury by an authorized officer of Taxpayer attesting to the accuracy of the representations and facts set forth herein.

L. As required by section 7.01(18) of Rev. Proc. 2015-1, enclosed at Tab G is the ruling checklist.

M. Pursuant to section 7.02(5) of Rev. Proc. 2015-1, Taxpayer requests that an advance copy of any ruling letter issued in response to this request be sent by facsimile

transmission to the undersigned at _____. Taxpayer waives any disclosure violations to the extent they result from such a facsimile transmission of an advance copy of a ruling letter to the undersigned.

N. Pursuant to section 7.02(6) of Rev. Proc. 2015-1, if a tentative decision is made not to issue the ruling requested herein, we respectfully request that a conference be scheduled to discuss such decision.

O. Pursuant to section 15 and Appendix A of Rev. Proc. 2015-1, the user fee of $28,300 is enclosed.

* * *

Please contact the undersigned at _____ if you have any questions regarding this request or if further information is required.

Respectfully Submitted,

By: _____

LIST OF EXHIBITS

A. Standard Interconnection Service Agreement used by The Narragansett Electric Company

B. PE LLC Interconnect Energy Flow Assessment Report

C. Municipal Net Metering Finance Agreement

D. Distribution Generation Contract

E. Form 2848 Power of Attorney and Declaration of Representative

F. Penalty of Perjury Statement

G. Ruling Checklist

PENALTIES OF PERJURY STATEMENT

Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and, to the best of my knowledge and belief, the request contains all the relevant facts relating to the request, and such facts are true, correct and complete.

The Narragansett Electric Company

By:

_____ _____

Susan Greene
Assistant Treasurer

Date

Certificate of Service

I hereby certify that a copy of the cover letter and any materials accompanying this certificate was electronically transmitted to the individuals listed below.

Paper copies of this filing are being hand delivered to the Rhode Island Public Utilities Commission and to the Rhode Island Division of Public Utilities and Carriers.

Joanne M. Scanlon

July 7, 2015
Date

Docket No. 4483 – Wind Energy Development LLC & ACP Land, LLC – Petition for Dispute Resolution Relating to Interconnection
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