Raquel J. Webster
Senior Counsel

October 13, 2016

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 Status Update

Dear Ms. Massaro:

I write to provide the PUC with an update in the above-referenced matter. In National Grid's[1] letters to the PUC dated August 26, 2016 and September 16, 2016 regarding the Internal Revenue Service's (IRS) Notice 2016-36 (the New Notice), which addresses the "safe harbor" under Internal Revenue Code Section 118(b) for contributions of property to regulated public utilities, the Company explained its position regarding the New Notice and highlighted the ambiguities in the New Notice regarding whether Distributed Generation (DG) interconnections are now exempt from taxation. In these letters, the Company also informed the PUC that, given the ambiguities in the New Notice, it had not yet made a final determination on whether, under the New Notice, DG Interconnections are exempt from taxation.

In September 2016, the Company formally engaged Ernst & Young to provide it with a thorough written analysis of the New Notice so the Company could determine how best to proceed regarding DG Interconnections. On September 30, 2016, the Company received a written opinion from Ernst & Young regarding the application of the New Notice to DG Interconnections. *See* Attachment A, Confidential Memorandum from Ernst & Young to National Grid's Tax Department dated September 30, 2016. In its memorandum, Ernst & Young concluded that "[p]ayments made by the Facility to National Grid to construct an intertie connecting the Facility to the Company's distribution system do not meet the requirements of the safe harbor set forth in Section III. C of [the New Notice]." *See* Attachment A at p. 9. Pursuant to Rule 1.2 (g) and R.I. Gen. Laws § 38-2-2(4)(K), the Company is seeking protective treatment of Attachment A, as explained in the enclosed Motion for Protective Treatment. For the PUC's review, I have enclosed one copy of the unredacted, confidential Attachment A.

[1] The Narragansett Electric Company d/b/a National Grid (National Grid or Company).

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Based on the analysis of the Company's Tax Department and the confidential opinion from Ernst & Young, the Company must reasonably conclude that the "safe harbor" in IRS Notice 2016-36 does not include payments made by a facility to the Company to construct an intertie connecting to the Company's distribution system. Absent clear Treasury guidance to the contrary, the Company, therefore, must treat these payments as taxable income for National Grid in order to comply with federal tax law, and National Grid will continue to report them as such in its federal and state income tax returns.

Notably, National Grid and many other taxpayers affected by the New Notice have submitted comments to the IRS urging it to provide additional guidance regarding whether payments in connection with DG interconnections are covered by the "safe harbor." On June 28, 2016, a representative from the Company's Tax Department sent an e-mail to the IRS stating in part as follows:

> *National Grid urges IRS to provide written [sic] clear written guidance indicating that:*
>
> - *The definition of 'Intertie' in Section IIIB includes interconnections with 'distribution' systems.*
> - *The ownership requirement of Section III(C)(2) also applies to electricity passing through an 'Intertie' which is then distributed via a "distribution" system rather than wheeled or transmitted via a 'transmission' system*
> - *The requirement of Section III(B)(4) is satisfied if the 'Intertie' is used to distribute rather than transmit electricity*
>
> *As we discussed, the overall framework of Notice 2016-36 envisions a system of taxpayer self-assessment without the need of private letter rulings. For this plan to work effectively, taxpayers need clear and unambiguous guidance on the application of the notice to distribution system interconnections. National Grid urges the IRS to provide this clear guidance.*

See Attachment B, June 28, 2016 E-mail from National Grid to IRS Counsel, David Selig. Notably, Edison Electric Institute (EEI), a Washington DC-based association that represents all U.S. investor-owned electric companies, also submitted comments to the IRS requesting further guidance on this issue. *See* Attachment C, EEI letter to IRS dated September 13, 2016. To date, the IRS has not responded to the Company's June 28, 2016 correspondence. The Company also understands that the IRS has not responded to the EEI's letter dated September 13, 2016.

As the Company explained in its August 26 and September 16, 2016 letters in this docket, it must use its own best judgment regarding whether DG Interconnections are taxable because it will be responsible for paying federal taxes on these transactions. At this point, the Company intends to continue treating DG Interconnections as taxable transactions. This

conclusion is reinforced by the opinion of Ernst & Young. In the event that the IRS updates the New Notice to make it clear that DG Interconnections are covered by the "safe harbor", the Company will re-assess its position.

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

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

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.

The 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

October 13, 2016
Date

Docket No. 4483 – Wind Energy Development LLC & ACP Land, LLC – Petition for Dispute Resolution Relating to Interconnection Service List updated 6/13/16

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STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
RHODE ISLAND PUBLIC UTILITIES COMMISSION

In Re: DG Interconnection Dispute Between WED, LLC/ACP, LLC and National Grid	)	**Docket No. 4483**

NATIONAL GRID'S MOTION FOR PROTECTIVE TREATMENT OF CONFIDENTIAL INFORMATION

National Grid[1] respectfully requests that the Rhode Island Public Utilities Commission (PUC) provide confidential treatment and grant protection from public disclosure certain confidential information submitted in this docket, as permitted by PUC Rule 1.2(g) and R.I. Gen. Laws § 38-2-2(4)(K). National Grid also respectfully requests that, pending entry of that finding, the PUC preliminarily grant National Grid's request for confidential treatment pursuant to PUC Rule 1.2 (g)(2).

I. BACKGROUND

On October 13, 2016, the Company filed a letter with the PUC regarding whether the Internal Revenue Service's Notice 2016-36 (the New Notice), which addresses the "safe harbor" under Internal Revenue Code Section 118(b) for contributions of property to regulated public utilities, exempts distributed generation (DG) interconnections from taxation. In its October 13 letter to the PUC, the Company includes a confidential memorandum its Tax Department received from the Company's consultant, Ernst & Young, LLP, regarding the New Notice (Consultant Memorandum). The Consultant Memorandum includes Ernst & Young's work product, professional opinion, and advice to the Company. In this motion, the Company

respectfully requests that the PUC afford confidential treatment to the Consultant Memorandum, which is attached as Attachment A to the Company's October 13 letter.

II. LEGAL STANDARD

The PUC's Rule 1.2(g) provides that access to public records shall be granted in accordance with the Access to Public Records Act (APRA), R.I. Gen. Laws §38-2-1 *et seq.* Under the APRA, all documents and materials submitted in connection with the transaction of official business by an agency is deemed to be a public record, unless the information contained in such documents and materials falls within one of the exceptions specifically identified in R.I. Gen. Laws § 38-2-2(4). Therefore, to the extent that information provided to the PUC falls within one of the designated exceptions to the public records law, the PUC has the authority under the terms of the APRA to treat such information as confidential and to protect that information from public disclosure.

The APRA provides that, among other things, the following types of records shall not be deemed public:

> (K) Preliminary drafts, notes, impressions, memoranda, working papers, and work products; provided, however, any documents submitted at a public meeting of a public body shall be deemed public.R.I. Gen. Laws § 38-2-2(4)(K). The Consultant Memorandum is confidential and protected from public disclosure under R.I. Gen. Laws § 38-2-2(4)(K).

III. BASIS FOR CONFIDENTIALITY

Pursuant to R.I. Gen. Laws § 38-2-2(4)(K), the Company seeks confidential treatment of the Consultant Memorandum attached as Attachment A to its October 13 letter. The Consultant Memorandum should be protected from public disclosure under

[1] The Narragansett Electric Company d/b/a National Grid (National Grid or Company).

section 38-2-2(4)(K) because it is the privileged work product and opinion of the Company's tax advisor, and the Company would not normally disclose confidential opinions from its advisors to the public.

IV. CONCLUSION

Accordingly, the Company respectfully requests that the PUC grant protective treatment to the memorandum from its consultant, Ernst & Young, LLP, attached as Attachment A to the Company's October 13, 2016 letter to the PUC.

WHEREFORE, the Company respectfully requests that the PUC grant its Motion for Protective Treatment.

Respectfully submitted,

NATIONAL GRID

By its attorneys,

Raquel J. Webster, RI Bar # 9064
National Grid
40 Sylvan Road
Waltham, MA 02451
(781) 907-2121

Dated: October 13, 2016

Ermanski, Robert

From: Ermanski, Robert
Sent: Tuesday, June 28, 2016 4:26 PM
To: david.a.selig@irscounsel.treas.gov
Subject: National Grid and Notice 2016-36

Hi, David – I would like to thank you again for taking time to explain the application of Notice 2016-36 to "distribution" system interconnections like the one which was the subject of the National Grid PLR 201619007. In that ruling, a solar power generator paid for the construction of an interconnection between its facility and National Grid's local "distribution" system. The interconnection is used to permit the transfer of generated electricity to National Grid's distribution system. Title to the power passes to the generator's customer on or before the bus bar on the generator's end of the interconnection. The electricity is never transferred to National Grid's "transmission system."

During the call, you confirmed that Notice 2016-36 was indeed intended to cover transactions of this type. Nonetheless, you acknowledged that the IRS may need to issue additional guidance to make this clearer. National Grid agrees with this assessment. Although reference is made in Section IIIA of Notice 2016-36 to interconnections with "distribution" systems, the continued restrictive use of the term "transmission" in Sections IIIB and IIIC of the notice may cause confusion for taxpayers. In particular, following PLR 201619007, it is clear that the term "transmission" as used in Notices 88-129 and 2001-82 did not include the "distribution" of electricity. Consequently, the continued use of the restrictive term "transmission" in Section IIIB and IIIC of Notice 2016-36 may cause taxpayers to conclude incorrectly that the new safe harbor is only permitted when electricity which passes through a "distribution" system intertie is ultimately delivered to the utility's "transmission" system.

National Grid urges IRS to provide written clear written guidance indicating that:

- The definition of "Intertie" in Section IIIB includes interconnections with "distribution" systems.
- The ownership requirement of Section III(C)(2) also applies to electricity passing through an "Intertie" which is then distributed via a "distribution" system rather than wheeled or transmitted via a "transmission" system
- The requirement of Section III(B)(4) is satisfied if the "Intertie" is used to distribute rather than transmit electricity

As we discussed, the overall framework of Notice 2016-36 envisions a system of taxpayer self-assessment without the need of private letter rulings. For this plan to work effectively, taxpayers need clear and unambiguous guidance on the application of the notice to distribution system interconnections. National Grid urges the IRS to provide this clear guidance.

Robert A. Ermanski| National Grid | Director, U.S. Tax Research & Planning |Office: 781.907.2393 | robert.ermanski@nationalgrid.com

Miller & Chevalier

Alexander Zakupowsky, Jr.
Member
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September 13, 2016

Via Hand Delivery

Mr. David Selig
Office of the Associate Chief Counsel (Passthroughs and Special Industries)
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Notice 2016-36

Dear Mr. Selig:

Following on behalf of the Edison Electric Institute ("EEI") are comments on Notice 2016-36. EEI is the Washington, D.C.-based association that represents all U.S. investor-owned electric companies. Its members provide electricity for 220 million Americans, operate in all 50 states and the District of Columbia, and directly and indirectly employ more than one million workers. The industry's $100 billion of annual capital expenditures include the construction of modified and new infrastructure. Safe, reliable, affordable, and clean electricity powers the economy and enhances the lives of all Americans. Organized in 1933, EEI provides public policy leadership, strategic business intelligence, and essential conferences and forums.

Generally, EEI supports the guidance provided in the Notice but requests corrections and additional clarifications as indicated below.

1. Explanation of Provision. The Notice provides a safe harbor in which "a transfer of an intertie to a regulated public utility will not be treated as a contribution in aid of construction ("CIAC") under § 118(b) or give rise to gross income under § 118(a)." Section 118(a) is an exclusion provision and does not "give rise to gross income." Also, if it is important to include the provision that it "will not be treated as a CIAC," it seems

just as important to say it will not be treated as a contribution from a customer or potential customer since section 118(b) includes both a CIAC or any other contribution as a customer or potential customer. We suggest the following:

> This notice provides a new safe harbor in which a transfer of an intertie to a regulated public utility will not be treated as a CIAC or other contribution as a customer or potential customer under § 118(b) and will be treated as an exclusion from gross income under § 118(a).

We also suggest conforming changes in the Purpose, Requirements, and Change in Method of Accounting sections.

2. Removal of Requirement for Power Purchase Contract or Long-Term Interconnection Agreement. The Explanation of Provisions section explains that the Notice "removes the requirement that the generator must have a long-term power purchase contract or long-term interconnection agreement with the utility that constructs the upgrades."

   a. Inclusion of Distribution Utility Receipt of Interconnection Payment. The provision explains that as a result of the removal of the requirement of either a long-term power purchase contract or long-term interconnection agreement "a generator may contribute an intertie to a utility that qualifies under the new safe harbor even if the generator is interconnected with a distribution system, rather than a transmission system . . ." We assume your intent was to provide the same treatment for all transfers of an intertie to a distribution utility as is provided to transfers of intertie property to transmission utilities. Several references remain solely with respect to transmission. Those references should be changed to include distribution. For example, the definition of an "intertie" should be:

> An intertie includes new connecting and distribution or transmission facilities or modifications, upgrades, or relocations of a utility's existing distribution or transmission network that enable or facilitate the interconnection of a generator with a utility or improve the efficiency of the utility's distribution or transmission network.

References to the transmission of power or electricity should be replaced with "distribution or transmission of power or electricity," or the more general term "delivery of power or electricity." Also, the references to a transmission utility may now be more simply stated as "a utility," without the transmission limitation.

b. Termination of Power Purchase Agreement. Since application of the safe harbor is no longer dependent on the existence of a power purchase contract (which includes a long-term interconnection agreement under Notice 2001-82) the Proportionate Disqualification rules applicable to termination of a power purchase agreement or long-term interconnection agreement seem unnecessary. If this provision is continued it should be clarified that termination of a power purchase contract or long-term interconnection does not cause a disqualification with respect to the transfer of any intertie property by a utility other than the utility with which the generator entered into the power purchase contract or long-term interconnection agreement. This is important because many system upgrades may remain in use after the power purchase contract terminates. The examples dealing with the termination of a power purchase contract should no longer be applicable.

3. Definition of a Dual-Use Intertie. The application and effect of the Notice could be improved by providing common rules for dual use interties. The definition states that "[a] dual-use intertie includes an intertie that may be used to transmit power from a third party for sale to the generator." This provision seems to mean that all interties are dual use interties because any intertie "may be used to transmit power from a third party for sale to the generator." In contrast, the first requirement of application of the Notice is that "[t]he generator may not purchase electricity from the utility, unless the purchase satisfies the 5% test." If the generator only purchases power from a third party, the first requirement seems to be met under the general rule without application of the five-percent test. This is so because the general rule only states that "[t]he generator may not purchase electricity from the utility, unless the purchase satisfies the 5% test." Thus, the general rule is that "the generator may not purchase electricity from the utility." The

five-percent test is an exception to the general rule and seems to have no application unless some electricity is purchased from the utility, which is not the case when the generator is purchasing electricity only from a third party. This interpretation is further supported by the statement: "Power purchases by the generator from parties other than the utility are not taken into account [in applying the five-percent test]." The definition should be:

> A dual-use intertie is an intertie that is used to deliver power from a generator to a utility and that may be used for the utility to sell power to the generator. A dual use intertie may be used for example, when a generator relies on the utility as a backup or supplemental power source, either sporadically or on a regular basis.

4. Definition of Generator. A generator is defined as a "facility." The actual application of the Notice is to a taxpayer who owns the facility. We propose the following definition: "A generator is a taxpayer that owns an electricity generation or cogeneration facility or an energy storage facility."

5. Five-Percent Qualification Test and Proportionate Disqualification.

   a. Common Rule. There is a benefit in assuring that the power flows taken into account for purposes of initially qualifying under the Notice should be the same power flows taken into account in determining disqualification. Otherwise, an intertie may qualify even if it is known at the outset that it will be later disqualified. For example, assume an intertie has the capacity to handle power flow of 100 megawatts (MW) per year and the projection at the outset is that the generator will deliver 100 MW to the intertie in each year except the first four years. In the first four years the generator expects to deliver 94 MW to the intertie, and receive delivery of 6 MW from the intertie. The intertie meets the five-percent qualification test. Even without excluding the first year the total power flows over the intertie for 10 years are 1000 MW of which 24 MW or 2.4 percent are power flows from the utility to the generator. However, even if the

taxpayer elects to not consider the first year, if the generator receives 6 MW in the second year, third year and fourth year a disqualification event has occurred.

The general rule is that "[t]he generator may not purchase electricity from the utility" and the five-percent test is intended to provide an exception to that rule for some sale of electricity by the utility to the generator, typically to provide station power when the generator is not producing electricity. The principle of this rule is to assure that the intertie is not being built with the view that the generator (contributor) is a customer of the utility (recipient of contribution). If this is so, purchases by the generator from a third party should be irrelevant. A single five-percent test should be used both for initial and continued qualification. We suggest a simple test based on a comparison of power sold by the utility to the generator in comparison to total power flow, as follows: "For each of any three taxable years within any period of five consecutive taxable years, no more than 5% of the power flows over the intertie will be sales of power by the utility to the generator." This principle can be projected as a requirement for qualification over the first 10 taxable years and used as a disqualification event over the life of the Intertie.

b. Related Party Purchases. For purposes of the five-percent test "[p]ower flows to a generator include power flows to a related party of the generator, if the transmission of power to the related party has been facilitated by the contribution of the intertie." The facilitation of power flows on the grid is a complicated technical matter. This is particularly so when dealing with system upgrades. Furthermore, all power flow from a generator is facilitated by the intertie line itself. It is not uncommon for a generator to sell power into a market, and have a distribution company related to the generator purchase power in that market for sale to its customers. In such cases, it could be very difficult to determine whether the interconnection of the generator to the transmission system, or a system upgrade to the transmission system "facilitated" the transmission of the

power to the related party. This related party provision should be eliminated and the prohibition on sales be directed to the sale of electricity from the utility to the generator.

6. Change in Method of Accounting. It should be clarified that each transfer of an intertie is an item with its own method of accounting. This will allow utilities that have treated interconnection payments that now qualify under the safe harbor of the Notice as income in prior years to continue their method of accounting for past receipts (continue to depreciate the asset they took into account when they reported the intertie as income), but use the safe harbor treatment for future intertie receipts. It will also allow utilities to change their method of accounting for intertie receipts treated as income in the past and recover undepreciated basis in those interties through a section 481 adjustment on a selective basis, which some utilities will do for sizable interconnection payments received in recent years. To change the method of accounting for all interconnection payments that qualify for the safe harbor treatment under the Notice is not practicable in many cases and should not be a condition for the application of the Notice.

7. Application to Partnerships. There are two large transmission utilities that operate as partnerships. Since the Service's position is that intertie receipts are gross income in the absence of the relief provided in the Notice, the relief must be supported by a sound tax policy. The Service should consider extending that relief to intertie receipts by partnerships to avoid discrimination in the application of that tax policy against those partnerships. While we recognize that section 118 does not apply to partnerships, we see no rational distinction for a different tax policy with respect to the exclusion of intertie payments from gross income for intertie receipts by partnerships.

8. No Ruling Policy. The Notice states: "The IRS will not issue private letter rulings involving this safe harbor." While this Notice provides broad relief and will provide clear guidance to many taxpayers, experience has shown that new arrangements occur as the electricity market evolves and new technologies are developed. The private letter ruling process allows taxpayers to get needed guidance as the electricity market evolves

and new resources connect to the system. The private letter ruling process also provides a venue for the Service to understand the application of its relief as generation resources evolve. As an example, in coming years, there will be increasing penetration of distributed energy resources, such as rooftop solar, providing power to utilities, many of which will require intertie facilities. Unless utilities can obtain certainty of the tax result they will need to require gross-ups, which is contrary to the tax policy the Service is implementing in the Notice. At a minimum the Service should continue to rule when payments are not covered by the Notice and therefore are taxable income.

We would be pleased to further explain these comments or answer any questions you may have. You may reach me at 202-626-5950.

Sincerely,

Alexander Zakupowsky, Jr.

cc: Mr. Mark Agnew, Edison Electric Institute