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August 10, 2022

BY ELECTRONIC MAIL

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

**RE: Docket 5205 - DG Interconnection Projects
Review of Cost Allocation and Recovery of Ongoing O&M Expenses
Responses to PUC Data Requests – Set 3**

Dear Ms. Massaro:

I have enclosed an electronic version of Rhode Island Energy's¹ responses to the Rhode Island Public Utilities Commission's Third Set of Data Requests in the above-referenced matter.²

Thank you for your attention to this matter. If you have any questions, please contact me at 401-784-4263.

Very truly yours,

A handwritten signature in blue ink, appearing to read "Andrew S. Marcaccio".

Andrew S. Marcaccio

Enclosures

cc: Docket 5205/5206 Service List
John Bell, Division
Jon Hagopian, Esq.

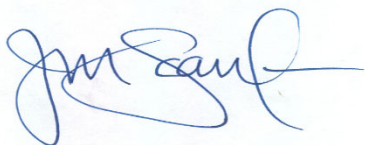
¹ The Narragansett Electric Company d/b/a Rhode Island Energy ("Rhode Island Energy" or the "Company").

² Per a communication from Commission counsel on October 4, 2021, the Company is submitting an electronic version of this filing followed by six (6) hard copies filed with the Clerk within 24 hours of the electronic filing.

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

August 10, 2022

Date

Docket No. 5205 - Review of the Cost Allocation and Recovery of Ongoing Operation and Maintenance Expenses Related to the Interconnection of Distributed Generation Projects (National Grid)

Docket No. 5206 - Review of Administrative Issues Related to the Interconnection Process (National Grid)

Service List as of 8/11/2022

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The Narragansett Electric Company
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PUC 3-1

Request:

Following up on PUC 1-3, consider the following hypothetical: A customer requires a system modification to connect to the distribution system of \$300,000.

- a. Please show the calculation of the customer contribution to the system modification if the customer is a load customer whose projected annual usage results in billings to the customer of \$24,000.
- b. Please show the calculation of the customer contribution for a renewable energy interconnecting customer with a standalone renewable energy facility that is billed at the C-06 rate. (please use the same mathematical formula as in 3-1.a. as at least part of the response, if possible).
- c. Please show the calculation of the customer contribution for a customer who is building new construction paired with an on-site solar installation that is expected to be sized, based on a projected annual consumption of energy, to produce electricity in an amount that is equal to the customer's projected on-site usage.
- d. Please show the calculation of the customer contribution for a customer who is building new construction paired with an on-site solar installation that is expected to be sized, based on a projected annual consumption of energy, to produce electricity in an amount that is equal to 50% the customer's projected on-site usage.

Response:

As noted in the Company's response to PUC 1-3, in terms of traditional load customers, R.I.P.U.C. No. 2243-A, Line Extensions and Construction Advance Policy for Commercial, Industrial and Existing Residential Customers – Policy 3, Construction Advance formula $(A) = [C - [D \times M] \div K]$,¹ allows a customer's estimated annual revenue to be taken into consideration when evaluating their overall upfront customer contribution.

Also noted in the Company's response to PUC 1-3, unlike traditional load customers, stand-alone multi-MW distributed generation customers provide minimal annual distribution revenue ("D"). The C-06 rate has a \$10 monthly customer charge and a \$3.78 per month Renewable Energy Growth ("REG") charge. Therefore, these customers are required to pay the full cost of a necessary system modification/upgrade upfront as the costs of upgrades for stand-alone projects typically exceed \$100,000. For a behind the meter customer, there is no incremental distribution revenue that can be used in the Policy 3 calculation. In fact, a behind the meter customer has

¹ See https://www.rienergy.com/media/pdfs/billing-payments/tariffs/ri/neco-tcs-policy-3_ripuc_2243.pdf.

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negative incremental distribution revenue. If negative distribution revenue was used, the customer would end up paying more than the estimated cost of any system upgrade. The Company has never used negative distribution revenue. Instead, the Company uses \$0 as distribution revenue when determining the cost for any upgrade.

- a. Please see Calculation PUC 3-1a.
- b. Please see Calculation PUC 3-1b.
- c. Please see Calculation PUC 3-1c.
- d. Please see Calculation PUC 3-1d.

In the below calculations:

A = Construction Advance paid to the Company by the Customer.

C = The total estimated cost of construction for facilities required exclusively to meet the distribution service requirements of the Customer. This cost includes capital and non-capital costs and the Company's liability for tax required on the value of the material and labor provided by the Customer. Where these new or upgraded facilities are not solely to provide service to the Customer, the Company shall appropriately apportion these costs.

D = For a single customer, the estimated annual Distribution Revenue derived from the Customer within the first year following the completion of the Company's construction of facilities; or for developments, the estimated additional annual Distribution Revenue derived from those new customers in the development anticipated to be supplied directly with electric service within one year from the commencement of the delivery of electricity to the first customer in the development.

M = 0.5, the revenue apportionment factor.

K = The annual carrying charge factor, expressed as a decimal.

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Calculation 3-1a

$$(A) = [C - [D \times M] \div K]$$

$$(A) = [\$300,000 - [\$24,000 \times .5] \div 15.72\%]$$

$$(A) = [\$300,000 - [\$12,000] \div 15.72\%]$$

$$(A) = [\$300,000 - \$76,335.88]$$

$$(A) = \$223,664.12$$

Calculation 3-1b

$$(A) = [C - [D \times M] \div K]$$

$$(A) = [\$300,000 - [\$0 \times .5] \div 15.72\%]$$

$$(A) = [\$300,000 - [\$0] \div 15.72\%]$$

$$(A) = [\$300,000 - \$0]$$

$$(A) = \$300,000.00$$

Calculation 3-1c

If the customer load and on-site solar, sized in an amount that is equal to the customer's projected on-site usage and is served behind the meter, come in at the same time, then the calculation would assume 0KW for D, annual Distribution Revenue.

$$(A) = [C - [D \times M] \div K]$$

$$(A) = [\$300,000 - [\$0 \times .5] \div 15.72\%]$$

$$(A) = [\$300,000 - [\$0] \div 15.72\%]$$

$$(A) = [\$300,000 - \$0]$$

$$(A) = \$300,000.00$$

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If the customer load comes in first, which is a typical occurrence, and onsite solar after, then the calculation would assume an estimated D, annual Distribution Revenue

$$(A) = [C - [D \times M] \div K]$$

$$(A) = [\$300,000 - [\$24,000 \times .5] \div 15.72\%]$$

$$(A) = [\$300,000 - [\$12,000] \div 15.72\%]$$

$$(A) = [\$300,000 - \$76,335.88]$$

$$(A) = \$223,664.12$$

Calculation 3-1d

$$(A) = [C - [D \times M] \div K]$$

$$(A) = [\$300,000 - [\$12,000 \times .5] \div 15.72\%]$$

$$(A) = [\$300,000 - [\$6,000] \div 15.72\%]$$

$$(A) = [\$300,000 - \$38,167.94]$$

$$(A) = \$261,832.06$$

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PUC 3-2

Request:

Is the tax treatment the same for the calculation of a customer's contribution to system modifications to the distribution system whether the customer is a load customer or a renewable interconnecting customer? If so, please provide an illustrative example. If not, why not?

Response:

Yes. Pursuant to applicable tax law, all contributions in aid of construction ("CIACs") are includible in the taxable income of the recipient, unless an exception applies. Please see, Internal Revenue Code §§61 and 118. One notable exception is provided in IRS Notice 2016-36 ("Notice"). There are specific conditions set forth in the Notice that must be satisfied to be eligible for an exclusion of the CIAC from taxable income. To the Company's knowledge, there are no applicable exclusions for distributed generation interconnections to the distribution system.

Please see Attachment PUC 3-2-1 for a copy of the Notice and Attachment PUC 3-2-2 for an illustrative example of the tax gross-up rate calculation and the application of the gross-up tax rate to a customer bill.

Transfers of Property to Regulated Public Utilities by Electricity Generators

Notice 2016-36

I. PURPOSE

This notice provides a safe harbor for transfers of property from either an electricity generation or cogeneration facility or an energy storage facility to a regulated public utility, used to facilitate the transmission of electricity over the utility's transmission system, to be treated as a contribution to the capital of a corporation under § 118(a), and not a contribution in aid of construction (CIAC) under § 118(b). 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, (collectively, the "Notices") are modified and superseded.

II. BACKGROUND

A. Law and Legislative History

Section 61(a) of the Internal Revenue Code and § 1.61-1 of the Income Tax Regulations provide that gross income means all income from whatever source derived, unless excluded by law. Section 118(a) provides that in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Section 118(b) provides that for purposes of § 118(a), except as provided in § 118(c), the term "contribution to the capital of taxpayer" does not include any CIAC or any other contribution as a customer or potential customer.

Section 1.118-1 provides, in part, that § 118 also applies to contributions to capital made by persons other than shareholders. For example, the exclusion applies to the value of land or other property contributed to a corporation by a governmental unit or by a civic group for the purpose of enabling the corporation to expand its operating facilities. However, the exclusion does not apply to any money or property transferred to the corporation in consideration for goods or services rendered.

The legislative history to § 118 indicates that Congress added the exclusion from gross income for nonshareholder contributions to capital of a corporation to address situations in which such contributions cannot be called gifts because the contributors expect to derive indirect benefits; nor can the contributions be characterized as payments for future services because the anticipated future benefits are too intangible. The legislative history also indicates that the provision was intended to codify the existing law that had developed through court decisions on the subject. H.R. Rep. No. 1337, 83rd Cong., 2d Sess. 17 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 18-19 (1954).

B. Notice 88-129

Notice 88-129, which was amplified and modified by Notice 90-60 and Notice 2001-82, provided specific guidance with respect to the treatment of transfers of property to regulated public utilities by qualifying small power producers and qualifying cogenerators (collectively, "Qualifying Facilities"), as defined in section 3 of the Federal Power Act, as amended by section 201 of the Public Utilities Regulatory Policies Act of 1978 (PURPA).

As explained in Notice 88-129, PURPA and the regulations thereunder require a utility to interconnect with a Qualifying Facility for the purpose of allowing the sale of power produced by the Qualifying Facility. These rules require the Qualifying Facility to bear the cost of the purchase and installation of any equipment required for the interconnection (“intertie”). Generally, the utility takes legal title to the intertie, which becomes part of the utility's transmission network. Qualifying Facilities generally sell electricity to utilities pursuant to long term power purchase contracts, and some of these contracts require the Qualifying Facility to construct and install the intertie and transfer it to the utility.

1. Safe harbor

Section 1 of Notice 88-129 provided a safe harbor under § 118 for certain transfers of interties by a Qualifying Facility to a regulated public utility. Under the safe harbor, when a Qualifying Facility transfers an intertie to a utility exclusively in connection with the sale of electricity by the Qualifying Facility to the utility, the utility would not realize income upon the transfer (a “QF transfer”). The possibility that an intertie may be used to transmit power to a utility that will in turn transmit the power across its transmission network for sale by the Qualifying Facility to another utility (“wheeling”) would not cause the contribution of that intertie to be treated as a CIAC includible in income pursuant to § 118(b).

Under certain other power purchase contracts, a utility may construct and install an intertie on behalf of a Qualifying Facility, with the Qualifying Facility reimbursing or financing the construction and installation costs. A utility that constructs an intertie in exchange for a cash payment from a Qualifying Facility

pursuant to a PURPA contract must recognize income from the construction in the same manner as any other taxpayer constructing similar property under contract. However, subsequent to the construction of the intertie, the Qualifying Facility will be deemed to transfer the intertie to the utility in a QF transfer that is treated in exactly the same manner as an in-kind QF transfer.

Section 2 of Notice 88-129 further explained that, in addition to transmitting power from a Qualifying Facility to a utility, an intertie may be used to transmit power from the utility for sale to the Qualifying Facility (a “dual-use intertie”). Notice 88-129 treated the contribution of a dual-use intertie to a utility as a QF transfer if it satisfied a “5% test.” A contribution satisfied the 5% test if, in light of all information available to the utility at the time of transfer, it was reasonably projected that during the ten taxable years of the utility beginning with the taxable year in which the transferred intertie was placed in service, no more than 5% of the projected total power flows over the intertie would flow to the Qualifying Facility. The notice required the projection to be supported, if practicable, by a report from an independent engineer. For purposes of the 5% test, total power flows meant power flows to or from the Qualifying Facility over the intertie and included power flows to a related party of the Qualifying Facility if the transmission of power to the related party was facilitated by the transfer of the intertie. Concerning the 5% test, the notice provided that transfer of an asset necessary only for sale of power by the utility to the Qualifying Facility was not a QF transfer and constituted a CIAC, even if the asset was used, in part, in connection with the transmission of power to the utility.

Section 3 of the notice provided that a transfer of an intertie by a Qualifying Facility to a utility would not be treated as a QF transfer to the extent the intertie was included in the utility's rate base or if the term of the power purchase contract was less than ten years.

2. Termination of safe harbor

Section 4 of Notice 88-129 provided that certain events would terminate the safe harbor and require the utility to recognize income as a consequence of the QF transfer.

Under section 4.A of Notice 88-129, if, for each of any three taxable years within any period of five consecutive taxable years, more than 5% of the total power flow over the intertie flowed from a utility to a Qualifying Facility (a "disqualification event"), then the Qualifying Facility was deemed to have made a transfer to the utility that constituted a CIAC, and a portion of the fair market value of the intertie had to be included in income by the utility.

Section 4.B of Notice 88-129 provided that, upon the termination of the power purchase contract between a Qualifying Facility and a utility, if the utility obtained or retained ownership (for tax purposes) of the intertie, then the Qualifying Facility was deemed to have made a transfer to the utility that constituted a CIAC as of the first day of the termination. The amount of the CIAC was the fair market value of the intertie, less the amount, if any, paid by the utility to obtain or retain ownership of the property for tax purposes. Absent unusual circumstances, the fair market value of a CIAC was determined under the replacement cost method.

3. Cost recovery

Finally, Notice 88-129 provided that the cost of property transferred in a QF transfer was required to be capitalized by the Qualified Facility as an intangible asset and recovered as appropriate. Taxpayers were not permitted to currently deduct the total amount of an expenditure that resulted in the creation of an asset having a useful life that extended substantially beyond the close of the taxable year but were required to capitalize such expenditures as assets and recover the cost of the expenditures over the useful life of the asset in question. See, e.g., § 1.461-1(a)(1) and (2); Rev. Rul. 70-413, 1970-2 C.B. 103.

Notice 88-129 did not allow a utility to claim depreciation (or amortization) deductions with respect to property transferred in a QF transfer. However, if property that was the subject of a QF transfer was subsequently transferred or deemed transferred to the utility as a CIAC, the utility was allowed to take depreciation deductions with respect to the property.

C. Notice 90-60

Notice 90-60 amplified and modified Notice 88-129. Notice 90-60 clarified that for purposes of determining the fair market value of a CIAC under section 4.A of Notice 88-129, the replacement cost method included taking into account the condition of property deemed transferred as a CIAC in establishing its fair market value. Absent unusual circumstances, the fair market value of used CIAC property was the depreciated replacement cost.

Notice 90-60 also provided that upon the termination under section 4.B of Notice 88-129 of a power purchase contract between a Qualifying Facility and a

utility, if the utility obtained or retained ownership (for tax purposes) of property transferred in a QF transfer, the Qualifying Facility was deemed to have made a transfer to the utility as of the first day of the termination. Notice 90-60 modified Notice 88-129 by providing that a deemed transfer was not treated as a CIAC, except in circumstances indicating an intention by the parties to characterize as a QF transfer a transaction that in substance constitutes a CIAC.

Finally, Notice 90-60 modified Notice 88-129 by deleting the requirement that any property that was the subject of a QF transfer be subsequently transferred or deemed transferred to the utility “as a CIAC” for the utility to be allowed to take depreciation deductions with respect to the property.

D. Notice 2001-82

Notice 2001-82 further amplified and modified Notice 88-129. Notice 2001-82 extended the safe harbor provisions of Notice 88-129 to include transfers of interties from both Qualifying and non-Qualifying Facilities and transfers of interties used exclusively or in part for wheeling electricity. Notice 2001-82 required that ownership of the wheeled electricity pass to the purchaser prior to its transmission on the utility’s transmission grid. This ownership requirement was deemed satisfied if title passed at the busbar on the facility’s end of the intertie. Further, Notice 2001-82 provided that a long-term interconnection agreement in lieu of a long-term power purchase contract could be used to satisfy the safe harbor provisions of Notice 88-129 with respect to wheeling transactions. Finally, Notice 2001-82 required that a facility capitalize

the cost of transferred property as an intangible asset and recover such cost using the straight-line method over a useful life of 20 years.

E. Industry Changes

1. Regional implications of interconnecting to the grid

Since the issuance of the Notices, electricity transmission and distribution systems have evolved and become interlinked so that close coordination of operations within the major U.S. power grids is needed to maintain the various interlinked components.

Utilities across geographic regions interconnect for improved reliability and efficiency. Utilities can draw power from generator reserves in different regions to ensure continuing, reliable power and to diversify their loads. Interconnection also provides access to cheap bulk energy by allowing utilities to receive power from different sources. Further, through greater coordination, utilities can help one another maintain the frequency of oscillation of alternating current and manage interconnections between utility regions.

In addition, utilities are responsible for maintaining the safety of their systems and planning for future customer needs. A large failure in one part of the grid can cause failures in other parts of the grid. Regional transmission operators (RTOs) measure the available transmission capacity on transmission lines and monitor the activities of parties that use space on power lines. Parties may agree to a transaction involving specific transmission lines that, in theory, are able to handle new capacity. However, the additional power delivered over those lines may overload different transmission lines in another part of the grid,

as the physical and the contractual flow of power may differ. When buyers and sellers attempt to send more power over transmission lines than the system can handle, RTOs can activate procedures that enable them to stop the flow of, or in some situations, even cancel, power sales contracts (collectively, “curtailment”).

To avoid curtailment, an electricity generator in one region and a utility in a different region that owns a transmission system that will be affected by power delivered by the generator may enter into an agreement in which the utility constructs upgrades to its transmission system, allowing it to handle the generator’s new capacity, and the generator reimburses the utility for the costs of the upgrades. The safe harbor in Notice 88-129, as amplified and modified by Notice 2001-82, did not apply to such a transfer unless the upgrades were constructed pursuant to a long-term power purchase contract or a long-term interconnection agreement between the generator and the utility that constructed the upgrades. Electricity generators typically do not enter into long-term power purchase contracts with utilities outside of their service areas and do not enter into long-term interconnection agreements with transmission systems that are not located within their connectivity range (“neighboring transmission systems”). Therefore, contributions of transmission system upgrades to neighboring transmission systems would not qualify under the former safe harbor.

2. Energy storage facilities

Most sections of the U.S. power grid operate at 60 Hz. This is the frequency with which electric current oscillates. The frequency fluctuates from one second to the next as people turn on and off lights, TVs, computers, air

conditioners, and other equipment that requires electricity to function. Grid operators try to keep the frequency of the electricity on the grid within a narrow band, from 59.8 to 60.2 Hz, for example. A drop in electricity demand as people turn off equipment causes the frequency to increase. A spike in demand as people turn on equipment causes the frequency to decrease. The fluctuating frequency can cause damage.

Grid frequency is becoming harder to manage as more and more intermittent wind and solar projects connect to the grid. Batteries and other storage facilities play an important role in managing grid frequency. Standalone batteries connected to the grid can allow the grid to shed electricity and call it back in very short intervals to manage frequency as well as smooth the transition to other energy sources.

III. SAFE HARBOR

A. Explanation of Provisions

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 under § 118(b) or give rise to gross income under § 118(a). This notice consolidates the safe harbor requirements under the Notices and 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. Because no long-term power purchase contract or long-term interconnection agreement is required under the new safe harbor, a generator (such as a solar or wind farm) 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, if all of the requirements under section III.C of this notice are met. This notice also extends the provisions of the safe harbor to transfers of interties from energy storage facilities to regulated public utilities. The Treasury Department and the Internal Revenue Service (IRS) believe that these modifications will promote reliability and economic efficiency throughout the grid and the development and interconnection of renewable energy resources.

B. Definitions

1. Generator. A generator is an electricity generation or cogeneration facility or an energy storage facility.

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

3. Dual-use intertie. A dual-use intertie is an intertie that is used to transmit power from a generator to a utility and that may be used to transmit power from the utility for sale 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. A dual-use intertie includes an intertie that may be used to transmit power from a third party for sale to the generator.

4. Utility. A utility is a regulated public utility.

C. Requirements

A contribution of an intertie, including a dual-use intertie, by a generator to a utility will not be treated as gross income under § 118(a) or a CIAC under 118(b) if all of the following conditions are met:

1. The generator may not purchase electricity from the utility, unless the purchase satisfies the 5% test.

a. 5% Test. If, in light of all information available to the utility at the time the intertie is contributed, it is reasonably projected that, during the ten taxable years of the utility beginning with the year in which the contributed intertie is placed in service, no more than 5% of the projected total power flows over the intertie will flow to the generator, the 5% test will be satisfied. Such a projection must be supported by appropriate documentation. Total power flows mean power flows to or from the generator over the intertie. Power 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. For purposes of the 5% test, power flows in the taxable year in which the transferred property is placed in service may, at the option of the utility, be ignored. Power purchases by the generator from parties other than the utility are not taken into account.

b. Example. A utility and a generator enter into a power purchase contract with a term of twenty years, under which the generator will purchase electricity from the utility. Power flows from the utility to the generator are expected to comprise 10% of total power flows over the intertie in the first year (the taxable year in which the facility is placed in service), 1% in the second and third years,

and 0.5% in each of the fourth through tenth years. Total power flows are projected to be 100 megawatt hours ("MWH") in the first and second years, and 200 MWH in the third through tenth years. The utility excludes the first year of the contract from the projection. Thus, the utility reasonably projects that power flows to the generator will be 0.59% of total power flows over the intertie for the applicable nine-year period $((1\% \times 100 \text{ MWH}) + (1\% \times 200 \text{ MWH}) + (7 \times (0.5\% \times 200 \text{ MWH}))) / (100 \text{ MWH} + (8 \times 200 \text{ MWH}))$. The purchase of electricity by the generator satisfies the 5% test.

2. In the case of electricity wheeled over the utility's transmission system, ownership of the wheeled electricity remains with the generator prior to its transmission onto the grid. This ownership requirement is deemed to be satisfied if title to electricity wheeled passes to the purchaser at the busbar on the generator's end of the intertie.

3. The cost of the intertie is not included in the utility's rate base.

4. The intertie will be used for transmitting electricity.

5. The cost of the intertie is capitalized by the generator as an intangible asset and recovered using the straight-line method over a useful life that is treated as 20 years. A utility may not claim depreciation (or amortization) deductions with respect to the intertie. However, if the intertie is subsequently transferred or deemed transferred to the utility, the utility may be allowed to take depreciation deductions with respect to the intertie.

IV. TERMINATION OF SAFE HARBOR

The occurrence of an event specified below will terminate the safe harbor and require the utility to recognize income as a consequence of the contribution of an intertie to a utility by a generator.

A. Proportionate Disqualification

1. General rule.

If, for each of any three taxable years within any period of five consecutive taxable years, more than 5% of the total power flows over the intertie flow from the utility to the generator (a "disqualification event"), then the generator will be deemed to have made a transfer to the utility that constitutes a CIAC under § 118(b) as of the last day of the third such year. At the option of the utility, the taxable year in which the property is placed in service shall not be taken into account in determining whether there has been a disqualification event. The amount of the CIAC shall be equal to the percentage of the fair market value of the intertie as of the date of the deemed transfer that reflects the use of the intertie for the purpose of selling power to the generator, as determined by the IRS by taking into account all facts and circumstances. Relevant factors include the use of the intertie since the date it was placed in service and the reasonably anticipated use of the intertie. This proportionate disqualification does not apply to any property necessary for, and used solely to facilitate, the transmission of power by the generator to the utility.

2. Examples.

These principles are illustrated by the following examples.

Example 1. A generator contributes a dual-use intertie to a utility that is a calendar year taxpayer. The utility places the intertie in service in 2010 and reasonably projects that, over the ten taxable years beginning in 2010, power flows over the intertie to the generator will be less than 5% of total power flows over the intertie. Actual power flows over the intertie to the generator constitute the following percentages of total flows over the intertie: 10% in 2010; 7% in 2011; 6% in 2012; 3% in 2013; 1% in 2014; and 6% in 2015. The utility excludes 2010 (the year in which the intertie is placed in service) from the determination of whether a disqualification event has occurred. A disqualification event occurs due to power flows in 2015, the third year within the five year period from 2011 to 2015 in which more than 5% of power flows over the intertie flow to the generator. Therefore, the generator is deemed to have made a CIAC transfer to the utility as of December 31, 2015.

Example 2. A contract between a generator and a utility requires the utility to relocate a major transmission line and to construct an intertie to the generator, including protective devices that are necessary and used solely for the delivery of power to the utility. Several years into the contract, the use of the intertie by the utility for delivery of power results in a disqualification event. Payments made for the construction of the protective devices are not subject to proportionate disqualification because the protection devices were necessary for, and used solely to facilitate, the transmission of power by the generator to the utility. However, because the transmission line is used for the delivery of power over the

intertie by the utility to the generator, payments made for the relocation of the transmission lines are subject to proportionate disqualification.

3. Determination of fair market value.

The fair market value of a CIAC generally is determined under the replacement cost method, taking into account the condition of the property deemed transferred as a CIAC. See Notice 87-82, 1987-2 C.B. 389. Absent unusual circumstances, the fair market value of used CIAC property will be its depreciated replacement cost (the percentage of the replacement cost that reflects the remaining economic useful life of the property). For example, a trunk line originally cost \$100x to install. Ten years later, the replacement cost of the line is \$150x, and 60% of its useful life remains. The depreciated replacement cost is \$90x (60% of \$150x).

B. Termination of Power Purchase Contract

1. General rule.

Upon the termination of a power purchase contract between a generator and a utility, if the utility obtains or retains ownership (for tax purposes) of the intertie, the generator will be deemed to have transferred the intertie to the utility as of the first day of such termination. Such a deemed transfer will not be treated as a CIAC, except in circumstances that indicate an intention by the parties to characterize a contribution of an intertie as a transaction that in substance constitutes a CIAC. The utility shall include in income the fair market value of the property deemed transferred less the amount, if any, paid by the utility to obtain or retain ownership of the property for tax purposes.

The amount paid by the utility to obtain or retain ownership of the property deemed transferred shall include any "extension allowance" or similar payment by the utility to the generator during the term of the power purchase contract. For this purpose, an extension allowance is a payment to compensate the generator in consideration of the anticipated use of the property by the utility to deliver power to customers other than the generator.

2. Determination of fair market value. The fair market value of the property deemed transferred upon termination (except for any deemed transfer treated as a CIAC) shall be determined by taking into account all facts and circumstances, including the age and condition of the property and whether the property is needed to serve the utility's customers.

If a utility pays to a generator an amount that is determined upon termination of a power purchase contract to be the fair market value for such property under a procedure or method established or used by the relevant utility commission, such fair market value shall be presumed correct in the absence of substantial contrary evidence. For this purpose, a utility commission may take into account any relevant factors, including payments made in connection with the retention of property by a utility upon the termination of a contract and payments by the utility during the term of the contract (for example, extension allowances).

3. Examples. These principles are illustrated by the following examples:

Example 1. A generator contributes to a utility a circuit breaker that is installed as part of an intertie to protect the utility against damage to its system in

the event of a breakdown at the generator. At the termination of the power purchase contract, the utility does not need the circuit breaker to serve its customers. The fair market value of the circuit breaker is its salvage value (less any cost of removal).

Example 2. Upon the termination of a 20-year power purchase contract, a utility retains ownership of a 50-megawatt trunk line that was transferred by a generator at the commencement of the contract. The utility will not use the trunk line other than to supply power to a 10 megawatt customer who has hooked into the trunk line. The fair market value of the trunk line is the economic value to the utility of a 20-year old 10-megawatt line, taking into account any other characteristics or factors that are relevant.

Example 3. Assume the same facts as Example 2, except that upon termination the local public utility commission requires the utility to pay \$10x to the generator, which the commission has determined to be the fair market value of the trunk line. In the absence of substantial contrary evidence, the commission's finding will be presumed correct. The \$10x will be treated as the fair market value for federal income tax purposes, and, because the \$10x fair market value is offset by the \$10x the utility paid to the generator, the utility will not be required to include any amount in income upon termination.

Example 4. A generator transfers a trunk line to a utility pursuant to a long-term power purchase agreement. The trunk line cost the generator \$10x to construct. Three years later, a customer of the utility interconnects into the trunk line, and the local public utility commission requires the utility to pay to the

generator an extension allowance of \$5x. The following year, another customer of the utility interconnects into the line, and the commission requires another extension allowance of \$4x. The commission employs a procedure under which the utility will be required to compensate the generator for the fair market value of property deemed transferred upon termination. When the contract terminates, the commission determines that the utility has, by means of the extension allowances, paid to the generator the fair market value of the property. In the absence of substantial contrary evidence, the commission's finding will be respected, and the utility will not be required to include any amount in income upon termination.

Example 5. A generator transfers a trunk line to a utility pursuant to a 20-year power purchase contract. Upon the termination of the contract, the utility commission determines the fair market value of the trunk line to be \$10x, but does not require the utility to pay this amount to the generator. No presumption of correctness attaches to the utility commission's findings.

V. CHANGE IN METHOD OF ACCOUNTING

A. In General. A change in a utility's treatment of a transfer of an intertie, including a change to or from the safe harbor method of accounting provided in section III of this notice, is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations thereunder apply. A utility that wants to change to the methods of accounting described in this notice must use the automatic change procedures in Rev. Proc. 2015-13, 2015-5 I.R.B. 419, or its successor.

B. Automatic Change. Rev. Proc. 2016-29, 2016-21 I.R.B. 880, is modified to add new section 15.16 to read as follows:

15.16 Transfers of interties under the safe harbor described in Notice 2016-36 (§ 118).

(1) Description of change.

(a) Safe harbor applicable. This change applies to a utility that wants to change to the safe harbor method of accounting provided in section III.C of Notice 2016-36, I.R.B. 2016-25, for the treatment under § 118 of a transfer of an intertie, including a dual-use intertie, by a generator to a utility. Under this safe harbor method of accounting, such a transfer will not be treated as gross income under § 118(a) or a contribution in aid of construction (CIAC) under § 118(b) if all of the conditions specified in section III.C of Notice 2016-36 are met.

(b) Safe harbor terminates. This change applies to a utility that is using the safe harbor method of accounting provided in section III.C of Notice 2016-36 and is required to terminate that safe harbor method of accounting because of the occurrence of an event specified in section IV of Notice 2016-36. The occurrence of such event will require the utility to recognize income as a consequence of the transfer of an intertie, including a dual-use intertie, to the utility by a generator.

(2) Definitions. For purposes of this section 15.16, the terms “utility,” “intertie,” “dual-use intertie,” and “generator” are defined in section III.B of Notice 2016-36.

(3) Certain eligibility rules inapplicable. The eligibility rules in sections 5.01(1)(d) and (f) of Rev. Proc. 2015-13, 2015-5 I.R.B. 419, do not apply to a utility making a change under this section 15.16.

(4) Manner of making change.

(a) The change in method of accounting under section 15.16(1)(a) of this revenue procedure is made with a § 481(a) adjustment.

(b) The change in method of accounting under section 15.16(1)(b) of this revenue procedure is made using a cut-off method and applies to a transfer of an intertie, including a dual-use intertie, by a generator to a utility made on or after the beginning of the taxable year in which the safe harbor method of accounting terminates.

(5) Concurrent automatic change. A utility making a change under this section 15.16 for more than one transfer of an intertie, including a dual-use intertie, for the same year of change should file a single Form 3115 for all such transfers. The single Form 3115 must provide a single net § 481(a) adjustment for all changes under section 15.16(1)(a) of this revenue procedure.

(6) Designated automatic accounting method change number. The designated automatic accounting method change number for a change to the methods of accounting under this section 15.16 is “226.”

(7) Contact information. For further information regarding a change under this section 15.16, contact David Selig at (202) 317-4137 (not a toll-free call).

VI. EFFECT OF THIS DOCUMENT

This document serves as an "administrative pronouncement" as that term is described in § 1.6661-3(b)(2) and may be relied upon to the same extent as a revenue ruling or a revenue procedure.

VII. EFFECT ON OTHER DOCUMENTS

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, are modified and superseded. Rev. Proc. 2016-29 is modified to include the accounting method changes provided in section V of this Notice in section 15 of Rev. Proc. 2016-29.

VIII. EFFECTIVE DATE

This notice applies to transfers of interties meeting all of the requirements under this notice made on or after June 20, 2016. However, taxpayers may choose to rely on this safe harbor for transfers with respect to qualifying transfers made prior to June 20, 2016. The IRS will not issue private letter rulings involving this safe harbor.

IX. DRAFTING INFORMATION

The principal author of this notice is David Selig of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Mr. Selig at (202) 317-4137 (not a toll free call).

The Narragansett Electric Company d/b/a Rhode Island Energy
Tax Treatment of Contribution in Aid of Construction (Electric Distribution)

Step 1: Calculation of the Income Tax Gross-Up Rate

Line Notes:

Customer Contribution Calculation

1	Contribution towards Capital Investment	\$	100,000.00
2	Contribution towards Income Taxes	\$	11,077.42
3	Total Customer Contributor	\$	<u>111,077.42</u>

\$100,000 Contribution is an illustrative example used for purposes of developing CIAC Gross-Up Percentage
Line 8
Line 1 + Line 2

State and Federal Income Tax Calculation

4	State Tax on Total Customer Contribution at 0%	\$	-
5	Federal Tax on Total Customer Contribution at 21%	\$	23,326.26
6	Total State & Federal Taxes on Customer Contribution	\$	23,326.26
7	Net Present Value of Tax Benefit from Tax Depreciation at 6.97%	\$	(12,248.84)
8	Net Taxes to be collected in Customer Contribution	\$	<u>11,077.42</u>

Line 3 * 0%
[Line 3 - Line 4] * 21%
Line 4 + Line 5
Line 40(h)
Line 6 + Line 7

Income Tax Gross-up Percentage

11.08%

Line 2 / Line 1

Reconciliation

10	Gross Income Amount	\$	100,000.00
11	NPV %		6.97%
12	Present Value Depreciation Amount	\$	58,327.82
13	Net Amount	\$	41,672.18
14	Current Tax Rate		21.00%
15	Amount Owed Before Gross-Up	\$	8,751.16
16	Gross Up Rate		79.00%
17	Amount Due	\$	<u>11,077.42</u>

Illustrative example of a net present value percentage based on the company WACC rate

Tax Benefit from Tax Depreciation Calculation

	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
Year	MACRS Depreciation Rate	Federal Tax Depreciation	State Tax Depreciation	State Tax (@ 0.00%)	Federal Taxable Income	Federal Tax (@ 21%)	Total	
18	1	3.750%	\$ 3,750.00	\$ 3,750.00	\$ -	\$ 3,750.00	\$ 787.50	\$ 787.50
19	2	7.219%	\$ 7,219.00	\$ 7,219.00	\$ -	\$ 7,219.00	\$ 1,515.99	\$ 1,515.99
20	3	6.677%	\$ 6,677.00	\$ 6,677.00	\$ -	\$ 6,677.00	\$ 1,402.17	\$ 1,402.17
21	4	6.177%	\$ 6,177.00	\$ 6,177.00	\$ -	\$ 6,177.00	\$ 1,297.17	\$ 1,297.17
22	5	5.713%	\$ 5,713.00	\$ 5,713.00	\$ -	\$ 5,713.00	\$ 1,199.73	\$ 1,199.73
23	6	5.285%	\$ 5,285.00	\$ 5,285.00	\$ -	\$ 5,285.00	\$ 1,109.85	\$ 1,109.85
24	7	4.888%	\$ 4,888.00	\$ 4,888.00	\$ -	\$ 4,888.00	\$ 1,026.48	\$ 1,026.48
25	8	4.522%	\$ 4,522.00	\$ 4,522.00	\$ -	\$ 4,522.00	\$ 949.62	\$ 949.62
26	9	4.462%	\$ 4,462.00	\$ 4,462.00	\$ -	\$ 4,462.00	\$ 937.02	\$ 937.02
27	10	4.461%	\$ 4,461.00	\$ 4,461.00	\$ -	\$ 4,461.00	\$ 936.81	\$ 936.81
28	11	4.462%	\$ 4,462.00	\$ 4,462.00	\$ -	\$ 4,462.00	\$ 937.02	\$ 937.02
29	12	4.461%	\$ 4,461.00	\$ 4,461.00	\$ -	\$ 4,461.00	\$ 936.81	\$ 936.81
30	13	4.462%	\$ 4,462.00	\$ 4,462.00	\$ -	\$ 4,462.00	\$ 937.02	\$ 937.02
31	14	4.461%	\$ 4,461.00	\$ 4,461.00	\$ -	\$ 4,461.00	\$ 936.81	\$ 936.81
32	15	4.462%	\$ 4,462.00	\$ 4,462.00	\$ -	\$ 4,462.00	\$ 937.02	\$ 937.02
33	16	4.461%	\$ 4,461.00	\$ 4,461.00	\$ -	\$ 4,461.00	\$ 936.81	\$ 936.81
34	17	4.462%	\$ 4,462.00	\$ 4,462.00	\$ -	\$ 4,462.00	\$ 937.02	\$ 937.02
35	18	4.461%	\$ 4,461.00	\$ 4,461.00	\$ -	\$ 4,461.00	\$ 936.81	\$ 936.81
36	19	4.462%	\$ 4,462.00	\$ 4,462.00	\$ -	\$ 4,462.00	\$ 937.02	\$ 937.02
37	20	4.461%	\$ 4,461.00	\$ 4,461.00	\$ -	\$ 4,461.00	\$ 936.81	\$ 936.81
38	21	2.231%	\$ 2,231.00	\$ 2,231.00	\$ -	\$ 2,231.00	\$ 468.51	\$ 468.51
39	Total	100.000%	\$ 100,000.00	\$ 100,000.00	\$ -	\$ 100,000.00	\$ 21,000.00	\$ 21,000.00

Sum of Line 18 through Line 38

40	Net Present Value of Tax Benefit from Tax Depreciation at 6.97%	\$	<u>12,248.84</u>
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Net Present Value of Line 18(h) through Line 38(h) at Company WACC rate of 6.97% (i.e. Line 11)

Column Notes:

- (b) MACRS 20-Year Depreciation Rates
- (c) Line 1 * Column (b)
- (d) Line 1 * Column (b)
- (e) Column (d) * 0%
- (f) Column (c) - Column (e)
- (g) Column (f) * 21%
- (h) Column (e) + Column (g)

Step 2: Application of the Income Tax Gross-Up Rate to Customer Bills

41	Customer Contribution Before Tax Gross-up	\$	130,000.00
42	Less costs expensed as incurred and not subject to a tax gross-up	\$	30,000.00
43	Customer Contribution subject to tax gross-up	\$	100,000.00
44	Current Tax Gross-up Rate		11.08%
45	Calculated Tax Gross-Up	\$	11,077.42
46	Customer Contribution After Tax Gross-up	\$	141,077.42

Line 1 plus costs currently expensed and not subject to a tax gross-up
\$30,000 Illustration of a customer contribution for costs not capitalized and removed from the tax gross-up calc
Line 1 Customer contribution applied to capital investment and subject to the tax gross-up
Line 9
Line 43 x Line 44
Line 41 + Line 45