UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

New England Power Company — Docket No. ER03-793-001

ORDER GRANTING REHEARING
AND DIRECTING COMPLIANCE FILING

(Issued May 7, 2004)

1. On June 27, 2003, the Commission issued an order[1] conditionally accepting an unexecuted revised Interconnection Service Agreement (Revised Agreement) between New England Power Company (NEPCO) and AES Londonderry, L.L.C. (AESL) under NEPCO's Open Access Transmission Tariff (OATT). The Revised Agreement reflected AESL's transfer of ownership of a newly constructed switchyard located at AESL's generating plant in Londonderry, New Hampshire, to NEPCO and AESL's payment of network upgrade costs. NEPCO seeks rehearing of our order with respect to certain tax gross-up and related security requirements. We find that the record in the proceeding does not contain sufficient information to resolve the tax issue, and therefore we are requiring NEPCO to make a compliance filing, as discussed below. This order protects customers because it ensures the justness and reasonableness of such agreements.

I. Background

2. The Revised Agreement, as filed, gives AESL the option to pay for its share of certain costs with a lump sum pre-payment. This raised the question as to whether that pre-payment would qualify as income upon which NEPCO would be required to pay taxes. To address the risk that the lump sum payment would become taxable, under the Revised Agreement, AESL must also maintain for twenty years security for the tax gross-up associated with the lump sum pre-payment. AESL protested this provision, arguing that it was unjust for NEPCO to impose a security requirement where there was no current tax liability.

[1] New England Power Company, 103 FERC ¶ 61,364 (2003).

3. We ruled in favor of AESL, finding that the tax gross-up and related security requirements were unjust and unreasonable, given the mere possibility that the lump sum payment would be taxable as income to NEPCO. We directed NEPCO to recognize the validity of any private letter ruling (PLR) issued by the Internal Revenue Service (IRS) regarding the taxability of the pre-payment and not to impose any security requirement if the PLR confirmed that AESL's pre-payment would not result in a current tax assessment against NEPCO.

II. Rehearing Request

4. In its request for rehearing, NEPCO argues that we did not recognize the business risks that NEPCO will face if circumstances change resulting in a tax liability, and if AESL becomes bankrupt and is thus unable to pay such tax liability. NEPCO argues that the prospects of a bankruptcy or insolvency at any time over the twenty years for which NEPCO seeks the security requirement are not remote, given that other energy companies have filed for bankruptcy in recent years. NEPCO contends that it should not be required to accept this risk. AESL filed an answer to the request for rehearing.

III. Discussion

5. The Commission's procedural rules prohibit answers to requests for rehearing.[2] Accordingly, we will reject AESL's answer.

6. In light of the request for rehearing, we have re-evaluated the tax issue presented in this case, and we have arrived at a different conclusion than the one articulated in our June 27, 2003 Order. Upon reconsideration, we agree with NEPCO that it would be inappropriate to reduce the security amount based upon a PLR from the IRS. The PLR does not reduce the risk to NEPCO that the pre-payment may become taxable due to either the IRS changing its policy or a subsequent taxable event occurring.

7. For example, the IRS rulings that determined the nontaxable nature of payments from interconnection customers to transmission providers were based on the existence of certain conditions.[3] These conditions require, among other things, that the interconnection agreement have a term of no less than ten years. If one of these conditions is no longer met, (e.g., if the agreement is terminated before ten years have elapsed) then a subsequent taxable event will have occurred. The subsequent taxable event will make taxable the otherwise non-taxable payment from the AESL to NEPCO. A change in IRS policy may have a similar effect. Since the security is intended to address this kind of risk – i.e., that circumstances will change and make otherwise non-

[2] 18 C.F.R. § 385.713(d)(1) (2003).

[3] See IRS Notices 88-129, 2001-82.

taxable payments taxable – it is appropriate that NEPCO be allowed to require security even if a PLR concludes that the lump sum pre-payment is not currently taxable.

8. NEPCO proposes that a security of approximately $2.7 million to cover the tax gross-up be maintained for 20 years. The Commission notes that since the purpose of the security is to track the tax risk, to the extent that the risk associated with the potential tax becomes less over time, then the security should become proportionately less, as well. On compliance, we direct NEPCO to explain why the security amount should remain constant over time and not be reduced or eliminated due to depreciation or the expiration of the IRS statute of limitations.

The Commission orders:

(A) NEPCO's request for rehearing is granted, as discussed in the body of this order.

(B) NEPCO is directed to make a compliance filing providing the information required herein, within 30 days of the date of issuance of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.