

439. Progress Energy advocates that Article 5.14.3 include certain requirements regarding the Interconnection Customer-provided financial guaranty, such as requiring that the guaranty be issued by a financial entity acceptable to the Transmission Provider and that it be non-revocable for the term of the LGIA.

440. Dynegy proposes that the Commission make the security obligation mutual. The Final Rule should state that, when the Transmission Provider requires the Interconnection Customer to pay a tax gross-up because the Transmission Provider has determined in good faith that the payments or property transfers made to Transmission Provider should be reported as income subject to taxation, the Transmission Provider must post security for the amount of the gross-up, plus interest. This will protect the Interconnection Customer from becoming an unsecured creditor in the event of a Transmission Provider insolvency before the issuance of a private letter ruling that could result in the refund of the tax gross-up payment and interest to the Interconnection Customer.

441. Calpine argues that the security requirement should bear a reasonable relationship to the risk to which a transmission owner is exposed. Instead of allowing the Transmission Provider to require an Interconnection Customer to meet a costly security requirement—using funds that the Interconnections Customer could put to better use developing generation and infrastructure—the Commission should authorize the Transmission Provider to recover in its rates any future tax liability. If the Commission is unwilling to expose ratepayers to this risk, it should modify the Final Rule to ensure that any residual security that the Interconnection Customer would be obligated to post be reasonably related to the actual risk to which the Transmission Provider is exposed.

442. EPSA argues that an Interconnection Customer should not be required to pay the taxes of a Transmission Owner unless the Interconnection Customer is entitled to a refund if it is ultimately determined that the amounts paid for Interconnection Facilities and Network Upgrades are not subject to tax. If the Transmission Owner in an Affected System is not a Party to the Interconnection Customer's LGIA, the Interconnection Customer will have no means to enforce its right to a refund of any amounts it has previously paid in taxes. A Transmission Owner is able to insist on security indefinitely, to protect

against the remote possibility of a change in circumstances that might become a subsequent taxable event, the balance reflected in the Consensus Tax Provisions would be upset.

Commission Conclusion

443. In response to MidAmerican's request that proposed LGIA Article 5.14.3, which is designated Article 5.17.3 in the Final Rule LGIA, specify that the Transmission Owner as well as the Transmission Provider is indemnified, the term "Transmission Provider" in the LGIA includes the Transmission Owner, where applicable. Accordingly, there is no need to revise this provision.

444. SoCal PPA raises tax issues beyond the scope of Article 5.17, since this article addresses only federal tax liability. The Commission rejects the proposal that *ad valorem* property taxes be included in the Interconnection Customer's obligation to reimburse the Transmission Provider for taxes, since these expenses are annual and are more analogous to operating expenses that are not covered under the LGIA.

445. The Commission rejects requests that the Transmission Provider may recover any outstanding federal tax liability balance from customers. A Transmission Provider is to use the security option in Article 5.17.3 to protect itself from the risk that an Interconnection Customer will not pay the potential tax liability, so there should not be any outstanding liability. This, along with the ability to require security or, where appropriate, a gross-up, should sufficiently protect the Transmission Provider from potential tax liability. Should the Transmission Provider be unable for some reason to recover the full cost of its tax liability, it may propose to recover such costs in its rates, but the Commission is not pre-authorizing the recovery of these costs generically.

446. In response to SoCal Edison's request for a requirement that future payment include interest and penalties, as well as any other costs imposed by the IRS, this requirement is in Article 5.17.3.

447. The Commission rejects as unnecessary Progress Energy's request for greater specificity regarding the guaranty because Article 5.17.3 already gives the Transmission Provider the discretion to choose the security in a form "reasonably acceptable" to the Transmission Provider. Accordingly, the Transmission Provider has the discretion to require the Interconnection Customer to offer security that meets the criteria Progress Energy specifies.

448. The Commission agrees with Dynegy that the Interconnection Customer should receive security if a Transmission Provider determines that the payments or property transfers should be reported as income subject to taxation. It is reasonable to require the Transmission Provider to post security, since the gross-up puts the Interconnection Customer at risk in the event that it turns out that taxes do not have to be paid, but the Transmission Provider has become insolvent. Final Rule LGIA Article 5.17 gives the Interconnection Customer the option to request such security when the Transmission Provider has made an independent determination that taxes should be payable.⁷⁸

449. Regarding EPSA's argument that an Interconnection Customer should not be required to pay a gross-up unless it is entitled to a refund if the amounts paid ultimately are not taxed, the Commission notes that the refund protection is already in Article 5.17.7. This protection, together with the ability to require security for a gross-up, should afford an Interconnection Customer sufficient protection against the risk of nonrecovery.

450. EPSA raises issues regarding tax liability and Network Upgrades on Affected Systems. Obligations regarding tax liability and related indemnification should be set forth in a separate agreement between the Interconnection Customer and the Affected System related to the Network Upgrade.⁷⁹

451. Finally, in response to EPSA's argument that proposed LGIA Article 5.14.3 of the LGIA permits a Transmission Provider to insist on security indefinitely, the Final Rule has been revised to state that indemnification will terminate at the earlier of the expiration of the ten year testing period, as contemplated by the IRS safe harbor provisions, or the applicable statute of limitations, or the occurrence of a subsequent taxable event contemplated by this article and the payment of any related indemnification obligation. These are reasonable end points for the indemnification obligation because once the earlier of either of these events occurs, there is no further risk of new tax liability and, therefore, no further need for indemnification.

452. *Article 5.14.4—Tax Gross-Up Amount* (In the Final Rule LGIA: Article 5.17.4)—Proposed LGIA Article 5.14.4

⁷⁸ Security will not be available when a Governmental Authority directs a Transmission Provider to report payments of property as income subject to taxation.

⁷⁹ See Part II.A.2—Section 3.5 (Coordination with Affected Systems).