

described how the Parties would calculate the Tax Gross-Up Amount.

Comments

453. FP&L argues that the tax gross-up methodology in proposed LGIA Article 5.14.4, when combined with the requirement that the Transmission Provider provide refunds in the form of transmission service credits for its full costs of Network Upgrades (including income taxes), will not allow the Transmission Provider to be made whole for the income tax payments for Network Upgrades. It states that Article 5.14.4 requires the Interconnection Customer to pay up front the net present value of the income taxes due on Network Upgrades, based on the assumption that the Transmission Provider will get income taxes back through the future stream of tax depreciation benefits. But if the Transmission Provider is also required to give back to the Interconnection Customer the net present value of income tax payments, plus interest, through refunds, then the Transmission Provider is paying the full cost of income taxes on assets that it is purchasing and it will not be made whole. FP&L further states that the Commission should authorize two alternatives for the tax gross-up methodology: (1) The Interconnection Customer pays the full amount of taxes up front, but then receives refunds for its tax payments; or (2) the Interconnection Customer pays a reduced amount for the taxes up front, which is the present value of the Transmission Provider's carrying costs, calculated at its current weighted average cost of capital, for its tax payment associated with the contribution in aid of construction until it receives the payment back over time through tax depreciation, but then does not receive refunds for the payment of taxes. Under either alternative, it is essential that the Interconnection Customer not receive interest from the Transmission Provider on tax payments actually made to the government because, if it does, the Transmission Provider will not be made whole.

454. Southern asks the Commission to modify this article so that the calculation of the tax gross-up for payments that entitle the Interconnection Customer to credits is not reduced by depreciation deductions available to the Transmission Provider. FirstEnergy says the method of calculating the Present Value Depreciation Amount, should be clarified by adding the phrase "used for Federal and state purposes" after

"* * * Transmission Provider's anticipated tax deductions as * * *."

455. EPSA supports the tax gross-up calculation in Proposed LGIA Article 5.14.4. It argues that the calculation was drafted by tax professionals during the ANOPR process in an effort to ensure that the Transmission Provider is made whole. The drafting group determined that the most appropriate manner for calculating the tax gross-up is the methodology set forth in *Ozark Gas Transmission Corp.*, 56 FERC ¶ 61,349 (1991). EPSA also states that this formula has been approved by the Commission and many existing interconnection agreements use the *Ozark Gas* methodology to compute tax gross-ups for both interconnection facilities and network upgrades, without regard to whether the Interconnection Customer will receive transmission credits. EPSA further argues that the calculation takes into account a Transmission Provider's federal and state tax rate and the present value of all tax depreciation deductions to which the Transmission Provider is entitled over the life of the Interconnection Facilities and Network Upgrades. Finally, EPSA argues that the tax benefits associated with depreciation are not returned to the Interconnection Customer as transmission credits, as some commenters contend. Although the Transmission Provider will return the gross tax costs to the Interconnection Customer in the form of Transmission Credits, the Transmission Provider still benefits from being able to deduct the cost of the Interconnection Facilities and Network Upgrades.

Commission Conclusion

456. The Commission agrees with EPSA that Proposed LGIA Article 5.14.4 offers the appropriate methodology for ensuring that a Transmission Provider is fully compensated for tax consequences. FP&L and Southern have not sufficiently explained how the calculation fails to make the Parties whole, and we do not revise this article.

457. This article is designated Article 5.17.4 in the Final Rule LGIA.

458. *Article 5.14.5—Private Letter Ruling or Change or Clarification of Law* (In the Final Rule LGIA: Article 5.17.5)—Proposed LGIA Article 5.14.5 would have required that, at the Interconnection Customer's request and expense, a Transmission Provider file with the IRS a request for a private letter ruling as to whether any property transferred or sums paid or to be paid by the Interconnection Customer to the Transmission Provider under the LGIA would be subject to federal income taxation. The point of obtaining such a

ruling is to get a definitive answer up front as to whether taxes will be due. If a private letter ruling concludes that such sums are not taxable, the Interconnection Customer's obligations would be reduced accordingly.

Comments

459. Commenters criticize the proposed relationships between the Interconnection Customer and the Transmission Provider in seeking a private letter ruling. El Paso argues that the Transmission Provider should have sole discretion to decide how to minimize its taxes, including whether to seek a private letter ruling or to contest a tax determination. While the Interconnection Customer must indemnify the Transmission Provider for tax liability, El Paso argues that this does not justify allowing the Interconnection Customer to require the Transmission Provider to dedicate its taxpayer status, time, and resources to seeking a private letter ruling or contesting a tax determination. This inappropriately places the Interconnection Customer in the position of deciding how the Transmission Provider will meet its obligations to the Interconnection Customer. In addition, even if the Interconnection Customer pays filing and legal fees associated with a private letter ruling or contest, this does not compensate the Transmission Provider for its internal costs of prosecuting such proceedings.

460. Dynegy generally supports this provision but contends that it should be revised because it (1) fails to recognize that the Interconnection Customer is the Party at risk of paying a tax gross-up that turns out not to have actually been required by the tax laws, and (2) unduly restricts the Interconnection Customer's ability to make the arguments it wants made in pursuing a private letter ruling. For instance, Dynegy says, Article 5.14.5 allows the Interconnection Customer to prepare only the "initial draft" of the private letter ruling request, and Article 5.16.6 provides for only one level of judicial review for appeals of adverse rulings. Such restrictions should be removed because it is the Interconnection Customer, not the Transmission Provider, that is paying the gross-up and funding the efforts to obtain a private letter ruling.

461. Salt River Project notes that this provision would require a Transmission Provider to file a private letter ruling, at an Interconnection Customer's request and expense, but establishes that the Interconnection Customer would prepare the initial draft of the letter. This will give rise to disclosure and