Expansion of Safe Harbor Provisions Under Notice 88–129

Notice 2001–82

PURPOSE

This notice amplifies and modifies Notice 88–129 (1988–2 C.B. 541) as modified and amplified by Notice 90–60 (1990–2 C.B. 345). Notice 88–129 provides that a regulated public utility (utility) will not realize income upon transfers of interties from 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). This notice extends the safe harbor provisions of Notice 88–129 to include transfers of interties from non-Qualifying Facilities. The safe harbor also is extended to transactions in which there is not a long-term power purchase contract between the utility and the power producer but rather the intertie is transferred pursuant to a long-term interconnection agreement and in which the intertie is used exclusively to transmit power across the utility's transmission grid for sale to consumers or intermediaries.

BACKGROUND

At the time Notice 88–129 was issued, most generators that were not owned by regulated public utilities (stand-alone generators) were Qualifying Facilities for regulatory purposes. As a stand-alone generator, the Qualifying Facility had to be connected to a utility's transmission lines in order to move its power to market. PURPA required that a utility interconnect with a Qualifying Facility for the purpose of allowing the sale of power produced by the Qualifying Facility. A Qualifying Facility generally sold its electricity under a long-term power purchase contract to the local utility with whom it was interconnecting at the utility's avoided cost. A Qualifying Facility also arranged in certain cases for the interconnected utility to transmit electricity across its transmission grid for sale to another utility (wheeling) at that utility's avoided cost.

Deregulation of the electric power industry has significantly changed the operation of the industry. Today, few new stand-alone generators are Qualifying Facilities. The Federal Energy Regulatory Commission (FERC) encouraged the construction of non-Qualifying Facilities starting in the late 1980's by issuing a number of orders to individual projects (known in the industry as independent power producers) approving sales of power at market rates. In addition, the Energy Policy Act of 1992 created a new class of stand-alone generators, called exempt wholesale generators, that are permitted to sell their power at market rates with FERC approval, and are exempted from certain utility regulation. Unlike PURPA, the Energy Policy Act has no requirement that utilities buy electricity from stand-alone generators.

In 1996, FERC issued Order No. 888 in an effort to ensure that every wholesale supplier of electricity, including, for example, power marketers and stand-alone generators, has open access to the national transmission grid. The order requires regulated utilities to allow stand-alone generators to interconnect to the grid and to file nondiscriminatory tariffs under which any wholesale supplier can pay to have its electricity wheeled. Stand-alone generators (including Qualifying Facilities) have additional outlets for their power today that they did not have in 1988, including sales of power at auction on regional power exchanges or spot markets and under short and medium-term contracts to specific customers or to power marketers that trade electricity. Regulated utilities have many more sources of supply for electricity than in 1988. As a result of these changes, very few utilities enter into long-term power purchase contracts with stand-alone generators. Electricity produced by stand-alone generators is more likely today than in 1988 to be wheeled across the transmission grid of the interconnected utility for sale to consumers or intermediaries rather than to be sold directly to the interconnected utility.

The new stand-alone generators still need to be interconnected to the transmission grid in order for a customer to take the power. Therefore, the stand-alone generator enters into a long-term interconnection agreement with the local utility. The term of a long-term interconnection agreement may be tied to the period that the stand-alone generator remains in commercial operation. This agreement may permit assignment of the agreement by the utility to accommodate future consolidation of local grids into regional transmission systems that will cover broad regions of the country.

MODIFICATIONS TO NOTICE 88–129 AND NOTICE 90–60

In light of the above-mentioned changes in the electric power industry, the safe harbor provisions of Notice 88–129 are modified as follows:

1. The safe harbor provisions are extended to include transfers of interties from non-Qualifying Facilities. Accordingly, the term "QF transfer" appearing in Notice 88–129 will be construed as including "qualified transfers" of interties from non-Qualifying Facilities that meet the other requirements of the safe harbor provisions. Similarly, the term "Qualifying Facility" for purposes of Notice 88–129 will be construed as including "stand-alone generators" that are not Qualifying Facilities.

2. The safe harbor provisions also are extended to include transfers of interties used exclusively or in part to transmit power over the utility's transmission grid for sale to consumers or intermediaries, including affiliated intermediaries (wheeling). This safe harbor only applies to transactions in which the intertie is transferred pursuant to a long-term interconnection agreement and in which ownership of the electricity wheeled passes to the purchaser prior to its transmission on the utility's transmission grid. The ownership requirement of the preceding sentence is deemed satisfied if title to electricity wheeled passes to the purchaser at the busbar on the generator's end of the intertie. The terms "power purchase contract" and "power supply contract" appearing in Notice 88–129 will be construed as including interconnection agreements in transactions in which the intertie is used for wheeling. Accordingly, a long-term interconnection agreement in lieu of a long-term power purchase contract or power supply contract may be used to satisfy the safe harbor provisions of Notice 88–129 in such transactions. The term "dual-use intertie" appearing in Notice 88–129 will be construed as including an intertie which may be used to transmit power from a third party for sale to the Qualifying Facility.

3. Section 6, sentence 4, of Notice 88–129, states, "The cost of property transferred in a QF transfer must be capitalized by the Qualifying Facility as an intangible asset and recovered as appropriate." This sentence is modified to read as follows: "The cost of property transferred in a QF transfer must be capitalized by the Qualified Facility as an intangible asset and recovered using the straight-line method over a useful life of 20 years."

EFFECT ON OTHER DOCUMENTS

Notice 88–129, as amplified and modified by Notice 90–60, is further amplified and modified.

EFFECTIVE DATE

This notice applies to transfers of property to regulated public utilities, pursuant to interconnection agreements, completed after December 26, 2001, the date this notice is published in the Bulletin. For transfers of interties occurring on or before December 26, 2001, and meeting the requirements of this notice, taxpayers may request application of this notice through a request for a private letter ruling (including in appropriate circumstances where the taxpayer's return for the year of transfer has already been filed).

DRAFTING INFORMATION

The principal author of this notice is Gregory N. Doran of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Mr. Doran at (202) 622–3040 (not a toll-free call).