Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
February 26, 2003

Legend:

Parent =

Intermediate =

Utility =

GenCo =

GenCo L.P. =
Plant =

Commission A =
Commission B =
State =
State Statute =
Section A =
Section B =
Final Order =
Clarifying Order =
New Name =
a =
b =
c =
d =
e =
f =
g =
h =
i =
j =
k =

Dear

This letter responds to your request for private letter ruling dated October 25, 2002. You requested that we rule on behalf of Utility, GenCo, and their respective qualified nuclear decommissioning funds, concerning certain tax consequences of the transfer of the Plant from Utility to GenCo, under section 468A of the Internal Revenue Code, in the context of a reorganization of Parent's business operations.

Facts:

Parent has represented the following facts and information relating to the ruling request:

Parent, through a regulated electric utility subsidiary (Utility), generates, purchases, transmits, distributes, and sells (in both retail and wholesale capacities) electricity in State. Utility is under the regulatory jurisdiction of Commission A and Commission B.

Parent owns one hundred percent of the common stock of Intermediate, which owns one hundred percent of the common stock of Utility. Utility owns a percent of the Plant, which consists of b units. Utility has established and maintained both qualified and nonqualified nuclear decommissioning funds for each unit of Plant. Parent, Intermediate, and Utility join in filing a consolidated tax return.

On c, State enacted changes to State Statute in order to allow full retail competition beginning on d. Pursuant to Section A of State Statute, Utility is required to separate its electric business into three segments corresponding to its generation, transmission and distribution, and retail activities on or before d. The terms of Section A of State Statute provide that, in order to achieve this separation, Parent may transfer its generation facilities to an affiliate.

Section B of State Statute provides that, beginning on d, any remaining costs associated with nuclear decommissioning obligations continue to be subject to cost of service rate regulation and shall be included as a nonbypassable charge to retail customers. Commission A responded to this requirement in Final Order by authorizing Utility to collect nuclear decommissioning costs by means of a non-bypassable transmission and distribution charge beginning on d.

In response to the foregoing requirements, Parent has proposed a plan of reorganization under which GenCo will be formed as a subsidiary of Utility. GenCo will be the sole owner of a limited liability company that will be the sole 1% general partner of a newly-formed limited partnership ("GenCo L.P."), and GenCo will directly own the remaining 99% limited partner interest in GenCo L.P. Parent represents that GenCo

L.P. and the general partner limited liability company will be treated as disregarded entities pursuant to section 301.7701-3 of the regulations. Under the plan of reorganization, Utility's nuclear generation assets and liabilities, including Plant and the associated qualified nuclear decommissioning funds, will be transferred to GenCo. GenCo will in turn transfer the assets and liabilities associated with Plant to GenCo L.P., but will be continue to be treated as the owner of Plant for federal tax purposes. GenCo (through its division, GenCo L.P.) will be liable for all expenses related to decommissioning GenCo's a percent interest in Plant.

Subsequent to the transfer of Plant to GenCo, Utility will distribute the stock of GenCo to Intermediate, which will in turn distribute the GenCo stock to Parent. Parent will transfer the stock to a wholly owned subsidiary, which in turn will transfer the stock to a wholly owned subsidiary, which in turn will transfer the stock to a wholly owned subsidiary (i.e. a third-tier wholly owned subsidiary of Parent).

Parent filed with Commission A a proposed plan of reorganization and separation on e, with amendments to the plan filed on f, outlining a restructuring of Taxpayer's operations. Commission A issued an interim order on g, followed by Final Order on h, approving Parent's proposal, as amended. Utility and GenCo have requested, but have not yet received, approvals from various regulatory entities including Commission B relating to several facets of the amended plan.

An updated version of the reorganization and separation plan was filed with Commission on i. This updated plan outlines proposed modifications to the original plan, as amended, as well as delays experienced in obtaining agency approvals and recent regulatory developments involving Commission A and Utility. The updated plan states that Parent will not be able to meet the deadline specified under Section A of State Statute for unbundling its operations, and proposes a "functional unbundling" plan that will be implemented by d. Functional unbundling involves the implementation of a code of conduct whereby Parent's generation business does not interact or communicate with Parent's transmission and distribution business, and instead operate independently. The objective of functional unbundling is to ensure that Parent's generation business does not receive preferential treatment (particularly in the area of ratemaking) from its transmission business. On j, Commission A issued a final order approving the updated plan and stating that Parent met the objectives of Section A of State Statute through its functional unbundling plan until regulatory approvals can be obtained and "legal" unbundling can be completed.

Following the implementation of the plan of restructuring and separation, GenCo will be a power generation company as defined in State Statute, and will be required to be registered with Commission A. GenCo will also be required to observe the policies, rules, guidelines, and procedures established by the independent system operator in its power region. GenCo will be subject to such sales of capacity as are prescribed by Commission A. GenCo and the qualified and nonqualified nuclear decommissioning

funds will continue to be subject to the rules of Commission A requiring the maintenance of external, irrevocable nuclear decommissioning funds and setting forth the requirements regarding trust investments.

Subsequently, Commission A, at Utility's request, issued Clarifying Order making certain clarifications regarding the funding of decommissioning costs for the Plant. Clarifying Order states that decommissioning costs will be collected from customers by Utility on behalf of the owner of Plant (i.e., for federal tax purposes, GenCo), that all decommissioning collections are required to be transferred to the owner of the Plant, and that the owner of the Plant is required to contribute such collections to its qualified and nonqualified nuclear decommissioning funds.

On k, the entity that was formed under the plan of restructuring and separation to conduct retail sales of electricity within State was sold, along with the rights to the name Utility, and Utility began operating instead as New Name. References herein to Utility pertaining to periods on or after l should be understood to refer to Utility operating as New Name.

Finally, Parent represents that Utility and GenCo will enter into a Decommissioning Funds Collection Agreement (hereinafter, "Agreement"), pursuant to which Utility will:

1) continue collecting decommissioning costs from customers in the same manner that it collected for decommissioning of the Plant prior to the proposed restructuring;

2) remit all such collections to GenCo by wire transfer each month;

3) comply with all applicable laws so as not to adversely affect the collectibility of the decommissioning costs or its ability to perform under the Agreement;

4) maintain procedures that allow it to identify all decommissioning costs collected from customers, and mark its records with a legend to show that the decommissioning costs have been collected;

5) not sell, assign, or otherwise dispose of the decommissioning collections in its possession or GenCo's interest in the decommissioning collections;

6) not have any right of setoff regarding the decommissioning costs;

7) not make any change in the character of its business or in the collection policy that would materially adversely affect the collectibility of decommissioning costs from customers;

8) execute and deliver all further instruments and documents, and take all further actions necessary to perfect, protect or more fully evidence GenCo's interest in the decommissioning collections; and

9) cooperate with GenCo in any future proceedings that GenCo may initiate regarding any increases or decreases in the amount of funds that may be collected to decommission the Plant.

In addition, the Agreement will provide that Utility will act as fiscal agent only, and GenCo will pay Utility's expenses incurred in performing under the Agreement; that GenCo will be solely responsible for the proper use and contribution of the decommissioning costs to the qualified nuclear decommissioning funds; that GenCo will accept and comply with any and all provisions for decommissioning in Commission A orders as if it were an original party to such orders; and that GenCo will fully cooperate in any and all future proceedings relating to decommissioning of the Plant no matter whether such proceedings are initiated by Utility, Commission A, or any other party.

The taxpayer has requested the following rulings:

Requested Ruling #1: Utility, GenCo, and their respective qualified nuclear decommissioning funds will not recognize any gain or loss or otherwise take any income or deduction into account by reason of the transfer of the assets of Utility's qualified nuclear decommissioning funds to GenCo's qualified nuclear decommissioning funds pursuant to the steps of the proposed restructuring plan, and GenCo's qualified nuclear decommissioning funds will have a basis in the assets received from Utility's qualified nuclear decommissioning funds equal to the basis of such assets in Utility's qualified nuclear decommissioning funds immediately prior to the transfers.

Requested Ruling #2: The decommissioning costs will be treated as having been included in GenCo's cost of service for purposes of section 468A(b)(1).

Law and Analysis:

Under section 1.468A-2(b)(2)(i) of the Income Tax Regulations, decommissioning costs are included in a taxpayer's cost of service for a taxable year to the extent such costs are directly or indirectly charged to customers of the taxpayer by reason of electric energy consumed during the taxable year or otherwise required to be included in the taxpayer's income under section 88 and the corresponding regulations.

Section 1.88-1(a) provides that decommissioning costs directly or indirectly charged to customers of the taxpayer include all decommissioning costs that consumers are liable to pay by reason of electric energy furnished by the taxpayer

during the taxable year, whether payable to the taxpayer, a trust, State government, or other entity.

Section 1.468A-5(a) sets out the qualification requirements for nuclear decommissioning funds. It provides, in part, that a qualified nuclear decommissioning fund must be established and maintained pursuant to an arrangement that qualifies as a trust under state law. An electing taxpayer can establish and maintain only one qualified nuclear decommissioning fund for each nuclear power plant. Section 1.468A-5(c)(1)(i) provides that if, at any time during the taxable year, a nuclear decommissioning fund does not satisfy the requirements of section 1.468A-5(a), the Service may disqualify all or a portion of the fund as of the date that the fund does not satisfy the requirements. Section 1.468A-5(c)(3) provides that if a qualified nuclear decommissioning fund is disqualified, the fair market value (with certain adjustments) of the assets in the fund is deemed to be distributed to the electing taxpayer and included in that taxpayer's gross income for the taxable year.

Section 1.468A-6 generally provides rules for the transfer of an interest in a nuclear power plant (and transfer of the qualified nuclear decommissioning fund) where after the transfer the transferee is an eligible taxpayer. Under section 1.468A-6(g), the Service may treat any disposition of an interest in a nuclear power plant occurring after December 27, 1994, as satisfying the requirements of the regulations if the Service determines that such treatment is necessary or appropriate to carry out the purposes of section 468A.

Based on the information submitted by Parent, including Parent's representation that GenCo L.P. and the proposed general partner LLC are disregarded entities under section 301.7701-3 and properly treated as a division of GenCo for federal tax purposes, the Service will treat these transfers as dispositions qualifying under the general provisions of section 1.468A-6. Commission A's approval in Final Order of the separation and reorganization plan, Commission A's issuance of Clarifying Order, the expected ratification by Utility and GenCo of the Decommissioning Funds Collection Agreement, and the legal requirement that the provisions of these orders and agreements be followed enables the Service to treat these transferred amounts as decommissioning costs included in cost of service that are directly or indirectly charged to customers of GenCo by reason of electric energy furnished by GenCo, within the meaning of sections 88 and 468A and the corresponding regulations. Thus, under section 1.468A-6 Taxpayer's qualified nuclear decommissioning funds will not be disqualified upon the transfer of the Plants and the qualified nuclear decommissioning funds to GenCo.

Section 1.468A-6(c)(1) provides that neither a transferor of an interest in a nuclear power plant nor the transferor's fund will recognize gain or loss or otherwise take any income or deduction into account by reason of a sale or other disposition. Section 1.468A-6(c)(2) provides that neither a transferee of an interest in a nuclear

power plant nor the transferee's fund will recognize gain or loss or otherwise take any income or deduction into account by reason of a sale or other disposition. Accordingly, neither Utility, GenCo, nor their respective qualified funds will recognize gain or loss or otherwise take into account any income or deduction upon the transfer of the qualified nuclear decommissioning funds to GenCo.

Section 1.468A-6(c)(3) provides that transfers to which section 1.468A-6 apply do not affect basis. Thus, the qualified funds in the hands of GenCo (through its division, GenCo L.P.) will have a basis in their assets equal to the basis in their assets prior to the transfer from Utility.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the transaction described above. In particular, no opinion is expressed or implied concerning whether GenCo is an "eligible taxpayer" as defined in section 1.468A-1(b)(1). In addition, no opinion is expressed or implied concerning whether GenCo L.P. or the proposed general partner limited liability company are properly disregarded for tax purposes and treated as divisions of any other entity. Finally, no opinion is expressed or implied concerning whether the non-bypassable transmission and distribution charge is includible in the gross income of, and deductible by, any entity other than Utility.

The rulings expressed, herein, are expressly conditioned on the ratification by Utility and GenCo of the Decommissioning Funds Collection Agreement, with terms substantially identical to those in the draft submitted to the Service along with this request for private letter ruling, i.e., Utility's collection of costs from ratepayers, the transfer of amounts collected to GenCo, and the contribution by GenCo (through its division, GenCo L.P.) of the authorized amounts to its funds. In addition, these rulings are expressly conditioned on the continued direct or indirect ownership and control of Utility, GenCo, and GenCo L.P. by Parent. Specifically, as continuing conditions to our response to Requested Ruling #2, 1) Utility and GenCo must be part of the same affiliated group (or be treated as a division of a member of the same affiliated group) as Parent (and Parent must satisfy the ownership requirement of section 1504(a)(2)(A) with respect to Utility and GenCo); 2) GenCo must continue to be able, under the Internal Revenue Code and regulations, to treat GenCo L.P. as a division for tax purposes; and 3) Parent, Utility, and GenCo must file a consolidated tax return (or must be treated for tax purposes as divisions of entities that file a consolidated return with Parent) for each year for which a deductible payment is made under 468A. If any of these conditions are no longer applicable no further contributions may be made to the qualified nuclear decommissioning funds with respect to the units of the Plant that are the subject of Requested Ruling #1.

This letter ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that this ruling may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, the a copy of this letter is being sent to Parent's authorized representatives. We are also sending a copy of this letter ruling to the Industry Director, Natural Resources and Construction (LM:NRC).

Sincerely,

Peter C. Friedman
PETER C. FRIEDMAN
Senior Technician Reviewer, Branch 6
Office of Associate Chief Counsel
Passthroughs and Special Industries

cc: