

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.

(Also Part I, §§ 61, 451, 1001)

Rev. Proc. 2002-49

SECTION 1. PURPOSE

This revenue procedure sets forth a manner in which an electric utility company may treat a transaction in which the utility is issued a financing order by a State agency authorizing the recovery of certain costs incurred by the utility.

SECTION 2. BACKGROUND

In general, State public utility commissions set rates for public utility companies that are calculated to allow for the recovery of prudently incurred costs. In the case of capital expenditures, rates are set to allow recovery of costs over an extended period of time. With the advent of restructuring and a competitive marketplace, these rates are no longer guaranteed. Thus, the recovery of previously incurred costs associated with generation facilities that have market values below their book value, as well as costs associated with contracts to purchase electricity at above-market prices, have become uncertain. Some States have enacted legislation to allow the recovery of these costs through a non-bypassable surcharge to customers upon their consumption of electricity within the utility's historic service area. These statutes, which also

authorize securitization of the surcharge, are unique to the regulated utility industry. Accordingly, the law and analysis applied to these transactions is peculiar to this situation.

SECTION 3. SCOPE

This revenue procedure applies to investor-owned public utility companies that, pursuant to transition legislation, receive an irrevocable financing order from an appropriate State agency determining the amount of transition costs the utility will be permitted to recover through qualifying securitization of an intangible property right created under the transition legislation.

SECTION 4. DEFINITIONS

.01 PUBLIC UTILITY COMPANY

For purposes of this revenue procedure, the terms "public utility" or "utility" refer to a utility company that is subject to the regulatory authority of the State public utility commission or other appropriate State agency.

.02 TRANSITION LEGISLATION

For purposes of this revenue procedure, transition legislation is legislation that:

(1) is enacted by a State to facilitate the conversion from a wholly regulated public utility regime to a competitive environment caused by restructuring of the public utility industry within the State;

(2) authorizes the utility to apply for, and authorizes the public utility commission or other appropriate State agency to issue, a financing order determining the amount of transition costs the utility will be allowed to recover;

(3) provides that pursuant to the financing order, the utility acquires an intangible property right to charge, collect, and receive charges in a fixed amount necessary to provide for the full recovery of the transition costs determined to be recoverable, and assures that the charges are non-bypassable and will be paid by customers within the utility's traditional service territory who receive electricity through the utility's transmission and distribution system, even if those customers elect to purchase electricity from a third-party generator;

(4) guarantees that neither the State nor any agency thereof has the authority to rescind or amend the financing order, to revise the amount of transition costs, or in any way to reduce or impair the value of the intangible property right, except as may be contemplated by periodic adjustments authorized by the transition legislation;

(5) provides procedures assuring that the sale, assignment or other transfer of the intangible property right from the utility to a financing entity will be perfected under State law as an absolute transfer of the utility's right, title and interest in the property; and

(6) authorizes the securitization of the intangible property right to recover

the fixed amount of transition costs through the issuance of bonds, notes, certificates of participation or beneficial interest or other evidences of indebtedness issued pursuant to an indenture, contract or other agreement of an electric utility or a financing entity.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective July 22, 2002.

SECTION 7. DRAFTING INFORMATION

.03 TRANSITION COSTS

For purposes of this revenue procedure, transition costs are the utility's non-economic costs caused by restructuring and the introduction of a competitive marketplace for electric services, and such other related costs that the State legislature may deem appropriate.

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.04 QUALIFYING SECURITIZATION

For purposes of this revenue procedure, qualifying securitization is an issuance of any bonds, notes, certificates of participation or beneficial interests or other evidences of indebtedness—

(1) secured by the intangible property right to collect charges for the recovery of transition costs and such other assets, if any, of the financing entity;

(2) initially capitalized by the utility with at least 0.5 percent of the total principal amount of each series of evidences of indebtedness issued; and

(3) providing for self-amortizing level payments of interest and principal on a quarterly or semiannual basis.

SECTION 5. APPLICATION

.01 The utility will be treated as not recognizing gross income upon:

(1) the receipt of a financing order that creates an intangible property right in the amount of transition costs that may be recovered through securitization;

(2) the receipt of cash or other valuable consideration in exchange for the transfer of that property right to a financing entity; or

(3) the receipt of cash or other valuable consideration in exchange for securitized evidences of indebtedness issued by the financing entity.

.02 The securitized evidences of indebtedness described in Section 4.04 will be treated as obligations of the utility.

.03 The non-bypassable charges are gross income to the utility recognized under the utility's usual method of accounting.