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Person To Contact:

Telephone Number:

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Date:  
December 07, 2010

**LEGEND:**

Authority =

State =

Cooperative =

Agreement =

New Members =

Supplemental Agreement =

Company =

Bonds =

Project =

Date 1 =  
Date 2 =  
Date 3 =  
Date 4 =  
Date 5 =  
Date 6 =  
Date 7 =  
Year 1 =  
Year 2 =  
a =

Dear :

This responds to Authority's request for a ruling that the forbearance to exercise certain termination rights with respect to a wholesale electricity requirements contract, will not cause that contract to be treated as entered into after September 19, 2002, for purposes of § 1.141-15(f)(2) of the Income Tax Regulations.

### **Facts and Representations**

You make the following factual representations. Authority is a body corporate and politic of State. Authority owns and operates a fully integrated electric utility system consisting of facilities for the generation, transmission, and distribution of electric power at wholesale and retail.

Cooperative is a rural electric cooperative that provides wholesale electric service to its member rural electric cooperatives (the "Members") in State. Authority and Cooperative are parties to the Agreement, under which Authority supplies substantially all of the electricity requirements of Cooperative and its Members.

Several of Cooperative's current Members were added as new members (the New Members) of Cooperative as of Date 1, which is some years subsequent to the date that the Agreement was originally executed by Authority and Cooperative. Beginning on Date 2 and under the Agreement, Authority began supplying electric power to

Cooperative for resale to the New Members. On Date 3, Cooperative requested that Authority and Cooperative begin formal negotiations to consider changes to the terms of the Agreement. In connection with these negotiations, Cooperative informed Authority that it has the opportunity to obtain the power requirements for the New Members from Company, an investor-owned public utility.

On Date 4, Authority and Cooperative entered into a supplement to the Agreement (the "Supplemental Agreement") which would permit Cooperative to purchase from Company the electric power requirements necessary to serve the New Members (the "New Members Load"). Subject to regulatory approval, the New Members Load will transition to Company over a seven-year period beginning in Year 1, which by Year 2 would result in a reduction in the requirements served under the Agreement of approximately a megawatts.

The Agreement has a 35-year initial term (to Date 5) and an automatic renewal for successive 35-year periods, subject to the right of either party to terminate the Agreement on any date on or after Date 5 upon giving at least 10 years' notice. Under the Supplemental Agreement, and in light of the Authority's release of the New Members Load from the Agreement, the parties (Authority and Cooperative) agreed to defer the effective date of any elective termination of the Agreement for approximately 6.5 years (until Date 6) and agreed to negotiate in good faith for a deferral beyond Date 6. The Supplemental Agreement did not change the length of the original term, any renewal periods, or the notice period for any elective termination.

Authority adopted on Date 7, a resolution to issue the Bonds to finance a portion of the costs of the acquisition and construction of Authority's ownership interest in a new electric power generating facility (the Project).

### **Law and Analysis**

Section 103(a) of the Internal Revenue Code (the "Code") provides that, except as provided in § 103(b), gross income does not include interest on any state or local bond. Section 103(b) provides, in part, that § 103(a) shall not apply to any private activity bond which is not a qualified bond (within the meaning of § 141).

Section 141(a) provides that the term "private activity bond" means any bond issued as part of an issue which meets (1) the private business use test of § 141(b)(1) and the private security or payment test of § 141(b)(2), or (2) the private loan financing test of § 141(c).

Section 141(b)(1) provides that, except as otherwise provided, an issue meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Section 141(b)(6)(A) defines "private business use" as use (directly or indirectly) in a trade or business carried on by a person other than a

governmental unit. Section 1.141-3 provides that the 10 percent private business use test is met if more than 10 percent of the proceeds of an issue is used in a trade or business.

Section 141(b)(2) provides that, except as otherwise provided, an issue meets the private security or payment test if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of such issue is (under the terms of such issue or any underlying arrangement) directly or indirectly (A) secured by an interest in (i) property used or to be used for a private business use, or (ii) payments in respect of such property, or (B) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

Section 141(b)(4) provides that an issue 5 percent or more of the proceeds of which are used with respect to any output facility (other than a facility for the furnishing of water), shall be treated as an issue of private activity bonds if the nonqualified amount (as defined in § 141(b)(8)) of such issue exceeds the excess of \$15 million over the aggregate nonqualified amounts with respect to all prior tax-exempt issues 5 percent or more of the proceeds of which are or will be used with respect to such facility (or any other facility which is part of the same project).

Section 1.141-7 sets forth rules to determine whether arrangements for purchases of output from an output facility cause an issue of bonds to meet the private business use tests. An output facility is defined by § 1.141-1(b) as electric and gas generation, transmission, distribution, and related facilities, and water collection, storage, and distribution facilities. Section 1.141-7(c)(1) provides that the purchase pursuant to a contract by a nongovernmental person of available output of an output facility financed with the proceeds of an issue is taken into account under the private business tests if the purchase has the effect of transferring to the nongovernmental person the benefits of owning the facility and the burdens of paying the debt service on the bonds used (directly or indirectly) to finance the facility (the “benefits and burdens test”).

Section 1.141-7(c)(3)(i) provides that a requirements contract may satisfy the benefits and burdens test under paragraph (c)(3)(ii) or (iii) of this section. See § 1.141-15(f)(2) for special effective dates for the application of this paragraph (c)(3) to issues financing facilities subject to requirements contracts.

Section 1.141-7(c)(3)(iii)(A) provides that a requirements contract that is a sale at wholesale (a wholesale requirements contract) may satisfy the benefits and burdens test, depending on all the facts and circumstances. Section 1.141-7(c)(3)(iii)(B) provides that significant factors that tend to establish that a wholesale requirements contract meets the benefits and burdens test, include, but are not limited to – (1) the term of the contract is substantial relative to the term of the issue or issues that finance the facility; and (2) the amount of output to be purchased under the contract represents a substantial portion of the available output of the facility.

Section 1.141-15(f)(1) provides that, except as otherwise provided in this section, §§ 1.141-7 and 1.141-8 apply to bonds sold on or after November 22, 2002, that are subject to section 1301 of the Tax Reform Act of 1986.

Section 1.141-15(f)(2) provides that for bonds otherwise subject to §§ 1.141-7 and 1.141-8, § 1.141-7(c)(3) applies to output contracts entered into on or after September 19, 2002. An output contract is treated as entered into on or after that date if it is amended on or after that date, but only if the amendment results in a change in the parties to the contract or increases the amount of requirements covered by the contract by reason of an extension of the contract term or a change in the method for determining such requirements. For purposes of this paragraph (f)(2) –

- (i) The extension of the term of a contract causes the contract to be treated as entered into on the first day of the additional term;
- (ii) The exercise by a party of a legally enforceable right that was provided under a contract before September 19, 2002, on terms that were fixed and determinable before such date, is not treated as an amendment of the contract. For example, the exercise by a purchaser after September 19, 2002 of a renewal option that was provided under a contract before that date, on terms identical to the original contract, is not treated as an amendment of the contract;
- and (iii) An amendment that increases the amount of requirements covered by the contract by reason of a change in the method for determining such requirements is treated as a separate contract that is entered into as of the effective date of the amendment, but only with respect to the increased output to be provided under the contract.

The Agreement, under which Authority is contractually obligated to provide wholesale electric service to Cooperative and its Members, was entered into by the parties prior to September 19, 2002. The Agreement has a 35-year initial term (to Date 5) and an automatic renewal for successive 35-year periods, subject to the right of either party to terminate the Agreement on any date on or after Date 5 upon giving at least 10 years' notice. However, Authority and Cooperative entered into the Supplemental Agreement on Date 4, which was after September 19, 2002.

Under the Supplemental Agreement, in light of the Authority's release of the New Members Load from the Agreement, Cooperative agreed to defer the effective date of any elective termination of the Agreement until Date 6, or approximately 6.5 years. Section 1.141-15(f)(2) provides that an output contract is treated as entered into on or after September 19, 2002, if it is amended on or after that date, but only if the amendment results in a change in the parties to the contract or increases the amount of requirements covered by the contract by reason of an extension of the contract term or a change in the method for determining such requirements. The issue is whether the parties' deferral of any elective termination of the Agreement for 6.5 years is an amendment that increases the amount of requirements covered by the contract by reason of an extension of the contract term within the meaning of § 1.141-15(f)(2).

We conclude that it is not. Section 1.141-15(f)(2)(ii) provides that the exercise of a renewal option provided in a contract before September 19, 2002, on terms identical to the original contract is not an extension to the contract causing the contract to be treated as entered into after September 19, 2002. Under its terms as stated above, the Agreement will remain in effect for an initial term of 35 years. Thereafter, the Agreement will automatically renew for consecutive subsequent terms of 35 years, subject to the right of either party to terminate the Agreement upon giving at least 10 years' notice. Thus, the renewal of the Agreement on Date 5 and every 35 years thereafter is not treated as an amendment. Similarly, the right of either party to terminate the Agreement with 10 years' notice is a legally enforceable right provided in the Agreement. The Supplemental Agreement retains the right but defers the effective date of any termination resulting from the exercise of such right from Date 5 until Date 6. The right to terminate or not was provided in the Agreement, a contract before September 19, 2002, and thus, the deferral is not an amendment.

### **Conclusion**

Based on the information submitted and representations made, we conclude that the agreement between Authority and Cooperative to defer the effective date of any termination of the Agreement, is not an amendment to the contract for purposes of § 1.141-15(f)(2) and will not cause the Agreement to be treated as an output contract entered after September 19, 2002.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any transaction or item discussed or referenced in this letter.

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

In accordance with a Power of Attorney on file with this office, a copy of this letter is being sent to the authorized representatives of Authority.

The ruling contained in this letter is based upon information and representations submitted by Authority and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the materials submitted in support of the request for a ruling, it is subject to verification upon examination.

Sincerely,

Associate Chief Counsel  
(Financial Institutions and Products)

By: \_\_\_\_\_  
Johanna Som de Cerff  
Senior Technician Reviewer  
Branch 5

cc: