

FOR CONSIDERATION

December 19, 2017

TO: The Finance and Audit Committee of the Board of Trustees

FROM: Thomas Falcone

REQUEST: Recommendation to the Board of Trustees to Support the Transfer of Assets from the Qualified Nuclear Decommissioning Trust Fund to the Non-Qualified Nuclear Decommissioning Trust Fund for the Nine Mile Point 2 Nuclear Power Station.

Requested Actions

Recommend to the Board of Trustees the approval of a Resolution of support to the Internal Revenue Service.

The Finance and Audit Committee is requested to recommend to the Board of Trustees the approval of a Resolution of support to the Internal Revenue Service to disqualify the qualified Nuclear Decommissioning Trust Fund (the “Qualified Fund”) for Nine Mile Point 2 Nuclear Power Station and transfer the assets to the non-qualified Nuclear Decommissioning Trust Fund (the “Non-Qualified Fund”) (together, the “Funds”).

Background.

The Long Island Lighting Company (“LILCO”), a wholly-owned subsidiary of LIPA, owns an 18 percent interest in the Nine Mile Point Nuclear Power Station Unit 2 (the “Plant”), a nuclear generating facility near Oswego, New York. In connection with such ownership, LILCO must maintain one or more nuclear decommissioning funds to hold assets set aside for the purpose of decommissioning the Plant. LILCO has both a qualified nuclear decommissioning fund and a non-qualified nuclear decommissioning fund for the Plant. The sole difference between the Funds is their Federal income tax treatment. Since acquiring LILCO in 1998, LIPA has been paying Federal income tax on the earnings of the Qualified Fund. Now, for tax and administrative reasons, LILCO desires to terminate the Qualified Fund and transfer all its assets to the Non-Qualified Fund. Such action would relieve LILCO of its income tax obligation under the Qualified Fund. LIPA believes such a transfer will result in present value tax savings of approximately \$16 million, while continuing to preserve all the assets required for decommissioning the Plant.

On May 29, 1990, LILCO signed a trust agreement (the “Trust Agreement”) with Mellon Bank as Trustee. Under the Trust Agreement, LILCO established both the Qualified Fund and the Non-Qualified Fund to hold monies for decommissioning the Plant. LILCO also established a trust (the “Trust”) for the collective investment of both Funds. As of October 30, 2017, approximately \$125.8 million is in the collective Trust; 53 percent of this amount is in the Non-Qualified Fund, while the remaining 47 percent is in the Qualified Fund. Because the Funds’ assets are held together in the Trust, transferring assets from one fund to the other would be considered an allocation rather than a physical transfer of assets. LIPA also expects that the transfer

will trigger a one-time Federal income tax liability of approximately \$1.77 million on the gain on the assets held in the Qualified Fund.

LIPA/DPS Support Requirement.

The Authority has been working with outside counsel to determine the best way to eliminate the ongoing tax liability. After discussions with counsel and a conference with the IRS, LIPA pursued the disqualification of the Qualified Fund. The Trust Agreement contains two provisions relevant to the termination of the Qualified Fund and transferring its assets. Section 5.02 of the Trust Agreement provides that the “applicable portion of the Qualified Fund shall terminate upon its disqualification from the application of 468A of the Code, whether pursuant to an administrative action on the part of the [IRS] or the decision of any court of competent jurisdiction.” Section 5.04 of the Trust Agreement further provides that, upon termination of any fund, the Trustee shall liquidate the assets of the fund and distribute them to LILCO; “provided, however, that no such distribution shall be made unless either (a) an Order¹ has been issued which specifically authorizes such distribution or (b) the Trustee has received an opinion of legal counsel to [LILCO] to the effect that no such Order is necessary to authorize the distribution.” Because the disqualification of the Qualified Fund will not result in a physical transfer of assets, and all assets will remain solely dedicated to decommissioning, an Order is unnecessary to satisfy the Trust Agreement, but the IRS indicated that a letter of support from the PSC would be required to obtain a favorable ruling. The reasoning for the IRS request is that state regulatory agencies like PSC help ensure sufficient funding is available to decommission nuclear power plants.

Counsel has informed the IRS that the PSC does not have regulatory jurisdiction over LILCO and requested permission to provide support from LIPA’s Board of Trustees and the Department of Public Service (“DPS”). The IRS indicated that they want the support to come from the entity that approves the contributions to the Funds. Because LIPA’s Board of Trustees approves the contributions, and DPS has limited oversight authority over LIPA, support from these entities should be sufficient for IRS purposes. Counsel also plans to prepare a brief memorandum to explain to the IRS why LIPA and DPS – and not PSC – are the proper entities to provide such support.

Recommendation

Based upon the foregoing, I recommend approval of the above requested action by the adoption of the Resolution in the form attached.

Attachments

Exhibit A Resolution Recommending that the Board of Trustees Support the Proposed Transfer of Assets from the Qualified Fund to the Non-Qualified Fund for the Nine Mile Point 2 Nuclear Power Station.

¹ Section 1.01(21) defines “Order” as “any action relating to decommissioning the Plant issued by the [New York Public Service Commission] or the [Nuclear Regulatory Commission].”

Exhibit A

RESOLUTION RECOMMENDING THAT THE BOARD OF TRUSTEES SUPPORT THE PROPOSED TRANSFER OF ASSETS FROM THE QUALIFIED NUCLEAR DECOMMISSIONING FUND (THE “QUALIFIED FUND”) TO THE NON-QUALIFIED NUCLEAR DECOMMISSIONING FUND (THE “NON-QUALIFIED FUND”), AS ESTABLISHED FOR THE NINE MILE POINT NUCLEAR POWER STATION UNIT 2 FACILITY (THE “PLANT”)

WHEREAS, on May 29, 1990, the Long Island Lighting Company (“LILCO”) entered into a trust agreement (the “Trust Agreement”) with Mellon Bank as Trustee establishing both a qualified nuclear decommissioning fund and a non-qualified nuclear decommissioning fund (collectively the “Funds”) to hold monies for decommissioning the Plant; and

WHEREAS, LILCO also established a trust (the “Trust”) for the collective investment of both Funds; and

WHEREAS, pursuant to transactions undertaken in 1997, LILCO is now a wholly-owned subsidiary of the Long Island Power Authority (“LIPA”), a tax-exempt municipal instrumentality of the State of New York; and

WHEREAS, in 1998, LILCO and LIPA obtained a private letter ruling from the IRS, which provided that LILCO is not subject to tax so long as it remains wholly-owned by LIPA and continues to operate as a state agency; and

WHEREAS, in connection with the transfer of assets from the Qualified Fund to the Non-Qualified Fund, LILCO would no longer pay federal income tax on the investment earnings for the Qualified Fund but all assets in the Funds will continue to be solely dedicated to the decommissioning of the Plant; and

WHEREAS, the Internal Revenue Service (“IRS”) has requested that the entity that approves contributions to the Funds support such transfer of assets; and

WHEREAS, the LIPA Finance and Audit Committee desires to recommend that the LIPA Board of Trustees support the proposed transfer of assets from the Qualified Fund to the Non-Qualified Fund.

NOW, THEREFORE, BE IT RESOLVED, that the LIPA Finance and Audit Committee hereby recommends that the LIPA Board of Trustees support the proposed transfer of assets from the Qualified Fund to the Non-Qualified Fund.

Dated: December 19, 2017