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Date:

June 22, 2004

LEGEND:

Issuer =

State =

a =

b =

c =

Covered Bonds =

Selected Bonds =

Year 1 =

Date 1 =

This is in response to your request on behalf of Issuer for a ruling that the use of bond proceeds in a parity reserve fund as described below to redeem certain bonds secured

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by the reserve will not cause the issues to which those proceeds are allocated to be refunding issues.

Facts and Representations

Issuer owns and operates an electric power system (the “Power System”) and a water and wastewater system (the “Water System”). Over a span of nearly two decades, Issuer issued bonds to finance both the Power System and the Water System (the “Combined Bonds”). The Combined Bonds are parity bonds secured by, and payable from, revenues of both the Power System and the Water System. In addition, the Combined Bonds are secured by the Reserve Fund described below.

In Year 1, Issuer began issuing bonds for the Power System and the Water System separately (the “Separate Bonds”), secured by, and payable from, revenues of the Power System and the Water System, respectively. The Separate Bonds are subject to new ordinances and are not secured by the Reserve Fund. Some of the Separate Bonds are current refunding bonds of Combined Bonds.

Pursuant to the ordinances authorizing the issuance of the Combined Bonds (the “Combined Ordinances”), Issuer established a single parity reserve system (the “Reserve Fund”) for the Combined Bonds. The Combined Ordinances required Issuer to fund the Reserve Fund with cash and to maintain a certain balance in the Reserve Fund (the “Required Reserve”) until final payments on all Combined Bonds are due. Issuer funded the Reserve Fund with original proceeds of several issues of Combined Bonds and with equity. The Combined Ordinances provide that the Required Reserve shall be used solely for the payment of debt service on the Combined Bonds on a pro rata basis when and to the extent other sources of payment are insufficient and, in addition, may be used to retire the last of the Combined Bonds outstanding. Issuer has never used the Reserve Fund for the payment of debt service.

Although under State law the Reserve Fund may be used only to pay debt service on the Combined Bonds, for Federal income tax purposes a portion of the Reserve Fund (currently, approximately \$a) is allocated as transferred proceeds of the Separate Bonds. Currently, approximately \$b out of a total of \$c in the Reserve Fund is allocated as proceeds of various issues of Combined Bonds or Separate Bonds (collectively, the “Covered Bonds”).

Issuer proposes to use a bond insurance policy to satisfy the Required Reserve and to use the amounts currently in the Reserve Fund that are no longer needed for the Required Reserve to redeem certain long-term Combined Bonds (the “Selected Bonds”). Nearly all of the Selected Bonds will be redeemed on Date 1. In redeeming the Selected Bonds, Issuer will be using proceeds of an issue (the “former issue”) to pay

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the redemption price on another issue more than 90 days after the issue date of the former issue.

The Combined Ordinances would not permit Issuer to fund the Reserve Fund with a bond insurance policy. To be able to do so, Issuer obtained the consent from bondholders holding at least 51 percent of the principal amount of each issue of outstanding Combined Bonds to amend the Combined Ordinances (the "Amended Ordinances"). Under the Amended Ordinances, amounts in the Reserve Fund released by the bond insurance policy must be used to pay, discharge, or defease the Combined Bonds in a manner that reduces outstanding principal.

Issuer chose the Selected Bonds among the outstanding Combined Bonds based on maximum debt service savings and the elimination of the maximum amount of Combined Bonds from the market as soon as possible, selecting long-term Combined Bonds with the earliest call dates. The weighted average maturity of the outstanding Combined Bonds will be significantly less after the proposed transaction.

Law and Analysis

Section 103(a) of the Internal Revenue Code provides generally that gross income does not include interest on any state or local bond.

Section 149(d)(1) provides that nothing in § 103(a) or any other provision of the law shall be construed to provide an exemption from Federal income tax for interest on any bond issued as part of an issue described in paragraph (2), (3), or (4). Section 149(d)(3) provides, in part, that an issue is described in that paragraph if any bond (issued as part of such issue) is issued to advance refund a bond unless the refunding bond is only the first advance refunding of the original bond issued after 1985, or the first or second advance refunding of the original bond if the original bond was issued before 1986. Section 149(d)(5) provides that a bond shall be treated as issued to advance refund another bond if it is issued more than 90 days before the redemption of the refunded bond.

Section 1.150-1(a)(1) of the Income Tax Regulations generally provides that the definitions in § 1.150-1 apply for all purposes of §§ 103 and 141 through 150. Section 1.150-1(d)(1) defines "refunding issue" as an issue of obligations the proceeds of which are used to pay principal, interest, or redemption price on another issue, including the issuance costs, accrued interest, capitalized interest on the refunding issue, a reserve or replacement fund, or similar costs, if any, properly allocable to that refunding issue.

Section 1.150-1(d)(2) provides exceptions and special rules for purposes of § 1.150-1(d)(1). Section 1.150-1(d)(2)(iv) provides that in the absence of other applicable controlling rules under this paragraph (d), the determination of whether an issue is a

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refunding issue is based on the substance of the transaction in light of all the facts and circumstances.

Parity bonds, such as the Combined Bonds, are bonds with equal and ratable claim on the same security and source of payment for debt service. An issuer may establish a common reserve for multiple issues of parity bonds, the purpose of the reserve being to pay debt service on those bonds when other sources of payment are insufficient. The funding requirement of such a parity reserve generally is calculated in the aggregate based on all the issues secured by the reserve (e.g., as a percentage of principal or annual debt service). An issuer may fund some or all of this requirement with bond proceeds from one or more of the issues secured by the reserve. If an issuer funds some or all of a parity reserve with bond proceeds, and the issuer is required, due to shortfalls, to draw monies from the parity reserve to pay debt service, this expenditure could result in proceeds of one issue being allocated to the payment of debt service on another issue.

To rule that the use of a parity reserve under the specific conditions for which the reserve expressly was established is a refunding would place significant constraints on the function and utility of parity reserve funds, constraints that we do not believe Congress intended. In this case, however, Issuer's proposed use of the amounts in the Reserve Fund is not under such conditions. Nevertheless, based on the facts and circumstances, we conclude that the proposed use is not a refunding.

The Reserve Fund is a parity reserve that secures multiple issues of Combined Bonds, which are parity bonds. Issuer funded the Required Reserve, in part, with original proceeds of the Combined Bonds. The Selected Bonds that Issuer will redeem are Combined Bonds secured by the Reserve Fund. These facts are identical to those in the situation described above. It is only the event triggering the use of the Reserve Fund that differs from the above situation. The Reserve Fund has never been used to pay debt service on any of the Combined Bonds. The Combined Ordinances did not permit Issuer to use the Required Reserve except in time of shortfalls; bondholder consent was required to permit this use; and it is permitted only as a result of the substitution of the bond insurance policy. Nearly all of the Selected Bonds will be redeemed on the same date.

Conclusion

Based on the facts and circumstances, we conclude that the use of amounts in the Reserve Fund allocable to proceeds of the Covered Bonds to redeem the Selected Bonds will not cause the Covered Bonds to be refunding bonds.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed

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by an appropriate party. While this office has not verified any of the material submitted in support of the request for a ruling, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed concerning any future use of bond proceeds that may be deposited into the Reserve Fund.

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

Sincerely yours,

Assistant Chief Counsel
(Exempt Organizations/Employment
Tax/Government Entities)

By: _____
Johanna Som de Cerff
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cc: