

Tax Issues forward to the NYISO from Market Participants through COB
Wednesday, 10/13:

From Steve Wemple:

Ray, following are the two questions that I'd appreciate if the NYISO can address for our next meeting:

- If the NYISO accepts the submission of a Direct Pay Agreement or a Sales Tax Exemption certificate to address its concerns about sales tax liability, would that be an admission that retail customers are purchasing directly from the NYISO and wouldn't that undermine arguments that the NYISO or Market Participants may wish to make regarding the GRT issue?

NYISO Response:

End user Customers are and have been making purchases through the NYISO markets as permitted under the NYISO tariffs. The NYISO takes no position as to whether sales to certain customers are “retail sales.” The NYISO’s proposal regarding Direct Pay Agreements or Sales tax Exemption certificates was a result of discussions with the Tax Commission to assure that the NYISO would not have to incur a substantial capital expenditure to revise current software systems in order to administer the collection of sales taxes. The notion that certain parties have purchased electricity directly from the NYISO is factually accurate and consistent with current tariff provisions.

- Can the NYISO provide an estimate of the amount of annual purchases (in MWH or \$) that Direct Customers made from the NYISO markets? Some estimate of the historic load or \$ value of NYISO purchases is necessary for Market Participants to estimate the potential liability if the taxing authorities decide to pursue claims for prior GRT and/or sales taxes. I believe this type of information was requested at the last BIC meeting as well.

NYISO Response:

Based on an initial analysis, it became clear that any estimate would be grossly inaccurate without specific detailed guidance from the taxing authorities about how to calculate the tax (e.g., who are the responsible taxpayers; which transactions/products are subject to taxation; what rates apply, etc.) Should any taxing authority declare an intent to retroactively impose a state or local tax, NYISO will calculate the liability in accordance with that authority’s rules and instructions.

- In addition, I'd appreciate the NYISO's thoughts on whether the OATT or Services Tariff could be modified to include a clause that obligates any purchaser to reimburse the NYISO (or perhaps the sellers into the NYISO markets) for any

GRT obligations associated with their retail use. While this does not address the historic liabilities and leaves open a potential billing nightmare, it at least would end any prospective GRT liabilities and may be worth considering.

NYISO Response:

The NYISO believes the proposed tariff language satisfies the potential GRT concerns raised by various parties.

- We should spend a little time at the next meeting discussing possible solutions in order to get a quick read of (1) what's administratively and/or legally feasible from the ISO's perspective, and (2) what's acceptable to stakeholders. The NYISO does not consider it administratively feasible to collect taxes utilizing the systems currently in place. Substantial capital expenditures and certain ongoing administrative costs would be required to modify those systems; consequently, the NYISO is attempting to facilitate a resolution that will comply with the law while not unnecessarily imposing costs on the market.

NYISO Response:

These issues will be discussed at the December 6, 2004 S&P Working Group meeting.

- In addition to the three options I outlined in the slide I sent you on Thursday night which I'll summarize as:
 - 1) Require sale for resale certificates so that Direct Customers have to document that they are "reselling" to an affiliate.

NYISO Response:

This is an option included in the NYISO's proposed tariff language.

- 2) Add language to the ISO tariff obligating Direct Customers to assume liability for GRT which would enable the ISO or Sellers into the NYISO markets to bill and collect from the Direct Customers any GRT liability.

NYISO Response:

One option included in the NYISO's proposed tariff language is for end use customers to pay the tax directly. We note, however, that the direct pay concept included in the sales tax context does not appear to be explicitly provided in the GRT context. The NYISO will not administer or collect any tax for which it is not liable as a corporation.

- 3) Change the tax law to allow for direct payment of GRT taxes by Direct Customers.

NYISO Response:

Legislative changes must be pursued by stakeholders.

To present a full spectrum of scenarios, I think a 4th option should be listed (which obviously we and others are opposed to) to identify what I believe is MI's position which might read:

- 4) Address the Sales Tax issue as proposed by the NYISO and do nothing additional regarding GRT.

NYISO Response:

Such an approach is acceptable to the NYISO, however the Market Participants have asked the NYISO to facilitate a compromise solution. As such, the NYISO is currently working with its stakeholders to reach a solution that is acceptable to a large cross-section of stakeholders. In the event a compromise solution is not reached, the NYISO is prepared to unilaterally take whatever action is required to comply with the law.

From Bart Franey:

- If the NYISO requires Retail Certificates from all direct customers, does the NYISO still bear the sales tax and GRT liability if a direct customer with a retail certificate defaults? What is the original purpose of a Retail Certificate? Can any company obtain a Retail Certificate?

NYISO Response:

The NYISO understands the purpose of a resale certificate to be a certification to the tax authorities that a buyer is indeed, reselling the product and is, therefore, not an end user and not subject to the sales tax. Moreover, the resale certificate would indicate that it was a wholesale sale and no GRT would presumably attach. The NYISO assumes that only an entity that meets the requirements for such status can obtain such a certificate.

From Mike Mager:

Ray -

This email sets forth some additional comments on behalf of Multiple Intervenors with respect to tax issues involving sales to Direct Customers. Although we advanced most (if not all) of these positions at last Friday's meeting, we thought it might be helpful for the NYISO if we summarized our positions on these contentious issues. Please feel free to circulate these comments in the same manner that other comments submitted on tax issues are handled.

Initially, Multiple Intervenors submits that the tax issues related to sales to Direct Customers that are under discussion can be organized into four groups of issues: (1) prospective treatment of sales taxes; (2) retroactive treatment of sales taxes; (3) prospective treatment of GRT; and (4) retroactive treatment of GRT. Each of these issues should be addressed separately. Much of the discussions to date have, in Multiple Intervenors' opinion, blurred or confused the issues in an unproductive manner.

With respect to the prospective treatment of sales taxes, it is Multiple Intervenors' understanding that the NYISO proposes to limit future sales to those Direct Customers that are fully or partially exempt from sales taxes and/or have a direct pay permit. Based on feedback received to date from Multiple Intervenors' members, that approach is satisfactory. It is our understanding that, once implemented, all prospective sales tax issues would be resolved.

With respect to the retroactive treatment of sales taxes, Multiple Intervenors does not believe that any issue currently is ripe for action. It is Multiple Intervenors' understanding, for instance, that: (1) the Tax Department has not attempted to recover retroactively any sales taxes associated with sales to Direct Customers; and (2) in discussions with the NYISO, the Tax Department has not given any indication that it has any interest in attempting to pursue the retroactive recovery of such sales taxes. Thus, there does not appear to any issue requiring NYISO action. As indicated above, the changes proposed by the NYISO should eliminate any prospective sales tax liability. There is no need to take any additional action with respect to retroactive sales tax liability (in any event, it is doubtful that any prospective action would eliminate or reduce retroactive liability, to the extent any such liability even existed).

NYISO Response:

The NYISO agrees that asking the Tax Commission for documentation that no retroactive tax liability exists would be problematic at best. The NYISO's proposed tariff language would not address potential sales tax liability for prior periods.

With respect to the prospective treatment of GRT, it is important to remember that: (1) Direct Customers are not liable for GRT - it is a seller's tax (to the extent applicable); (2) the NYISO has an advisory opinion from the Tax Department indicating that it is not subject to the GRT; and (3) at this point, it is Multiple Intervenors' understanding that no entity is claiming that generators selling power into the NYISO are liable for GRT, with the possible exception of Con Edison Solutions. However, Multiple Intervenors is willing to work with market participants on the development of possible modifications to NYISO rules to mitigate or eliminate possible prospective GRT liability. Multiple Intervenors would, however, oppose any attempts to eliminate the Direct Customer option or impose unreasonable constraints on that option. To the extent Con Edison Solutions' concerns relate to existing tax laws creating competitive advantages or disadvantages, such concerns should be addressed in the first instance with the Legislature.

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With respect to retroactive GRT liability, once again, there is no evidence that any such liability exists. According to the NYISO, at this time the Tax Department has not asserted that any such liability exists, nor has it stated any intention to attempt to recover such liability. Additionally, there are legitimate legal questions as to whether any retroactive GRT liability exists, or how such a liability possibility could be calculated (which impossibility could render the tax inapplicable). Moreover, to the extent any market participant desires finality with respect to this issue, it easily can request an advisory opinion from the Tax Department on the issue. At this time, Multiple Intervenors is not aware of any prospective action that the NYISO can take that would reduce or eliminate retroactive liability (to the extent it existed).

For the foregoing reasons, Multiple Intervenors believes that: (a) the sales tax issues are being addressed satisfactorily by the NYISO's proposal; and (b) the focus of the NYISO's efforts should be on examining possible changes to address possible prospective GRT liability. Such changes, if any, should balance the interests of, among others, Direct Customers and generators selling into the NYISO.

Finally, it is Multiple Intervenors' understanding that the aforementioned tax issues will not be addressed at the next S&P meeting but, rather, will be addressed at a future S&P meeting to be scheduled. Please let us know when these issues will next be addressed as soon as the meeting is scheduled. Thank you.

Mike Mager

From Glenn Haake:

In response to the NYISO's notice soliciting comments issued on October 8, 2004, IPPNY provides the following issues. First, however, I should note that IPPNY stands behind the positions advanced in its October 5, 2004 letter to NYISO General Counsel Robert Fernandez which are hereby incorporated herein by reference.

The law is clear that that any sales into FERC-jurisdictional ISO-administered markets are solely wholesale transactions. Indeed, Southern California Edison FERC opinion referenced in Robert Fernandez' responsive letter to IPPNY of October 7, 2004 (the "Fernandez Letter") explicitly says as much. IPPNY's members have submitted bids to the NYISO and otherwise have participated in the NYISO markets on that basis.

As I noted at the October 8, 2004 S&P working group meeting, IPPNY and its members have, since the NYISO's commencement, construed the Service Tariff's definition of "Load Serving Entity," or LSE, to provide that Direct Customers (i.e., "any entity that takes service directly from the ISO to supply its own load in the NYCA," Services Tariff § 2.91) are purchasing such service on a wholesale basis. This can be affected in several ways, the most obvious of which is for the Direct Customer to create an affiliate to which it would sell its wholesale purchases of energy and from whom it would buy back such energy. In this manner, the Direct Customer would be purchasing for its own load, but pursuant to a wholesale transaction with the NYISO.

Indeed, as noted at Friday’s S&PWG meeting, when KeySpan sought to establish a Direct Purchase arrangement, it was advised by the NYISO that it must establish an affiliate to effectuate the transaction. In light of the foregoing, IPPNY construes the statement in the Fernandez Letter that “IPPNY’s members are, or should have been, aware that a limited number of direct sales have occurred since the NYISO’s start-up in 1999,” as consistent with our interpretation that the definition of LSE requires Direct Customers to transact with the NYISO on a wholesale basis.

Suggestions that Direct Customer sales are retail in nature (i.e., to end-use consumers) are clearly erroneous, as FERC lacks jurisdiction to have approved a tariff provision to that effect. Such a provision in the tariff would be *void ab initio*. Given that any act by FERC to approve such a provision would be *ultra vires*, IPPNY is troubled by language in the NYISO’s presentation at the October 8, 2004 S&P working group to the effect that direct sales to end-use consumers have occurred from the NYISO. Frankly, IPPNY believes the NYISO has misconstrued its tariff.

IPPNY and its members have relied upon the NYISO to maintain all necessary procedures to implement its tariff that ensure no retail sales to end-use consumers occur. KeySpan’s experience noted above suggests that this reliance has not been misplaced. IPPNY and its members, of course, have no way of confirming whether the NYISO has consistently enforced appropriate and necessary requirements on Direct Customers. Given the uncertainty generated by recent discussions of the sales and gross receipts tax issue, IPPNY suggests that it would be appropriate to promptly clarify the Services Tariff to make clear the requirements that Direct Customers must satisfy in order to engage in wholesale transactions with the NYISO.

NYISO Response:

The NYISO believes IPPNY’s comments were addressed in the October 7, 2004 letter from Robert Fernandez to Glenn Haake which is posted on the NYISO website.

A Market Participant Who Wished to Remain Confidential Raised the Following Questions:

- Can the NYISO provide an estimate of the amount of annual purchases (in MWH or \$) that Direct Customers made from the NYISO markets? Some estimate of the historic load or \$ value of NYISO purchases is necessary for Market Participants to estimate the potential liability if the taxing authorities decide to pursue claims for prior GRT and/or sales taxes.

NYISO Response:

See answer to above question #2 from Steve Wemple

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- Identify the possibility and feasibility that the OATT or Services Tariff could be modified to include a clause that obligates any purchaser to reimburse the NYISO (or perhaps the sellers into the NYISO markets) for any GRT obligations associated with their retail use.

NYISO Response:

See the answer above to the same question.