NYISO Direct Customer Tax Issues Presentation

Scheduling & Pricing Working Group Meeting
December 6th, 2004

Prepared by Fluent Energy

Essential Issues To Address

- Generators are concerned that they may incur or have incurred GRT tax liability as a result of sales into the NYISO-administered markets.

- Con Ed Solutions has asserted that Direct Customers enjoy an unfair competitive advantage in comparison to ESCO's based on GRT tax liability.

- A "Preliminary Draft For Discussion Purposes Only" proposes draft language as a basis for amending the New York ISO's tariff.

Note: *Fluent Energy has submitted concurrent with this presentation a more detailed analysis in the document "New York ISO Market Participant Tax Issues Analysis, December 2004", which we hope Market Participants will review and find helpful in addressing the issues at hand.*

Generators are concerned that they may incur or have incurred GRT tax liability as a result of sales into the NYISO-administered markets.

We suggest the following:

1. At the expense of stating the obvious: the scope and application of any tax is defined by those tax authorities that enforce it, in accordance with the intent of the appropriate legislative entities. If the appropriate tax authority, subject to the law, indicates a party is liable for a specific tax, it is liable; if the appropriate authority indicates that a tax does not apply, it does not apply.

2. Our best efforts to assess whether Generators can properly be said to be exposed to any GRT tax liability leads us to conclude that such a liability is extremely unlikely (in our estimation, based on advisory opinions and overall tax theory).

3. Clearly, our understanding is not a guarantee that such liabilities could not exist, and therefore we understand and acknowledge this concern.

4. New York State's GRT tax is scheduled to expire in January 2005, eliminating exposure to all Market Participants, leaving local GRT as a central issue.

5. Concerning local municipalities and associated GRT:

    a. We can find no basis to support the idea that any local municipality in New York State has any authority or jurisdiction over Generators participating in the NYISO.

    b. We believe the structure and practice of the transactions of the NYISO make it impossible to properly claim that Generators could be found liable for GRT with respect to any sale of electricity into the NYISO-administered markets.

    c. We do not believe that any tax authority in the State of New York has indicated or presented any rationale that Generators may be liable for local GRT.

    d. Question: Has any market participant to date formally requested an Advisory Opinion from any tax authority to positively address this "potential" liability? If the potential liability is as great a concern as it appears, why wouldn't concerned parties formally request an Advisory Opinion for clarification? (To date, Fluent Energy has not considered it appropriate or productive to separately request Advisory Opinions that

focus on the tax liabilities of other market participants.)

6. If no Generator or NYISO GRT-related liability has been or can be established, attempts to require Direct Customers to assume such "liabilities" (either directly or indirectly) can be construed as circumventing tax laws in the State of New York, especially if the law, as originally drafted and subsequently interpreted, places no liability on Direct Customers. If serious attempts to obtain clarification from the appropriate authorities do in fact establish liability, it can at least be said that the legislative intent and application of the law has been respected.

7. If the NYISO intends to address competitive fairness issues relating to the proper application and scope of tax laws, does it intend to require all market participants to demonstrate adherence to the requirements of all applicable tax authorities as a condition of participating in its markets? For example, do Utilities in NYS remit GRT on energy consumed by their own corporate facilities? If not, have they created a "potential liability" for Generators? Would the NYISO seriously consider amending its tariff to cover all potential liabilities that market participants "might" impose on other market participants subject to their interpretations and adherence to tax law?

8. In the October 7th, 2004 letter addressed to IPPNY, the NYISO's General Counsel, Robert Fernandez indicated that

   "The NYISO has taken no position as to whether generators' or any other parties' sales into the spot market are, as a matter of law, taxable for GRT purposes. That question can only be addressed by the taxing authorities, the affected market participants, and perhaps the legislature and the courts. The NYISO would, of course, facilitate a dialogue on these issues between the market participants and the Department of Taxation and Finance."

   We believe that in this regard, the NYISO's posture demonstrates a desire to be fair to all market participants while respecting the appropriate authorities of the State of New York. Furthermore, we appreciate the NYISO's offer to facilitate a dialogue between market participants and the Department of Taxation and Finance, as we believe that all market participants are best served through this approach, and we encourage others to seriously consider it.

Con Ed Solutions has asserted that Direct Customers enjoy an unfair competitive advantage in comparison to ESCO's based on GRT tax liability.

We suggest the following:

1. Certainly the determination of whether a competitive advantage exists based on tax status cannot be properly addressed within the NYISO. Given the competing interests between various market participants, any serious attempt to assess a potential competitive inequity should be considered beyond the bounds of the NYISO, especially on the grounds of tax liability.

2. We believe that no competitive disadvantage is created by Direct Customers who are not required to pay GRT. The Direct Customer's Corporate Franchise Tax liability, commensurate with its applicable income tax rate, increases as the Direct Customer's costs of energy decrease. This higher liability may even exceed the prevailing GRT rates in question.

3. Furthermore, it can be easily argued that any GRT remitted by the seller is simply passed on to the end user via the seller's pricing, in direct conflict with the legislative intent of the law: to collect taxes for income deriving from the sale of commodity, from the party that profits from said sale. The law was never intended to burden the end-user with this tax. One of the reasons why the State of New York is eliminating its GRT is to eliminate this burden and provide end-users with more competitive energy pricing. The Legislature determined that the GRT was a regressive tax as applied in practice.

4. Other than the analyses offered by Fluent Energy, no basis or evidence for supporting the premise that GRT liability has produced any competitive advantage has been produced by any party to this discussion, to the best of our knowledge.

A "Preliminary Draft For Discussion Purposes Only" proposes draft language as a basis for amending the New York ISO's tariff.

We suggest the following:

1. We support the NYISO requirement for Direct Customers along with any other applicable market participants to present evidence of exemption status for State Sales Tax, or to submit a certificate that allows a tangible means of remittance to the State Tax Department, not only because the NYISO was ordered to register as a tax collection agency, but because it is a fair and reasonable requirement to ensure sales tax compliance and prevent inequities between market participants.

2. Our understanding is that the NYISO's outside counsel has determined that the GRT statute does not require the NYISO to act as collection agent for market participants that might be subject to this tax. Additionally, an advisory opinion from the NYS State Tax Department in 2000 determined that the NYISO is not subject to GRT for any of its activities. Accordingly, where does the NYISO's authority to impose GRT tax status requirements (or any other NYS tax exclusive of State Sales Tax) on any market participant originate? Any attempt to amend the NYISO tariff that seeks to impose tax-based requirements on market participants in this regard is arguably outside the bounds of the NYISO's authority, and undermines the proper tax authorities of the State of New York and the governing bodies from which such authority derives.

3. Furthermore, any motion which results in a NYISO tariff amendment that attempts to modify the tax liability of any market participant (either directly or indirectly) demonstrates a gross disrespect for the tax laws of New York State, and must be rejected.

4. In light of the points made above, any motion that singles out Direct Customer market participants is discriminatory; at a minimum such a motion would need to include requirements that address any "potential tax liability" issues involving other market participants as well. There exists confusion in the energy markets of New York State concerning the applicability of GRT, for example. Questions of where the purchase of commodity actually occurs provides opportunities for varying interpretations of the law, which may produce inconsistent tax compliance and potential competitive inequities. We do not believe that the NYISO alone can address these issues properly, and perhaps not at all. That is why our focus has remained on examining and understanding the intent of the law, and respecting the appropriate authorities – and it is they who should be consulted if a good faith effort to address these issues is reasonably to be made. We believe that laws exist and are modified to help preclude the existence of

inequities, competitive or otherwise.

5. We therefore encourage parties to this discussion to seek to establish a proper basis to address allegations of competitive advantage, now and in the future. We also believe that the NYISO exposes itself to unnecessary liabilities if it pursues an ill-advised foray into the tax domains of its market participants, including the appearance of using tax issues as a pretense to eliminate competition at the insistence of specific market participants.