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March 15, 2005

VIA HAND DELIVERY

Hon. John W. Boston
Chairman of the Board
c/o Mr. Mark S. Lynch
President and CEO
New York Independent System Operator, Inc.
3890 Carman Road
Schenectady, New York 12303

Re: Appeal of Management Committee Decision

Dear Chairman Boston:

Multiple Intervenors, an unincorporated association of approximately 55 large commercial and industrial energy consumers with manufacturing and other facilities located throughout New York State, hereby submits the original and three copies of the "Notice of Appeal of Multiple Intervenors of the Management Committee's Approval of a Motion Pertaining to Gross Receipts Tax and Direct Customers." A copy of the enclosed Notice of Appeal will be circulated to all members of the Management Committee via electronic mail.

Multiple Intervenors does not request oral argument on this appeal. However, if the NYISO Board elects to conduct oral argument on the issues raised on appeal – either on its own motion or in response to a request by another market participant – then Multiple Intervenors hereby states its desire and intent to participate in such oral argument.

If you have any questions concerning this filing, please call me at (518) 320-3409.

Very truly yours,

COUCH WHITE, LLP

Michael B. Mager

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Enclosures
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**NOTICE OF APPEAL OF MULTIPLE INTERVENORS OF THE
MANAGEMENT COMMITTEE'S APPROVAL OF A MOTION PERTAINING
TO GROSS RECEIPTS TAX AND DIRECT CUSTOMERS**

SUMMARY

Multiple Intervenors, an unincorporated association of approximately 55 large commercial and industrial energy consumers with manufacturing and other facilities located throughout New York State, hereby submits to the Board of Directors (“Board”) of the New York Independent System Operator, Inc. (“NYISO”) this appeal of the decision by the Management Committee (“MC”) on March 2, 2005 to approve Motion #2, which purports to address market participant concerns related to gross receipts tax (“GRT”) and Direct Customers (hereinafter, the “Motion”).¹

Although not defined formally in the NYISO’s tariffs, the term “Direct Customer” refers typically to a large end-use consumer that opts to take service directly from the NYISO to supply its own load.² If implemented, the Motion would impose new, substantial requirements on Direct Customers that, as a practical matter, would eliminate or significantly burden the Direct Customer option to the detriment of large consumers. For the reasons demonstrated herein, Multiple Intervenors’ appeal should be granted because the Motion: (a) seeks to have the NYISO address matters of tax policy that are outside of its necessary and proper authority; and (b) would cause definite and substantial harm to a

¹ Five members of Multiple Intervenors are active members of the MC.

² See, e.g., NYISO Open Access Transmission Tariff (“OATT”) at § 1.16a (defining “Load Serving Entity” as “including an entity that takes service directly from the ISO to supply its own load in the NYCA”).

segment of the market in order to protect another segment of the market from a tax liability that is highly speculative and, to date, has never been enforced.

ARGUMENT

A. Background

Direct Customers have participated in the NYISO's markets since the commencement of the NYISO's operations. In a letter circulated to all market participants, the NYISO's General Counsel confirmed that: "The NYISO has properly administered its tariffs by permitting sales to certain large direct customers. Such transactions are, and have been, contemplated by the NYISO's tariffs since they were first developed in 1997."³

It is very important to many large end-use consumers, including Multiple Intervenors members, that the Direct Customer option remain viable and unburdened by the imposition of inappropriate and unnecessary requirements. The option provides end-use consumers with additional competitive purchasing options, including direct access to NYISO real-time markets. Inasmuch as New York businesses continue to struggle with electricity prices that far exceed national and regional averages, effectively eliminating the Direct Customer option only would add to the competitive burden that those businesses face.

During 2004, the NYISO was contacted by the New York State Department of Taxation and Finance ("Tax Department") regarding sales tax issues pertaining to certain transactions. The NYISO entered into discussions with the Tax Department, and separately

³ Letter, dated October 7, 2004, from Robert E. Fernandez, Esq. to Glenn Haake, Esq.

with market participants, regarding those issues. Multiple Intervenors has no objections to the NYISO's preferred course of action with respect to the sales tax issues raised by the Tax Department, and those issues are not part of the instant appeal. Significantly, according to NYISO staff, the Tax Department's concerns are limited to sales tax issues and do not extend to the GRT issues addressed by the Motion.

Around the time deliberations commenced on sales tax issues, certain market participants raised concerns regarding GRT and Direct Customers. One concern raised is that GRT typically is not paid on transactions involving Direct Customers, and, consequently, certain marketers are at a competitive disadvantage vis-à-vis the Direct Customer option. The other primary concern advanced is that because GRT is imposed on sellers and not purchasers, if the NYISO is exempt from GRT liability (consistent with an advisory opinion from the Tax Department to that effect),⁴ then generator owners potentially could be liable for GRT on sales made into NYISO markets, at least to the extent such electricity is purchased by Direct Customers. Importantly, the entities advancing this concern have not presented any legal analysis demonstrating its viability, nor have any recent legal changes involving GRT or Direct Customers been identified as necessitating action.⁵

⁴ See The New York Independent System Operator, Inc., Adv Op Comm T&F, January 14, 2000, TSB-A-00(1)C.

⁵ The only recent change in the law involving GRT is that the State's GRT on electric commodity was reduced to zero percent effective January 1, 2005. N.Y. Tax Law § 186-a. Cities and villages still are able to impose GRT on electric commodity (hereinafter, "local GRT"). N.Y. Gen. City Law § 20-b; N.Y. Village Law § 5-530.

B. The Motion Would Have a Substantial, Detrimental Impact on the Direct Customer Option

At the MC's March 2, 2005 meeting, the Motion was approved with a weighted vote of 74.37% in support.⁶ The Motion incorporates proposed tariff language that, if adopted, would impose new and substantial requirements on Direct Customers.⁷ Briefly, if a Direct Customer is located in a municipality with a local GRT, the Motion would require that customer to provide the NYISO with: (a) a Reseller's Certificate; (b) a certificate exempting the customer's transactions from GRT; or (c) a written agreement from each applicable taxing authority which provides that the authority waives any and all claims for GRT liability against sellers into NYISO-administered markets with respect to the Direct Customer's purchases under the NYISO tariffs, and that such sellers may enforce said waiver. If a Direct Customer is unable to satisfy these requirements, the Motion would require it to cease operating as a Direct Customer.

Multiple Intervenors asserts that, as a practical matter, existing and potential future Direct Customers will not be able to satisfy the Motion's requirements. For instance, Direct Customers typically do not possess Reseller's Certificates – Direct Customers participate in NYISO markets to supply their own load, not to resell to others. Additionally,

⁶ There were 25 votes in support, 16 votes in opposition, and 17 abstentions.

⁷ The pertinent tariff language contains explicit exemptions for suppliers, transmission owners and municipal utilities. These exemptions – which underscore why the Board should refrain from according undue weight to the final vote tally of the MC – highlight the potentially discriminatory nature of the Motion from the Direct Customer perspective. For instance, arguments can be advanced that purchases by a transmission owner from NYISO markets to power corporate facilities are not different materially from purchases made by Direct Customers to serve their own load.

while exemption certificates are available to certain individual consumers for sales tax, such certificates do not exist for GRT. Finally, it is not realistic to expect Direct Customers to obtain the broad, explicit waivers from taxing authorities that are required by the Motion.

Thus, for those Direct Customers with facilities in municipalities that have a local GRT, the Motion, if implemented, would represent the end of the Direct Customer option.

C. The Motion Seeks to Have the NYISO Act Outside of its Proper Authority

Proponents of the Motion have asserted that Direct Customers possess a competitive disadvantage vis-à-vis marketers due to how GRT is applied in practice.

Marketers allege that GRT liability is triggered by serving end-use customers, and they are “forced” to pass such liability through to those customers.⁸ Consequently, marketers allege that the “playing field” is slanted unfairly in favor of Direct Customers. For the reasons set forth below, the NYISO has no business addressing matters of tax policy, and should not permit its stakeholder process to be used for what clearly is a legislative purpose.

⁸ In many instances, this allegation would be factually inaccurate, particularly outside of New York City, because the requirements to trigger local GRT liability are not satisfied. Cities and villages are authorized to impose GRT only (i) within their territorial limits, and (ii) on transactions that originate and are consummated entirely within their territorial limits. See N.Y. Gen. City Law § 20-b; N.Y. Village Law § 5-530. Thus, transactions between marketers and customers that do not originate within the territorial limits of the municipality should not be subject to “local” GRT. A statutory exception exists for cities having a population of one million or more (i.e., New York City). See N.Y. Tax Law §§ 1201, 1221 (authorizing the establishment of different requirements for the imposition of “local” GRT where the sale is made by a utility not subject to the supervision of the Department of Public Service). The local GRT enacted by New York City does not require that the transaction originate within its territorial limits. See City Admin. Code §§ 11-1101(5), 11-1102(a) (applicable to receipts from any sale made or service rendered within the city).

Initially, contrary to the marketers' arguments, it is not at all clear that any GRT liability is triggered in a transaction involving Direct Customers purchasing services from NYISO markets. GRT, to the extent applicable, imposes liability on sellers, not purchasers. Moreover, GRT is targeted at retail transactions.⁹ Significantly, however, the NYISO's OATT, as approved by the Federal Energy Regulatory Commission ("FERC"), specifies that transactions involving Direct Customers are made in the wholesale market:

Wholesale Market: The sum of purchases and sales of Energy and Capacity for resale along with Ancillary Services needed to maintain reliability and power quality at the transmission level coordinated together through the ISO and Power Exchanges. A party who purchases Energy, Capacity or Ancillary Services in the Wholesale Market to serve its own Load is considered to be a participant in the Wholesale Market.¹⁰

Significantly, whether transactions involving Direct Customers trigger GRT liability on the part of some entity is irrelevant for purposes of this appeal. Even if, arguendo, Direct Customers enjoy a competitive advantage vis-à-vis marketers due to how GRT is applied in practice, it is not the NYISO's function to address matters of tax policy that more appropriately are within the purview of the State Legislature.

The NYISO's primary functions involve the safe and reliable operation of the bulk power system and the administration of non-discriminatory electricity markets:

⁹ See, e.g., N.Y. Tax Law § 186-a(2)(c) (defining "gross income" subject to GRT as receipts received by reason of a sale "rendered for ultimate consumption or use by the purchaser in this state").

¹⁰ NYISO OATT at § 1.49e (emphasis added). See also ISO Agreement at § 1.136.

The ISO shall maintain the reliable, safe, and efficient operation of the NYS Power System ... and the administration of the ISO Open Access Tariff ... and the ISO Market Administration and Control Area Services Tariff ... in accordance with the Reliability Rules and the terms of the ISO Related Agreements.¹¹

In fact, on its website, the NYISO states that: “Its mission is to ensure the reliable, safe and efficient operation of the State’s major transmission system and to administer an open, competitive and nondiscriminatory wholesale market for electricity in New York State.”¹²

The NYISO’s role should not be expanded to addressing alleged inequities in the tax law, or advancing revisions to its market rules that unduly burden one segment of the market because one or more other market segments do not like how GRT is being implemented. As detailed, supra, the Direct Customer option has been available since the NYISO commenced operations, and the Motion does not respond to any recent changes in the law or GRT-related concerns advanced by the Tax Department. Rather, the Motion embodies an attempt by some market participants to eliminate, or significantly burden, the Direct Customer option for their own competitive purposes. These issues should be addressed, if at all, by the State Legislature, not the NYISO.

D. The Motion Does Irreparable Harm to the Direct Customer Option in Order to Shield Generator Owners From a Highly Speculative Tax Liability

If implemented, the Motion would impose new and substantial requirements that, as a practical matter, would eliminate or impair severely the Direct Customer option.

¹¹ ISO Agreement at § 2.01; see id. at § 5.08 (describing the Board’s responsibilities).

¹² Posted at: www.nyiso.com/overview.html.

Significantly, the Motion was advanced, in large part, to shield generator owners from a tax liability that is speculative and, upon information and belief, has never been enforced.

Initially, generator owners acknowledge readily that they do not believe any GRT liability attaches to them for sales made into NYISO markets that ultimately may be purchased by Direct Customers. Generator owners assert that they are engaging in wholesale transactions and, consequently, no GRT liability attaches.¹³ Thus, the Motion is being advanced, as a protective measure, to protect generator owners from a potential liability that even they do not believe exists.

The contention that generator owners making sales into the NYISO's markets are engaging in wholesale transactions (for which no GRT liability should attach) has support from FERC. In 1997, Southern California Edison Company ("SoCal") petitioned FERC for a declaratory order that all electric power sales into the California Power Exchange ("PX") would qualify as wholesale sales, notwithstanding that "some direct access (retail) customers may purchase power directly out of the PX." FERC granted SoCal's petition and concluded that all sales by PX participants would be treated as wholesale sales.¹⁴ Relying on that decision, FERC also ruled recently that participants in the New England Power Pool ("NEPOOL") are engaging in wholesale transactions that would not jeopardize their status as

¹³ This position is consistent with the NYISO's tariffs. See, e.g., NYISO OATT at § 1.49e.

¹⁴ Docket No. EL-97-36-000, Southern California Edison Company, 80 FERC ¶ 61,262, Declaratory Order Concerning Sales of Electricity into the California Power Exchange (1997).

exempt wholesale generators, notwithstanding direct participation of Market Participant End Users in the NEPOOL market (who are similar to Direct Customers).¹⁵

The speculative theory upon which the Motion was advanced – i.e., that generation owners could be found liable for GRT relating to purchases by Direct Customers – is not based on any change in the law. Moreover, the proponents of the Motion have never presented to stakeholders any detailed legal analysis demonstrating that the hypothetical tax exposure exists. In fact, such proponents have not identified a single instance of a generator owner being found liable for GRT as a result of Direct Customers’ participation in the NYISO markets and, upon information and belief, there has been no such instance.

Furthermore, even if, arguendo, an argument could be advanced that transactions involving Direct Customers potentially would be subject to GRT, substantial hurdles still would remain before a local GRT could be imposed on a generator owner. For instance, as detailed, supra, GRT applies to retail transactions, yet FERC has approved the NYISO’s tariffs which provide unequivocally that Direct Customers participate in the “Wholesale Market.”¹⁶ Moreover, for an income-based tax to be applicable, there generally must be a point of realization for what is being taxed, i.e., one or more specific points at which the amount of the tax can be computed and levied with reasonable certainty and

¹⁵ Docket No. ER04-110-000, Ninety-Ninth Agreement Amending New England Power Pool Agreement, 106 FERC ¶ 61,051, Letter Order (2004).

¹⁶ NYISO OATT at § 1.49e.

accuracy.¹⁷ For several reasons, there is no apparent point of realization upon which a local GRT could be imposed on generator owners relating to the activities of Direct Customers.

Initially, unlike other transactions that may trigger GRT liability, there are no discernible transactions between generator owners and Direct Customers. Generator owners make wholesale sales into the NYISO markets, and Direct Customers purchase services directly from the NYISO – there is no privity of contract or any transaction involving a specific generator owner and a specific Direct Customer. Thus, hypothetically, if on April 1st at 3:00 p.m. there are 50 LSEs purchasing electricity from the NYISO, 20 of which are Direct Customers, and, at the same time, 30 generator owners operating 45 different facilities are selling their output into the NYISO markets, it seemingly would be impossible for a taxing authority to prove that a specific generator owner realized receipts attributable to a specific Direct Customer. Additionally, any analysis that attempts to make such a demonstration would have to be replicated, in its entirety, thousands of times to account for all transactions within a given year (which would be necessary because, *inter alia*, the amount of electricity sold by generator owners and purchased by Direct Customers fluctuates constantly throughout each day, and the rate for local GRT varies by municipality).

Thus, Multiple Intervenors agree with generator owners who assert that they are not subject to GRT for wholesale sales made into NYISO markets, notwithstanding the existence of Direct Customers. Accordingly, the Board should grant this appeal and reject

¹⁷ See, generally, Deborah H. Schenk, “An Economic Analysis of the Realization Rule,” Colloquium on Tax Policy and Public Finance (NYU Sch. of Law, Spring 2004).

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the Motion because it would impair severely – if not eliminate – the Direct Customer option in order to protect generator owners against a potential tax liability that is highly speculative and heretofore unenforced.

CONCLUSION

For all the foregoing reasons, the Board should reject the GRT Motion that was approved by the MC and grant this appeal.

Dated: March 15, 2005

Respectfully submitted,

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