NYISO Board of Directors Decision on Appeal of Management Committee Action on Gross Receipts Tax Tariff Amendment Dated March 2, 2005

Introduction

Multiple Intervenors ("MI"), Fluent Energy ("Fluent") and KeySpan Ravenswood ("KeySpan") (collectively, "Appellants") each appeal proposed amendments related to State and local gross receipts taxes ("GRT") approved by the Management Committee ("MC") on March 2, 2005. The NYISO Board of Directors considered the GRT appeals and the underlying proposed GRT tariff amendments in tandem with tariff amendments, also approved by the MC but not appealed, that facilitate NYISO's compliance with New York State sales tax requirements. The Board Governance Committee reviewed all written submissions in favor of and opposed to the GRT[1] amendments and NYISO management's analysis. The Board Governance Committee heard oral arguments on August 15, 2005 and made a recommended decision that the Board adopted at its August 16, 2005 meeting.

The sales tax and GRT amendments are related in that both arise from purchases by certain Load Serving Entities ("LSEs") to supply their own load *i.e.*, for their own consumption. The two proposed amendments are, however, distinct in a number of respects. The sales tax amendment represents the culmination of a collaborative effort among NYISO staff and the MC on how best to comply with registration, reporting, collection and remittance *requirements* imposed corporately upon the NYISO by the New York State Department of Taxation and Finance ("DTF"). The NYISO management has no choice but to comply with the DTF's legal requirements, but developed in conjunction with Market Participants ("MPs") a method for compliance that should minimize costs and potential liability for sales tax defaults by individual MPs. DTF actively participated in developing this approach. In short, the sales tax amendments resolve a corporate compliance issue for the NYISO. On August 16, 2005, the Board unanimously approved the sales tax amendments for filing under section 205 of the Federal Power Act ("FPA").

In contrast, the proposed GRT amendment does not address a legal obligation imposed upon the NYISO and did not arise from a government directive. Indeed, the NYISO has been found not to be subject to GRT. Rather, the GRT amendment represents an effort by certain MPs to shield themselves from the *possibility* of taxation under State and local GRT statutes. Other MPs, who claim they cannot avoid GRT, seek to "level the playing field" with these tariff amendments by imposing new requirements on so-called "Direct Customers" who buy directly from the NYISO for end use. These requirements could, in effect, shift the burden of taxation, if assessed, to Direct Customers who, as a matter of law, are not presently liable for State or local GRT.

---

[1] The following parties submitted Notices of Appeal, Motions in Opposition, or other written comments: Multiple Intervenors, Fluent Energy, KeySpan Ravenswood, Independent Power Producers of New York ("IPPNY"), Con Edison, Central Hudson, and NYPA, Con Ed Solutions, the City of New York, Staff of the New York Public Service Commission.

The Direct Customers oppose the GRT amendment claiming, among other things, that the GRT liability for which suppliers seek protection is highly speculative, that NYISO should not be in the business of setting State or local tax policy, and that the new requirements are either impossible to satisfy or unduly burdensome.

As discussed below, the Board rejects the proposed GRT tariff amendments, grants the appeals of MI and Fluent and denies KeySpan's appeal.

Discussion

At the outset, we must emphasize that here, as in all appeals, the Board must look beyond the vote tally and determine whether the MC's action would work an injustice upon those MPs who opposed the tariff amendment. The Board also must examine whether the tariff amendments under appeal seek to accomplish a purpose that properly lies within the NYISO's province. For the following reasons, this matter represents an instance where the Board must respectfully disagree with the MC's action and decline to facilitate the proposed section 205 filing.

As an initial matter, we reject KeySpan's suggestion that NYISO has since November 1999 improperly made sales to Direct Customers. After examining the tariff definitions of "LSE"[2] and "wholesale market"[3] and reviewing the Member Systems'[4] filings that gave rise to the NYISO it is clear that sales to Direct Customers were explicitly contemplated when the NYISO's tariffs were drafted and approved. Moreover, the Board firmly believes that Direct Customers play an important part in NYISO's wholesale markets and should continue to participate in those markets. We do not agree with KeySpan's various assertions that retail versus wholesale markets and rules must be established in the tariffs -- which we believe are clear on their face.[5]

---

[2] The NYISO's Market Administration and Control Area Services Tariff ("Services Tariff") defines a "Load Serving Entity" as "Any entity, including a municipal electric system and electric cooperative, authorized or required by law, regulatory authorization or requirement, agreement, or contractual obligation to supply Energy, Capacity and/or Ancillary Services to retail customers located within the NYCA, including an entity that takes service directly from the ISO to supply its own Load in the NYCA." Services Tariff, § 2.91.

[3] The Services Tariff defines the "Wholesale Market" as "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." Services Tariff, § 2.196.

[4] In an affidavit describing how the competitive supply of electricity to NYS retail customers could be accommodated through the proposed wholesale market structure, Con Edison's Chief Engineer of Transmission Planning and Engineering stated that, "Large retail customers may opt to become their own LSE …" and "These LSEs will in turn interact with the NYISO … directly if the LSE meets the requirements to become a direct customer." See Affidavit of William L. Jaeger, Docket Nos. ER97-1523-000, OA97-470-000, and ER97-4234-000 (not consolidated).

[5] *Cf.*, 80 FERC ¶61,262 (1997) and 106 FERC ¶61,051 (2004).

There appear to be three basic prongs in support of the GRT amendment: First, that it will protect generators and suppliers who offer to sell into NYISO's wholesale markets from being taxed based upon purchases by Direct Customers they never intended to supply and, in fact, have no relationship with. Ironically, the suppliers and Appellants seem to agree that generators are *not* liable for GRT. Some parties cite the difficulty or impossibility of demonstrating the basic elements of a taxable transaction (*e.g.*, buyer and seller, quantity, and point where title transfers). Others claim that since NYISO markets are by definition "wholesale" in nature, GRT, which applies to "retail" transactions, cannot apply to wholesale sellers.

The second prong, contends that NYISO markets were never intended to allow Direct Customers to avoid GRT that others must pay. Con Ed Solutions argues that such tax avoidance by Fluent's clients creates an unfair competitive advantage; an "unlevel playing field" that the NYISO must rectify. Con Ed Solutions also argues, ostensibly on the generators' behalf, that suppliers who do not intend to make retail sales should not bear the risk of having GRT imposed upon them. The City of New York agrees, and goes so far as to suggest that Direct Customers are engaging in impermissible tax "evasion."

The third Prong, espoused by Con Edison, NYPA, and Central Hudson, suggests that since the tax may be too complex for local municipalities to impose upon suppliers they might go after the NYISO directly for the GRT and thus raise charges to the market under Rate Schedule 1. This, they argue, would be an unreasonable subsidy for Direct Customers. They apparently take no comfort in a DTF Advisory Opinion that found NYISO was not a seller of electricity for GRT purposes.[6]

Proponents of all three schools of thought do not say NYISO should eliminate Direct Customers outright. Rather, they seek to impose new tariff requirements, from which they all are exempt, that would force Direct Customers to form reseller affiliates to buy from the NYISO and resell to the Direct Customers. Although the GRT apparently has never been assessed upon a single generator in almost six years of NYISO operations, this preventive measure would restructure Direct Customers' transactions to shift the point of *potential* taxation away from generators and, effectively, onto the Direct Customers via the reseller affiliate.

As an alternative, the Direct Customers may choose to try to demonstrate that they or their transactions are exempt from GRT. The approaches outlined in the tariff language provide for at least the possibility that such exemptions could be procured by a buyer, but such exemption mechanisms do not appear to exist under any current statutory scheme. Finally, a Direct Customer may attempt to demonstrate that the jurisdiction in which it purchases has no GRT.

[6] DTF Office of Tax Policy Analysis – Technical Services Division, Petition No. C9990922A (January 14, 2000),

MI and Fluent, whose clients would bear the brunt of the GRT amendments, urge the Board to reject the MC's action for a number of reasons. First, they point out that Direct Customers have legitimately participated in the NYISO markets since their inception. The direct purchase option provides one way for New York's large businesses, to cope with electricity prices above the national average and remain competitive.

MI and Fluent argue that the GRT liability from which suppliers seek protection is highly speculative. They point out that neither New York State[7] nor any of the over 350 municipalities with GRT statutes have attempted to assess a single generator or supplier on the basis of purchases by Direct Customers. They point out that even if a taxing jurisdiction attempted to assess the tax it would be unable to demonstrate the basic elements of a taxable transaction. They agree with suppliers that suppliers should not be liable for the GRT, but disagree that any "preventive" measures, like those in the proposed amendment, are necessary. The proponents of the GRT amendment argue Fluent and MI, have never even performed a legal analysis that demonstrates the GRT would be viable in this context.

MI and Fluent argue further that should the Board approve the GRT amendments, it would be setting tax policy and acting beyond its proper role which is to operate the grid reliably and administer the wholesale markets.[8] The proper forum, they believe, for addressing these issues is the legislature; the NYISO should not create new tax policy in its tariffs. MI and Fluent claim also that the GRT amendments are either impossible to satisfy or unduly burdensome and would spell the end of the Direct Customer option as it exists today. They suggested at oral argument that Con Ed Solutions could become a bidding and scheduling agent, like Fluent, but has chosen not do so.

While there are no easy answers in this matter, on balance the Board must grant the appeals. First, no one has shown that there is a *likelihood* the GRT will be assessed on generators. Neither the State nor any municipality has done so in the NYISO's six-year history. Fluent and MI argue convincingly that proving a taxable transaction occurred is fraught with difficulty. Moreover, the representative of the City of New York stated at oral argument that the issue may be "transient" as the City is presently considering whether to retain the GRT at all. While we understand the generators' desire to protect themselves from the possibility of a tax, they seek to accomplish that objective at the expense of a small segment of the market that is not, as a matter of law, subject to GRT which expressly applies to sellers.

Similarly, we find Con Ed Solutions' plea to "level the playing field" unconvincing. Interestingly, Con Ed solutions doesn't appear to claim that Direct Customers are acting illegally. Direct Customers have simply found a way to avoid a tax that Con Ed Solutions apparently must pass on to its customers. This, says Con Ed Solutions, is an unfair competitive advantage that the NYISO must eliminate. The Board disagrees. Under Con Ed Solutions' logic the Board would arguably have an affirmative

[7] The State GRT on electricity commodity expired on January 1st 2005.
[8] The PSC Staff suggests that it would be inappropriate for the NYISO to file the GRT amendments with FERC and force that federal agency to interpret State law.

obligation to examine MPs' various tax positions to make sure that everyone has similar risks. Should the NYISO Board also examine other relative commercial "advantages" and "disadvantages" among the various MPs (*e.g.*, access to capital or use of a parent company's brand name) to determine if the playing field is level? We think not. It is devising advantages that forms the essence of competition and, absent some abuse of market power, the Board is reluctant to interfere with competitive forces that appear in markets. In sum, we reject Con Ed Solutions' approach as both unworkable and inappropriate.

Finally, we agree with MI and Fluent that the NYISO is neither a proper forum to create new State and local tax policy nor is it a proper role for this Board to effect such change via the tariffs. The mechanism created by the MC purports to protect suppliers from the *possibility* of a tax that, by its terms, might apply only to sellers of electricity. The MC accomplishes this result by shifting the *potential* point of taxation to purchasers via their newly-formed reseller affiliates. If suppliers believe either that they should not be taxed under New York law for their activities in the NYISO wholesale markets or that Direct Customers should be subject to GRT their recourse lies in other forums, namely: the legislature which can amend the law, the courts which can interpret the law and the taxing authorities which must implement the law. Putting aside the question of whether the GRT feared by suppliers is even viable, it is inappropriate for the NYISO Board to create by tariff amendment a tax on buyers that the legislature intended to apply only to sellers.

For the foregoing reasons, the appeals of MI and Fluent are granted and the KeySpan appeal is denied.

NYISO Board of Directors

September 16, 2005