

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

New York Independent System Operator, Inc,) Docket No. ER05-1507-000

**REQUEST FOR LEAVE TO ANSWER AND ANSWER OF
THE NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.
TO THE FINANCIAL MARKETERS' PROTEST**

In accordance with Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213 (2005), the New York Independent System Operator, Inc. ("NYISO"), respectfully requests leave to answer, and answers, the *Motion to Intervene and Protest* ("Protest") filed by EPIC Merchant Energy, L.P., SESCO Enterprises LLC, and Black Oak Energy, LLC (the "Protestors").¹ The Commission should reject the Protest because it fundamentally misrepresents both the nature of the NYISO's proposal and the applicable law. As is explained in detail below, the NYISO's proposal is not unlawful, does not intrude on the Commission's jurisdiction, will not "embroil" the Commission in State law disputes, and adopts rules that all market participants, including those that are not based in New York State, can easily meet. The proposal is a minimally burdensome means of accommodating State law requirements arrived at through months of discussions during the stakeholder process that the Protestors would have the NYISO defy. The Commission should therefore accept the NYISO's proposal and reject the Protest.

¹ Alternatively, the NYISO should be permitted to answer the Protest because it raises new issues that go beyond the boundaries of the NYISO's original filing in this proceeding.

I. STATEMENT OF ISSUES

In compliance with Order No. 663,² the NYISO respectfully identifies the following issues that are raised in this answer.

1. The Commission should exercise its discretion to allow the NYISO to answer the Protest because the NYISO's answers will correct the Protestors' mischaracterizations of fact and law, and will help to clarify the record.³
2. The NYISO's proposal is a reasonable attempt to comply with applicable State law, not an inappropriate attempt to enforce or enhance New York State's taxing authority.
3. The NYISO's proposal will not "embroil" the Commission in New York State tax law questions, but granting the Protest would.
4. The proposed solution requires a minimum burden for the Protestors to comply.
5. The NYISO's proposal would not require the Protestors, or any other entity to make filings, or register, with New York State beyond their current registration obligations that already exist.⁴
6. The Protestors ignore the NYISO's obligation to comply with all applicable New York State laws,⁵ and misrepresent the Commission precedent that they cite.⁶
7. The Protestors have not shown that the NYISO's proposal is unconstitutional or offered any other convincing legal rationale for rejecting it.

² *Revision of Rules of Practice and Procedure Regarding Issue Identification*, 112 FERC ¶ 61,297 (2005).

³ *See, e.g., New York Independent System Operator, Inc.*, 108 FERC ¶ 61,188 at P 7 (2004).

⁴ *See Answer* at 4-7.

⁵ *See, e.g., NYISO's Market Administration and Control Area Services Tariff* ("Services Tariff") at Sections 2.2 and 4.1.6. Those Sections specifically require the NYISO to comply with applicable state and local laws.

⁶ *See, e.g., New York Independent System Operator, Inc.*, 111 FERC ¶ 61,366 (2005); *Texas Gas Transmission Corp.*, 105 FERC ¶ 61,143 (2003) ("*Texas Gas*").

8. The Protestors would undermine the NYISO's independence by overriding its decision to comply with New York State tax law instead of defying it.⁷
9. The Protestors did not participate in the governance process leading to stakeholder approval of this filing and are now making an impermissible end-run around that process.⁸

II. REQUEST FOR LEAVE TO ANSWER

The NYISO recognizes that the Commission generally discourages answers to protests. The Commission has allowed such answers, however, when they correct inaccurate statements,⁹ help to clarify complex issues, provide additional information that will assist the Commission, or are otherwise helpful in the development of the record in a proceeding.¹⁰ In this case, allowing the NYISO to answer will correct the Protest's serious factual and legal misrepresentations. The NYISO therefore respectfully requests that the Commission exercise its discretion and accept this answer.¹¹

⁷ See, e.g., *Atlantic City Electric Co., et al.*, 77 FERC ¶ 61,148 at 61,574 (1996) (“The principle of independence is the bedrock upon which the ISO must be built if stakeholders are to have confidence that it will function in a manner consistent with this Commission's pro-competitive goals.”).

⁸ See, e.g., *New York Independent System Operator, Inc.*, 90 FERC ¶ 61,319 (2000).

⁹ *Southern Minnesota Municipal Power Agency*, 57 FERC ¶ 61,136 (1991).

¹⁰ See, e.g., *New York Independent System Operator, Inc.*, 108 FERC ¶ 61,188 at P 7 (2004) (accepting NYISO answer to protests because it provided information that aided the Commission in better understanding the matters at issue in the proceeding); *Morgan Stanley Capital Group, Inc. v. New York Independent System Operator, Inc.*, 93 FERC ¶ 61,017 at 61,036 (2000) (accepting an answer that was “helpful in the development of the record . . .”).

¹¹ In addition, if the Commission deems this answer to have been submitted one-day out-of-time, the NYISO respectfully requests a waiver so that this answer may be considered.

III. ARGUMENT

A. The Protest Misrepresents the Facts

1. The Protest Wrongly Depicts the Proposal as an Unlawful Attempt to Expand New York State's Taxing Authority When In Reality It Is a Reasonable Effort to Comply With DTF Rulings Without Creating Undue Burdens

The Protestors have mischaracterized the NYISO's proposal as an effort to use federal tariffs "to monitor, enforce and even enhance" the taxing powers of the New York State Department of Taxation and Finance ("DTF").¹² They also allege that the proposal is unlawful because it "improperly combine[s] State tax interests with Federal Authority," and because "no Commission approved tariff should require a 'Customer' to submit tax forms or seek a tax exemption that could not lawfully be required by the taxing entity itself."¹³

In reality, the NYISO's proposal attempts to deal efficiently and fairly with the obligations imposed by New York State tax law. As the NYISO has previously explained, it submitted its proposed tariff revisions only after: (i) the DTF determined, over the NYISO's objections, that the NYISO was subject to New York State tax law as an "agent" of sellers in its markets; a determination that would normally impose substantial compliance obligations and potential tax liability on the NYISO; (ii) the DTF could not be persuaded to change this ruling; (iii) the NYISO recognized, based on the legal opinion of tax counsel, that any attempt to overturn the DTF's decision was likely to fail; and (iv) the NYISO stakeholder process concluded that the burdens imposed by New York State tax law would be *de minimis* provided

¹² Protest at 2.

¹³ *Id.* at 2, 12.

that the proposal were put into effect.¹⁴ The DTF has indicated that the NYISO will not be exposed to onerous compliance requirements if it institutes the proposal.

In short, the proposal would enable the NYISO to avoid administering transactions in its markets that the DTF has concluded would result in the NYISO being required to collect, report, and remit sales taxes. It will also protect the NYISO from exposure to potential liability for unpaid sales taxes.

If the proposal were rejected by the Commission, the NYISO would face extensive new obligations under New York State law as a sales tax collection agent. The ultimate result would be the imposition of heavier burdens on the market participants that use the NYISO's services and pay its costs. In particular, the NYISO would be distracted from its core functions of promoting open transmission access, competitive electricity markets, and system reliability, and forced to divert resources to tax compliance.¹⁵ It is therefore not surprising that all of the market participants who took part in the stakeholder process on these issues, barring a few abstentions, concluded that the NYISO's proposal was reasonable.¹⁶ If anything, the NYISO's proposal is consistent with the Commission's recent emphasis on controlling costs and accountability to stakeholders.¹⁷

¹⁴ See *Filing of Tariff Revisions to Address New York State Sales Tax Issues*, Docket No. ER05-1507-000 (September 23, 2005) ("NYISO Filing") at 3.

¹⁵ See NYISO Filing, n. 8 (stating that the NYISO would incur \$1,000,000 in initial costs and \$150,000 in recurring annual costs to establish, maintain, and operate a system to collect and remit sales taxes, and would encounter substantial administrative difficulty in determining when sales taxes applied to particular transactions.)

¹⁶ See Section III.D, below.

¹⁷ See *Accounting and Financial Reporting for Public Utilities Including RTOs, Notice of Proposed Rulemaking*, 111 FERC ¶ 61,352 (2005).

The only other alternative to the NYISO's proposal, short of outright refusal to obey the DTF's rulings, would be to forbid all purchases by "Direct Customers" in its markets. This would be a far more drastic, and ham-fisted, remedy than the one that the NYISO stakeholder process overwhelmingly approved and is currently proposed. Moreover, other alternatives were considered and rejected over the course of a lengthy and thorough stakeholder process.

As is discussed in greater detail in Section III.B, there is nothing unlawful about the NYISO's proposal. Whatever the legal status of the Protestors may be in New York, the NYISO is a New York State corporation and the DTF has subjected it to certain requirements. The NYISO's tariffs and the *pro forma* NYISO Service Agreements all require both the NYISO, and its market participants to comply with applicable state and local law. The NYISO's proposal is entirely consistent with these provisions and with Commission precedent.

2. *The Proposal Will Not "Embroid" The Commission In State Tax Issues, Rather It Is the Protestors that Are Trying to Embroid the Commission in their Opposition to the DTF's Determinations*

The Protestors falsely claim that the proposed tariff revisions would somehow "embroid" the Commission in New York State tax enforcement matters.¹⁸ The truth is that the NYISO's proposal does not call on the NYISO, or the Commission, to make fact-intensive inquiries or to interpret New York State tax law. One of the proposal's primary virtues is its simplicity and administrative efficiency. If a market participant fails to comply with the rules, it will be deemed to be in default after an appropriate cure period. Existing tariff procedures already govern default events. Far from embroiding the Commission in unfamiliar state law issues, the NYISO's proposal requires no Commission action at all.

¹⁸ *See id.* at 9.

It is actually the Protestors who are trying to embroil the Commission in complex state tax law issues, by urging it to overrule the DTF. The first two points in their “Statement of Issues” concern the meaning of New York State tax law and the scope of New York State’s authority. They also assert that neither their transactions, nor the NYISO itself, are subject to New York State tax law, which directly contradicts the DTF’s conclusions, as observed in a number of meetings with DTF staff. New York and federal tax law are outside the Commission’s usual area of expertise and are, at least arguably, beyond the scope of the Federal Power Act.¹⁹ Any attempt by the Commission to preempt the DTF would be likely to give rise to a major, and unnecessary, legal battle. The NYISO’s proposal avoids this conflict by establishing a minimally burdensome compliance regime that will satisfy the DTF. While the NYISO did not ask to be subject to New York State tax law in this area, it believes that compliance is its obligation. If the Protestors wish to challenge the DTF’s decisions they have every right to do so but they should not be permitted to drag the NYISO, or the Commission, into that fight.

3. *Market Participants, Including the Protestors Will Be Able to Satisfy the NYISO’s Minimally Burdensome Compliance Requirements*

Putting aside the question of whether the NYISO’s proposal is lawful, the Protestors also allege that they “simply cannot comply” with the proposed tax status verification requirements as a practical matter.²⁰ This is mistaken. When the NYISO prepared its filing it knew that marketers based outside of New York State would be subject to its requirements. Under

¹⁹ Moreover, as is noted in Section III.B.4 below, if the Commission actually reaches the merits of the Protestors’ tax law argument, which is not necessary for it to dispose of the Protest, it will find the argument to be insufficient to justify rejecting the NYISO’s proposal.

²⁰ Protest at 5.

proposed Services Tariff Section 8.4(A)(1), such entities need only provide the NYISO with a New York State Resale Certificate confirming that any purchases in the NYISO-administered markets were made for purposes of resale. As out-of-state entities that are not required to register with New York State, their Resale Certificates would identify the State(s) in which they are registered to collect taxes, or if they are not required to register, they would provide a statement to that effect. As was explained in the NYISO's original filing, the NYISO needs all market participants to provide Resale Certificates, or comparable "exemption documents" in order to avoid the imposition of more stringent DTF requirements.

B. The Protest Misrepresents the Law

1. The NYISO and all Market Participants Are Required to Comply with Applicable State Laws

The Protest claims that the NYISO's proposal is "inconsistent with Commission precedent and practice."²¹ It also insinuates that the NYISO is inappropriately trying to co-opt Commission authority to impose DTF requirements on them. The truth, however, is that there is nothing radical, or even novel, about the NYISO's proposal. The Commission has always expected jurisdictional utilities, including the NYISO, to comply with applicable State laws. The fact that the NYISO is pervasively regulated by the Commission does not mean that it is not subject to New York State tax law. The NYISO's proposal is at bottom an effort to fulfill its State law obligations in a way that minimizes the effects on its markets and market participants.

Specifically, the NYISO's Commission-approved Services Tariff expressly states that the NYISO and market participants must comply with all applicable laws. Section 3.3 provides that the tariff "and any related Service Agreement are made subject to all applicable federal, state and

²¹ Protest at 5.

local laws, regulations and orders.” Section 4.1.6, entitled “Customer Responsibilities” states that “[a]ll Customers shall comply with all applicable federal, state and local laws, regulations and orders.” Similarly, Section 3.0(d) of *pro forma* service agreement contained in Attachment A of the Services Tariff requires each Customer to warrant that it is in compliance with all federal, state and local laws, rules and regulations related to its performance under the agreement. Further, Section 3.0(c) provides that “[t]he execution, delivery and performance of this Service Agreement will not materially conflict with, constitute a material breach of, or a material default under, any of the terms, conditions, or provisions of any law or order of any agency of government....”²²

The Protesters do not cite, and the NYISO is unaware, of any precedent establishing that it is inappropriate or unlawful for a tariff to more specifically identify steps that must be taken to ensure compliance with State law. The fact that the more general language in the currently effective NYISO tariffs has existed to date does not make it invalid to have more detailed language to address the tax issues raised by the DTF.

Indeed, in this case, because the NYISO’s compliance with New York State tax law depends on its Customers, the most efficient path to compliance is to include the ministerial obligations that its Customers must meet in the Services Tariff. The NYISO has proposed to treat a Customer’s failure to follow the rules as a default in order to create a strong incentive for them to give the NYISO the documentation that it needs. This is appropriate because the consequences of market participant’s non-compliance are so serious for the NYISO, and by extension, all of its Customers. The rationale for the requirement is identical to justification for

²² Section 2.0 of the *pro forma* service agreement states that “this Service Agreement shall be subject to, and shall incorporate by reference, all of the terms and conditions of the ISO Services Tariff.” Presumably, this includes the Services Tariff provisions cited above.

creditworthiness requirements, *i.e.*, the credit rules protect the NYISO and other Customers from the harm that one Customer's failure would cause.²³ In any event, the system is not draconian, despite what the Protestors would have the Commission believe and Customers can easily satisfy the NYISO's requirements.

2. *The Protestors' Grossly Mischaracterize the Commission's Rulings in the Long Island Power Authority Proceeding*

The Protestors refer to a proceeding that had to do with the inclusion of the Long Island Power Authority's ("LIPA") non-jurisdictional rates in the NYISO's tariff, as evidence that the Commission has been "troubled" by attempts to address New York State tax law issues through Commission-jurisdictional tariffs.²⁴ This is a complete distortion.

The real issue in that proceeding was what standard of review the Commission should use when it examined the NYISO's filing of LIPA's rate information on LIPA's behalf. Because LIPA is a non-jurisdictional entity, its rates are normally subject to very limited scrutiny under the Commission's "reciprocity" standard. After initially determining that this standard should apply, the Commission reversed itself and decided to conduct a more searching inquiry. Subsequently, it reversed itself again and returned to its original position.²⁵ None of this had anything to do with the incidental fact that the protestors who were trying to get the Commission to use a more rigorous standard did so because they disagreed with LIPA's interpretation of New

²³ See, e.g., *Policy Statement on Credit-Related Issues for Electric OATT Transmission Providers, Independent System Operators and Regional Transmission Organizations*, 109 FERC ¶ 61,186 at P 17 (2004) ("ISO/RTO members are exposed to the credit risk of other members. In addition, ISOs/RTOs are generally not capitalized sufficiently to absorb the impact of defaults by market participants on an outstanding obligation.").

²⁴ Protest at 11.

²⁵ See *New York Independent System Operator, Inc.*, 111 FERC ¶ 61,366 (2005).

York tax law matters. The tax law particulars were totally unrelated to the reasons why the Commission (briefly) set the matter for hearing and it is misleading for the Protestors to suggest otherwise.

3. *The Natural Gas Precedent Cited By Protestors Is Entirely Consistent With The NYISO's Filing*

The Protestors try unsuccessfully to distinguish a series of Commission orders that allowed natural gas pipelines to include tax collection provisions in their tariffs.²⁶ As the Protest observes, “the Commission has permitted certain natural gas pipelines to include provisions in their tariffs involving the collection of taxes, but only when the pipeline was obligated by law to collect and remit taxes that were actually incurred by its customers.”²⁷ In these cases, “customers could simply inform the pipeline (*and verify*) that they are not subject to any such tax to avoid any further obligations or exposure under the tariff.”²⁸ What the Protest does not mention is that the actual tariff language at issue in the case it cites, which was approved by the Commission in various other pipeline cases,²⁹ stated that customers would pay the pipeline applicable taxes “which amount Transporter is obligated by law to collect and remit. If Customer is exempt from the obligation to pay such taxes, Customer shall provide Transporter with documentation establishing that exemption.”³⁰

²⁶ See Protest at 12.

²⁷ *Id.*

²⁸ *Id.* (emphasis added)

²⁹ See *Texas Gas Transmission Corp.*, 105 FERC ¶ 61,143, *reh'g denied*, 106 FERC ¶ 61,224 (2003); see also *Columbia Gulf Transmission Corp.*, Letter Order, Docket No. RP05-598-000 (Sept. 15, 2005); *Columbia Gas Transmission Corp.*, Letter Order, Docket No. RP05-597-000 (Sept. 15, 2005).

³⁰ See *Filing of Texas Gas Transmission Corp.*, Docket No. RP03-544-000.

The NYISO is here proposing tariff language that would permit customers, pursuant to DTF's determinations, to verify that they are not subject to the applicable state tax by submitting the appropriate documentation to the NYISO. Importantly, a key role of both the NYISO and the pipelines in the Commission's gas cases, is to verify that customers are not subject to the tax in question. While the NYISO's proposal is more descriptive, and provides detail on the different types of documentation that the customer can actually obtain and provide to the NYISO, its verification role is similar to that of the gas pipeline in the proceeding cited by the Protestors. It is misleading for Protestors to suggest that because the NYISO's proposal is more detailed it will somehow do more to "embroil" the Commission in tax issues that would normally be beyond its purview.

4. *The Protestors' Arguments On the Merits Are An Inadequate Basis for Commission Action*

As was explained above, the NYISO does not believe that it is necessary, or advisable, for the Commission to address the merits of Protestors' state and federal tax law arguments in order to dispose of the Protest. If the Commission chooses to consider the Protestors' arguments, however, it should reject them on the merits.

The Protestors only support for their claim that the NYISO's proposal is unconstitutional is a citation to the Supreme Court's *Quill* decision.³¹ They present *Quill* as conclusively holding that they are exempt from New York tax State law. Beyond this, the Protestors simply state that New York tax laws do not apply to them, or to the NYISO.

Even a cursory review of *Quill*, reveals, however that it establishes a complex, fact-intensive test for determining the extent of State taxing authority under the due process and

³¹ See *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992).

commerce clauses of the United States Constitution. It is not obvious that *Quill* exempts entities that are domiciled outside of New York State, but that participate in the NYISO-administered markets, from State authority.

The DTF is presumably well aware of *Quill* and other relevant judicial precedent. Nevertheless, it concluded that New York State tax law applies to the NYISO and to transactions in its markets. Other out-of-state power marketers that support the NYISO's filing have at least acquiesced to the DTF's interpretation. The NYISO itself is neutral on the merits of the question, but has decided to avoid a lengthy battle by filing its proposal with the Commission.

In any event, the Protest's assertions provide too scant record for the Commission to reasonably overrule the DTF, even assuming that it has the authority to do so. Just as importantly, the Protest's naked claim that the NYISO's tariff filing is unconstitutional falls far short of justifying its rejection, especially in light of the consensus stakeholder support that it enjoys.

C. Granting the Relief Requested by the Protest Would Undermine The NYISO's Independence

The Protest alleges that the NYISO should have exhausted all possible legal challenges to the DTF before filing its proposal with the Commission.³² There is absolutely no support for this proposition. As was noted above, the NYISO is obliged to comply with New York State law. Moreover, as an independent entity, it is up to the NYISO's Board of Directors and management, after consultation with legal counsel, to determine how it will go about complying. It is certainly not for the Protestors to dictate to the NYISO, or to second guess it on these matters. The Protestors have no right to compel the NYISO to adopt a legal strategy that the NYISO has

³² Protest at 9.

concluded is not in its own best interest or that of its stakeholders. It is true that the NYISO makes many policy decisions through a highly successful “shared governance” system. This is an instance, however, where Protestors are inappropriately attempting to interfere with decisions that it is the NYISO’s sole prerogative to make.³³

D. The Protestors Should Not Be Allowed To Make An End-Run Around The NYISO’s Stakeholder Process

The NYISO’s proposal was unanimously approved, with abstentions, by the NYISO Management Committee. This vote came at the end of extensive stakeholder discussions that included consultations with DTF staff. These discussions fully explored each element of the proposal over a several-month period. All market participants, including power marketers such as the Protestors, are represented on both the Management Committee and the other stakeholder groups that reviewed the proposal. Nevertheless, none of the Protestors participated in the development of the proposal or the vote that approved it. They are now attempting to make an end-run around the NYISO’s governance system and asking the Commission to invalidate the NYISO’s proposal.

The Commission has found on other occasions that it is inappropriate for entities to ignore their opportunities to influence the development of ISO/RTO tariff proposals and to simply attack them once they are filed.³⁴ The Protestors are doing precisely that here. Although

³³ See, e.g., *Atlantic City Electric Co., et al.*, 77 FERC ¶ 61,148 at 61,574 (1996) (“The principle of independence is the bedrock upon which the ISO must be built if stakeholders are to have confidence that it will function in a manner consistent with this Commission’s pro-competitive goals.”); *Wisconsin Electric Power Co., et al.*, 79 FERC ¶ 61,158 at 61,728 (same); *Alliance Companies, et al.*, 91 FERC ¶ 61,152 at 61,580 (2000) (“[A]n ISO or RTO must comply with our independence principles...[I]ndependence is paramount....”).

³⁴ See, e.g., *New York Independent System Operator, Inc.*, 90 FERC ¶ 61,319 (2000) (rejecting alternative ICAP recall bid proposal put forward by a single party in opposition to a system approved by the NYISO’s stakeholder committees); *Sithe New England Holdings, LLC*
(continued...)

failing to take advantage of the stakeholder process does not constitute a formal waiver of rights under the Federal Power Act, it is appropriate for the Commission to look with disfavor on entities that deprive ISOs, and other stakeholders, of the chance to understand their concerns and consider their views before making a Section 205 filing. In this case, it would be especially appropriate for the Commission to send a clear message that it expects market participants to avail themselves of the stakeholder process because some of the Protestors have previously failed to do so.³⁵ Rewarding market participants for ignoring stakeholder processes sets a bad precedent that will reduce their efficacy. Ultimately, this will increase the Commission's workload by undermining ISOs' and RTOs' ability to craft consensus proposals and increasing the number of disputed issues that will be left for the Commission to resolve.

and Sithe New Boston, LLC v. New England Power Pool and ISO New England Inc., 86 FERC ¶ 61,283 (1999); *reh'g denied*, 88 FERC ¶ 61,080 (1999) (rejecting a market participant's attempted unilateral revision of a complex arrangement developed by an ISO); *PJM Interconnection, L.L.C.*, 84 FERC ¶ 61,212 at 62,035 (1998) (“[W]e emphasize that in accepting PJM's proposed revisions . . . we deferred to the judgment of the PJM ISO and its Board concerning a regional solution to an identified regional problem based on what we understand is a broad, if not unanimous, consensus.”).

³⁵ In Docket No. ER05-941-000, EPIC Merchant Energy LP, one of the Financial Marketers, did not participate in the stakeholder process concerning the NYISO's proposal to revise its virtual trading credit limits, but later submitted a protest notwithstanding its failure to participate in the process.

IV. CONCLUSION

WHEREFORE, for the foregoing reasons, the New York Independent System Operator, Inc. respectfully requests that the Commission accept this answer and reject the Protest.

Respectfully submitted,

/s/ Ted J. Murphy
Ted J. Murphy

Counsel for
New York Independent System Operator, Inc.

Ted J. Murphy
Hunton & Williams LLP
1900 K Street, NW
Washington, DC 20006-1109

Michael Whiteman
Whiteman Osterman & Hanna LLP
One Commerce Plaza
Albany, New York 12260

November 15, 2005

CERTIFICATE OF SERVICE

I hereby certify that I have on this day served the foregoing document on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, DC this 15th day of November 2005.

/s/ Ted J. Murphy
Ted J. Murphy
Hunton & Williams LLP
1900 K Street, NW
Washington, DC 20006
(202) 955-1500

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