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FLUENT ENERGY

March 15, 2005

HON. JOHN W. BOSTON **Via Overnight Mail**
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:

Fluent Energy Corporation, a technical consultant that specializes in providing procurement and risk management services to retail access clients, including end user LSEs throughout New York State, hereby files an original and three copies of its Motion in opposition to the March 2, 2005 decision of the Management Committee to approve Gross Receipts Tax Tariff Language pertaining to certain end user LSEs.

At this time we do not request oral argument in support of this Motion, however, should another party request oral argument in connection with its filing we ask that the Board provide us the opportunity to participate in same. Please do not hesitate to contact the undersigned with any questions relating to this filing.

Very truly yours,

Fluent Energy Corporation

/s/ David W. Koplas

David W. Koplas
General Counsel

DWK/ms
Enc.

NOTICE OF APPEAL OF FLUENT ENERGY CORPORATION OF THE MANAGEMENT COMMITTEE'S APPROVAL OF MOTION ADDRESSING END USER LSE GROSS RECEIPTS TAX ISSUES

Fluent Energy Corporation ("Fluent"), a technical consultant that specializes in providing procurement and risk management services to retail access clients including end user LSEs throughout New York State, submits this appeal, more particularly set forth hereafter, to the Board of Directors ("Board") of the New York Independent System Operator ("NYISO"). Fluent's standing for the filing of this appeal is its status as a market participant and non-voting member of the NYISO, in accordance with the provisions set forth in Sections 5.07 and 7.03 of the ISO Agreement.

This appeal challenges the approval at the March 2, 2005 Management Committee ("MC") meeting of the motion to add tariff language qualifying the requirements applicable to Customers that seek to purchase any services under the NYISO Tariff for their own use. Fluent's basis for this appeal, more particularly set forth in the four (4) sections that follow, address the arguments that: 1) The NYISO should be extremely cautious when considering proposed modifications to its tariff that may be contrary to either state or municipal tax laws; 2) Given the breadth and depth of issues underlying the motion before the Board, it is ill-advised to adopt the proposed language absent additional review of the underlying legislative issues and any legal ramifications of its overall impact; 3) There is insufficient proof that there is any exposure whatsoever to Market Participants ("MPs") as a result of the purported Gross Receipts Tax concerns that gave rise to this motion; and 4) Entertaining motions purportedly designed to address certain MP's perceptions of competitive inequities sets a dangerous precedent.

1. The NYISO should be extremely cautious when considering proposed modifications to its tariff that may be contrary to either state or municipal tax laws.

While there is certainly not enough space available under the NYISO's Appeal provisions to address the concept of Federal authority to interfere with State governance and powers, the underlying premise of the motion before the Board appears to be at odds with this longstanding constitutional

principle. It is arguable that the MC's recommendation to modify the tariff to set forth the language approved by a majority of MPs at the March 2, 2005 meeting attempts to place requirements upon a distinct group of Load Serving Entities ("LSEs") – i.e. the so-called Direct Customers that purchase electricity for their own use – that by definition under any State or local municipal laws do not legally apply.[1] This motion, in effect, seeks to assign inapplicable tax obligations on end user LSEs, while at the same time attempting to redefine other MPs' tax obligations, premised upon a tax obligation that hasn't been *proven* to even exist.

Notwithstanding this fact, the proposed motion is designed to require end user LSEs to provide forms of proof (the availability of which has not been explored and in all likelihood are unobtainable) that neither they nor any other *potentially* liable party is subject to an *unproven* Gross Receipts Tax ("GRT") liability on end user LSEs' purchases out of the NYISO markets. Alternatively, end user LSEs may enter into arrangements whereby they create intermediary entities for the (re)sale of commodity "to themselves" in order to insulate any other parties from said *unproven* GRT liability. In addition to there being no desire to explore or confirm the likelihood that this *unproven* liability would ever materialize, in the event that any *actual* GRT obligation ever did materialize, this motion would effectively impose said obligation on an otherwise non-responsible party – which is arguable contrary to tax law.

Upon information and belief, the NYISO itself learned through discussions with the New York State Department of Taxation and Finance ("NYSDTF") that no entity, regardless of its structure or underlying purpose, is able to avoid obligations that are clearly defined by law.[2] Fluent supports language revisions that protect the NYISO from any MP's failure to remit any applicable Sales Tax on its purchases from the NYISO markets. Furthermore, in light of the underlying premise of the present

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[1] Gross Receipts Tax, in the context applicable herein, is defined as an income tax on a utility or energy marketer that is a reseller of utilities, which by definition does not include Customers purchasing services for their own use, which are the sole entities subject to the requirements set forth in the motion before the Board.

[2] The NYISO's obligation to collect Resale Certificates, Exemption Certificates or any other related forms as an agent of the State for ensuring that a mechanism was in place for the proper handling of any State Sales Tax applicable to MPs was clear, notwithstanding the NYISO's status as a not-for-profit corporation – said obligation being unrelated to the existence of end user LSEs under the NYISO model.

motion, if there is a concern regarding the non-remittance of Sales Tax as it may relate to any as yet undefined purchases of services by *any* MPs, the NYISO should take the appropriate steps to protect itself and all MPs from any *potential* exposure as a result thereof.

Whereas the basis for the yet-to-be finalized language addressing the NYISO's obligations relating to the handling of Sales Tax matters is in direct response to clear requirements set forth by the NYSDTF, the present motion is not based upon any defined requirement from any authoritative entity. The Sales Tax motion has been tabled, to presumably address NYSDTF concerns surrounding the impact of its language. However, the present motion to address *unproven* GRT liability – which MPs originally demanded to be linked to the Sales Tax motion – is before the Board with an apparent lack of concern regarding the impact of its language presumably due to the fact that there is no authoritative entity to either raise or consult with regarding any such concerns.

Beyond the fact that the NYISO may be exposing itself to arguments that it is acting in the absence of any actual requirement placed upon it, or any of its MPs, by any applicable taxing authority, the motion itself contains provisions that are conceptually incorrect. While the motion language has improved as a result of the discussions in the various Committees, proposed section 8.4.2[A][1] still contains improper provisions. Certain end user LSEs could properly submit Resale Certificates for sales tax purposes, however, this would not address questions relating to GRT liability.[3] This is an indication of the complications that result from an ill-conceived rush to judgment into a complex area of the law, and we respectfully suggest that prior to Board approval of the motion either it, or the MPs that passed this motion, identify the legal basis therefor.

2. Given the breadth and depth of issues underlying the motion before the Board, it is ill advised to adopt the proposed language absent additional review of the underlying legislative issues and any legal ramifications of its overall impact.

[3] In contrast, and a point that proponents of the motion refuse to accept, the creation of "reseller affiliates" for the sole purpose of maintaining LSE status is either problematic, or outright infeasible, for certain end user LSEs given their corporate governance structures.

A review of the recent history of opinions and concerns emanating from numerous politicians, as well as from the Attorney General's office, relating to both taxes and energy costs in New York State and their negative impact on the economy, is revealing. It is of further note that many of these opinions and concerns were raised at the outset of the formation of the NYISO – and, presumably, were intended to stress the need for and value of a truly competitive market in New York State – and were well prior to the significant increase in electricity prices that has transpired since.

One of the NYISO's "Specific Duties" is that it "[g]ives all Market Participants the same opportunity to participate on a comparable and non-discriminatory basis in the purchase and sale of capacity, energy, ancillary services and transmission congestion contracts."[4] The Federal Energy Regulatory Commission ("FERC") approved tariff clearly provided the opportunity for end user LSEs to directly purchase out of the NYISO administered markets, *without compromising the wholesale nature of said markets.*[5] The acceptance of this invitation by numerous entities that were and are willing to take on the costs and responsibilities inherent with the decision to operate as end user LSEs has facilitated the development of the competitive markets, and arguably represents one of the best examples of the benefits resulting from the NYISO model.[6]

Fluent provides consulting services to twenty-two (22) LSEs, including municipal aggregation groups, financial institutions, hospitals, universities, industrial and commercial entities – nineteen (19) of which are end user LSEs. Since the formation of the NYISO, the savings that end user LSEs have achieved through direct purchases out of the NYISO administered markets are likely in excess of Fifty (50) Million Dollars.[7] These savings, either directly or indirectly, translate into reduced taxes, improved

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[4] Taken from the NYISO Market Participant User's Guide: Section 2.1 NYISO Duties.

[5] "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*." [Emphasis Added] Taken from Section 1.49(e) of the NYISO Tariff.

[6] In securing its advisory opinion (Petition No. C990922A) from the Commissioner of Taxation and Finance, the NYISO indicated ". . . that as an independent and disinterested entity, it will aid in the transformation of the electric industry in New York from a monopoly – dominated by vertically integrated, investor owned utilities – to a competitive market *for the benefit of the general public*." [Emphasis added]

[7] While Fluent is not privy to the savings achieved by all end user LSEs since the inception of the NYISO, its clients have collectively saved in excess of Forty (40) Million Dollars.

services, lower tuition, and retention of employers, and the jobs that they represent, in the State of New York. It is difficult to imagine any greater "benefit of the general public," and to summarily discount the importance of end user LSEs to the market, or to adopt language that discourages their future participation, seems to contradict the NYISO's own goals, and the aforementioned political opinions and concerns.

As early as October certain MPs sought approval of an earlier draft version of the current motion before the Board, without any indication that a thorough review of the subject matter had been considered. In fact, Fluent introduced the only substantive analysis to the debate surrounding the Sales tax and GRT issues, which has been followed by virtually no further analysis by MPs, suggesting that the requisite care and detailed review of the myriad issues underlying this motion is glaringly absent. The underlying motivation for the State's repeal of its GRT, based on its own set of opinions and concerns regarding the need to reduce the negative impact of energy costs in New York State, suggests that the NYISO should carefully consider the impact of this motion prior to summarily adopting it at the insistence of certain arguably self-interested MPs.

In addition, there may be significantly better options to address the underlying concerns once they are *proven*, through a detailed and reasoned argument, to be valid and deserving of the tariff modification requested. Again, the complexity of tax law, combined with the legislative interests that may be largely unaware of the impact of this motion on numerous politically sensitive constituents, supports a more deliberate and comprehensive review by all interested parties prior to the NYISO acting upon this motion. Notwithstanding the fact that the NYISO's authority is derived from the FERC, it should not operate in a vacuum given that it must interact with State entities, and considering the impact that its actions will have on a wide range of interests.

3. There is insufficient proof that there is any exposure whatsoever to Market Participants as a result of the purported GRT concerns that gave rise to this motion.

The lack of any detailed analysis in support of this motion raises the additional concern that the proposed modification to the tariff would cause far more harm to certain MPs with very little, if any, benefit to those seeking the change. As set forth in greater detail in Section 4 below, the passage of this motion could effectively eliminate the existence of end user LSEs, while the creation of a resale entity that would essentially allow an end user LSE to resell energy to itself merely facilitates the ability to secure a Resale Certificate, which, as pointed out above, has no applicability to GRT whatsoever.

One of the underlying tenets of tax theory is that in order for a tax to be due and payable (or in the converse, to be collectible and enforceable) it must be subject to both identification and quantification. Furthermore, the party required to remit said tax must be in a position to calculate the amount due and payable in a manner that allows it to be included as a cost of doing business. As mentioned hereinabove, due to the fact that end user LSEs, by definition, are not subject to GRT, and the NYISO by virtue of Advisory Opinion C990922A is also exempt from paying said tax, the only other *potentially* responsible party is the generator.

Generators have raised numerous concerns regarding their lack of desire to sell directly to end user LSEs. These concerns, and the very structure of the NYISO markets, support the argument that the identification requirement is impossible to meet – an argument ignored by most of the MPs driven to secure the passage of the motion presently before the Board. Generators bid into the NYISO without any desire, let alone ability, to determine or control what LSE will ultimately use the energy that each generator is providing to the market. Accordingly, given end user LSEs' aforementioned exemption by definition, and the inability to attach any wholesale sale into the market to an individual, fractional purchase out of said market, the identification element is lacking.

The generators' additional and equally legitimate concern involves their inability to account for this *unproven* liability – i.e. that they could not possibly calculate their *potential* exposure and include it as a marginal cost component of their bid, given the NYISO bidding process. Once again, this concern is the very basis for the contention that the likelihood of any GRT ever being assessed in connection

with DC purchases from the NYISO is virtually nonexistent. On what basis would a local taxing authority credibly assign a quantifiable GRT liability on a seller into the NYISO, given the structure and operation of the markets?

In addition to the above arguments, there is the added complication of source and sink requirements that underlie a municipality's attempt to collect GRT pursuant to its local code. A review of assorted municipal GRT provisions yields a consistent requirement that is the basis for the municipality's ability to assess this tax: the transaction that gave rise to the tax must both originate and conclude within the municipality. Clearly, there is no plausible way for a municipality to prove that these requirements have been met given the configuration of the NYISO market, which further supports the contention that the likelihood of any liability arising from end user LSE purchases from the NYISO administered markets is suspect, at best.

Notwithstanding these obstacles to any assessment of GRT, the MPs that are supporting this motion seek to impose requirements that could essentially preclude the ability for end user LSEs to continue to operate. The apparent goal is to completely insulate generators from improbable and *unproven* costs, which will arguably never materialize. The benefits derived from protecting a group of MPs from this extremely unlikely and *unproven* liability are far outweighed by the costs to end user LSEs as a result of this motion. This scenario suggests that the NYISO should exercise its powers under Section 3 of the NYISO Strategic Plan 2004-2008 in order to prevent the potential elimination of a group of market participants that have been key contributors to the development of the State's deregulated energy markets.[8]

4. Entertaining motions purportedly designed to address certain MP's perceptions of competitive inequities sets a dangerous precedent.

[8] Section 3 (Ensure Governance Structure is Fair and Balanced) includes as its Critical Activities: "The NYISO may also examine whether any entity or group of entities exerts undue influence, or chills the activities of Market Participants (whether or not such entities are Market Participants)" and "The NYISO management and Board will also remain vigilant to be sure that a "tyranny of the majority" does not compromise the goals of fairness and independence of the organization."

The objective of the NYISO governance system is to "[m]aintain and enhance a governance process that assures market participants, regulators and the public of its fairness, efficiency and independence." The initial, primary reason offered for this motion seems to completely contradict this objective,[9] and the NYISO should refrain from entertaining motions from MPs to address purported competitive inequities in its markets. This precedent is all the more dangerous when the NYISO is asked to address concerns relating to highly technical issues of tax law whose jurisdiction is narrowly defined under State and local law.

Arguably, LSEs that purchase energy for their own use are the quintessential entities for which the NYISO was formed. The end user LSE's ability to participate in a market that facilitates open competition and allows participants to directly purchase energy at wholesale prices seems to emulate the NYISO's mission statement and overall goals and objectives. In contrast, the MP that raised the concerns that resulted in the passing of the present motion appears motivated by its desire to insulate itself from competitive alternatives. Furthermore, the MPs that lobbied strongly for the passing of this motion – i.e. the generators – are also driven by the ability to profit from the NYISO markets. While generators are clearly necessary to ensure a functional and reliable system, they are perhaps also prone to resort to protective measures when there is even a de minimus perception that profit margins may be at risk.

It is hardly objectionable that MP's actions are driven by profit motive, or that they may seek competitive advantage where possible, but it is improper when such actions are pursued at the expense of other MPs, and retard otherwise healthy competition. End user LSEs seek simply to secure energy savings while complying with all applicable laws and the requirements as set by the NYISO – so long as the costs merit it. The Board should not be seen to condone a process that resulted in the passing of a

[9] ConEd Solutions' initial concerns suggesting the need to address the GRT impact relating to end user LSE purchases were based upon the competitive disadvantages that it faced when attempting to serve end user LSEs that were able to purchase directly from the NYISO administered markets.

motion that, while promoted as necessary to avoid competitive advantage, severely limits the ability of a subset of MPs to exercise their rights as clearly set forth in the tariff.

CONCLUSION

For the reasons set forth hereinabove, Fluent urges the Board to deny the GRT motion as approved by the Management Committee.

Dated: March 14, 2005
Buffalo, New York

Respectfully submitted,

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