

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-02(18)C
Corporation Tax
November 7, 2002

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C020412C

On April 12, 2002, a Petition for Advisory Opinion was received from NRG Energy, Inc., 901 Marquette Avenue, Suite 2300, Minneapolis, Minnesota 55402.

The issue raised by Petitioner, NRG Energy, Inc., is whether its receipts for maintaining electric generating capacity are taxable under section 186-a of the Tax Law as “gross operating income” from the sale of electricity or the furnishing of electric service.

Petitioner submits the following facts as the basis for this Advisory Opinion.

Petitioner is an independent power producer operating electric power plants in New York City and in upstate New York. Petitioner’s revenues from sources in New York State are derived primarily in two ways: (1) the sale of electricity and (2) the sale of electric generating capacity. All of Petitioner’s sales of electricity in New York are to resellers.

The New York regional power market is subject to supervision by the New York Independent Systems Operator (NY-ISO). The NY-ISO must deal with the physical fact that, for the electric grid to function properly, electricity supply must equal electricity demand at every instant in time. Because electricity demand by all but the largest consumers cannot be readily regulated, the NY-ISO attempts to match supply and demand by regulating the persons who buy the electricity for resale to end-users, such as public utilities or unregulated electricity marketers. Collectively, these resellers are called Load Serving Entities (LSEs). Under the NY-ISO’s rules, an LSE must not only purchase the electricity which it will resell to its customers but must also purchase an amount of electric capacity from businesses which generate electricity (“electricity generators”) based upon the anticipated demand for electricity by the customers who have contracted with that LSE to supply them with electricity. The supply of electric capacity represents the commitment by an electricity generator to maintain the capacity needed to supply a certain amount of electricity to the market if the NY-ISO deems that such electricity is needed to meet demand.

Petitioner typically enters into capacity agreements with LSEs whereby Petitioner will commit to maintain a certain amount of electric generating capacity to satisfy the LSEs’ commitment to the NY-ISO to purchase capacity. The capacity agreement does not commit Petitioner to sell any electricity to any particular power reseller or at any particular price. To purchase electricity, LSEs can either negotiate bilaterally with electric generators or they can participate in the NY-ISO’s auction.

Petitioner states the following are representative provisions of a typical capacity agreement:

1. Petitioner agrees to “maintain the electric generating capability of the [plant] at specified levels ... and whereby, during certain periods, [the LSE] will purchase from [the plant and the plant] will sell to [the LSE], specified amounts of Installed Capacity.” The term “Installed Capacity” is defined to mean electric generating capacity of the plants that satisfies all the requirements applicable to installed capacity imposed on the LSE by the NY-ISO or its predecessor, the New York Power Pool.
2. During the term of the agreement, Petitioner agrees to use commercially reasonable efforts to maintain the electric generating capability of the plants at specified levels.
3. The LSE remits a Capacity Payment on a monthly basis to each power plant equivalent to the annual rate of \$X per kilowatt of Installed Capacity. In the event the plants do not maintain adequate capacity, the owner of the plant is required to submit a Capacity Deficiency Payment to the LSE.

Applicable Law

Section 186-a.2(d) of the Tax Law provides that the words “gross operating income” mean and include:

receipts received in or by reason of any sale, conditional or otherwise, made for ultimate consumption or use by the purchaser of gas, electricity, steam, water or refrigeration, or in or by reason of the furnishing for such consumption or use of gas, electric, steam, water or refrigerator service in this state, including cash, credits and property of any kind or nature, without any deduction therefrom on account of the cost of the property sold, the cost of materials used, labor or services or other costs, interest or discount paid, or any other expenses whatsoever. . . .

Opinion

The NY-ISO is a not-for-profit corporation created in response to New York State and federal regulatory initiatives: (i) to promote competition in the supply of electric energy; (ii) to assure continued reliable, safe and secure operation of the New York State bulk electric transmission system in a competitive environment; (iii) to administer economically efficient spot markets for the wholesale trading of electric energy, capacity and related ancillary services; and (iv) to reduce the reliance upon government regulatory intervention to protect the interests of consumers and the

general public. As an independent and disinterested entity, the NY-ISO is aiding in the transformation of the electric industry in New York from a monopoly to a competitive market for the benefit of the general public. In a fully competitive market, generators will compete to supply wholesale electric energy and capacity, and energy service companies will compete to provide retail electric services to end users. For the public to benefit fully from competition, the bulk electricity transmission system (the electric grid) must be operated on an economically sound, nondiscriminatory basis, while remaining safe, reliable and secure. At the same time, spot markets for electric energy need to be operated efficiently and in a nondiscriminatory manner, both to facilitate the operation of a fully competitive market and to provide the proper economic signals for the dispatch of electric energy over the electric grid. The NY-ISO is responsible for the operational control of the electric grid and the administration of the spot markets for electricity. (The New York Independent System Operator, Inc., Adv Op Comm T&F, January 14, 2000, TSB-A-00(1)C)

In order for the electric grid to function properly, electricity supply must equal electricity demand at every instant in time. Therefore, the NY-ISO attempts to match supply and demand by regulating the LSEs, the resellers of electricity. In addition to purchasing the electricity that it will sell to its customers, an LSE must also purchase an amount of electric capacity from electricity generators as required by the NY-ISO. The supply of electric capacity represents the commitment by an electricity generator to maintain the capacity needed to supply a certain amount of electricity to the market if the NY-ISO deems that such electricity is needed to meet demand.

Petitioner, as an electricity generator, enters into capacity agreements with the LSEs whereby Petitioner commits to maintain a certain level of electric generating capacity necessary to meet the LSEs' anticipated demand for electricity by the market, based on requirements imposed on the LSEs by the NY-ISO. This commitment is necessary in order to fulfill the NY-ISO's responsibility for the assurance of safe and reliable electric service in the New York regional power market at all times.

Thus, Petitioner's receipts for maintaining electric generating capacity, pursuant to its capacity agreements with the LSEs, are directly connected to the furnishing of electricity. The definition of gross operating income under section 186-a.2(d) of the Tax Law includes receipts from the furnishing of electric service for ultimate consumption in New York State, as well as receipts from the sale of electricity for such consumption. Although Petitioner's capacity agreements do not commit Petitioner to sell electricity to any particular LSE at any particular price, Petitioner does furnish an electric service pursuant to these agreements for purposes of section 186-a.2(d). Accordingly, Petitioner's receipts from its capacity agreements constitute receipts from the furnishing of electric service. However, the commitment to maintain electric generating capacity is a component of the electricity or electric service resold by the LSEs to the LSEs' customers for ultimate consumption or use in New York State. Accordingly, since the furnishing of such electric service is not for the ultimate consumption or use by the LSEs (but a sale for resale),

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Petitioner's receipts from such capacity agreements do not constitute gross operating income under section 186-a of the Tax Law.

DATED: November 7, 2002

/s/
Jonathan Pessen
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NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.