NEW YORK CITY TAX APPEALS TRIBUNAL
ADMINISTRATIVE LAW JUDGE DIVISION

In the Matter of the Petition	**DETERMINATION**
of	**TAT(H) 04-32(UT)**
CASTLE POWER, LLC	

Schwartz, A.L.J.:

Petitioner, Castle Power, LLC, filed a Petition with the New York City ("City") Tax Appeals Tribunal ("Tribunal") requesting the redetermination of a deficiency in City Utility Tax ("UT") under Chapter 11 of Title 11 of the Administrative Code (the "Code") for the period beginning January 1, 1998 and ending December 31, 2002 (the "Tax Years").

A hearing was held before the undersigned on December 12, 13, and 14, 2005 at which testimony was taken and exhibits, including a stipulation of facts with accompanying exhibits, were entered into the record. The parties submitted Briefs and Reply Briefs, the last of which was submitted on April 19, 2006. Supplemental briefing was requested and the final submission was received on September 6, 2006. Petitioner was represented by Peter M. Metzger, Esq. and Joseph P. Stevens, Esq., of Cullen and Dykman LLP. Deborah M. Franco, Esq., also of Cullen and Dykman LLP, participated on the Briefs. The Commissioner of Finance (the "Commissioner" or "Respondent") was represented by Robert J. Firestone, Esq., who was then Senior Counsel of the City's Law Department and by Martin Nussbaum, Esq., Assistant Corporation Counsel.

ISSUES

I. Whether retail sales of natural gas made by Petitioner to end-users with premises in the City took place at the meters owned by the utility companies at the end-users' premises, in which case Petitioner would be subject to the City UT; or whether the sales took place outside the City as provided for in the contracts for the sale of the gas, in which case the City UT would not apply.

II. Whether Petitioner may recover from the City for the costs of contesting this matter.

FINDINGS OF FACT

1. During the Tax Years, Petitioner was a gas marketer who was in the business of supplying natural gas at retail to end-users. Such end-users owned or occupied premises located in the City and in other locations within and without New York State (the "State"), where the gas was ultimately used or consumed by such end-users.

2. Gas used in the City is made available by producers who find the gas and produce it in production areas such as the Gulf of Mexico. The gas is transported from the production areas via interstate pipelines to the "city gates"[1] which connect to the gas pipelines owned by Consolidated Edison ("Con Edison") or Brooklyn Union Gas ("BUG") (the "Utilities"), the two regulated Local Distribution Companies ("LDCs") that provide gas service within the

[1] The city gates are not necessarily at the border of the City. The term refers to designated points on the gas distribution system where the LDC takes delivery of the gas from a pipeline source. The city gate locations involved in this case were located in Staten Island, New York and in White Plains, New York.

City. The Utilities transport the gas locally via their pipelines from the city gates to the consumers' premises. Historically, small consumers in the City purchased "bundled" service from the Utilities which included both the gas as a commodity and the transportation of that gas from the city gate to the consumers' premises. However, in recent years, some consumers purchased their gas directly from marketers such as Petitioner and the Utilities just provided transportation of that gas from the city gate to the consumers' premises. It is this type of transaction that is at issue here.

3. Historically, the interstate pipeline companies, which owned various interstate pipelines and which are regulated by the federal government, controlled the price of gas because they provided the only means for the sale and distribution of gas from the production areas to the LDCs. In the late 1970s, because there was an insufficient supply of gas, the federal government permitted end-users to by-pass the interstate pipeline companies and contract directly for their gas supply and transportation and to have their gas delivered to the city gate.[2] At that time, certain large customers in the City, such as Long Island University and Domino Sugar, had sufficient gas requirements and had the resources to engage in these types of transactions. These purchases of gas by large customers generally took place outside the State and close to the production areas. A further relaxation of the rules occurred in the mid 1980s, when the Federal Energy Regulatory Commission ("FERC") issued an order allowing the interstate pipeline companies to transport gas owned by others. Then, in 1992, FERC issued FERC

[2] For a history of federal gas deregulation, *see General Motors Corp. v. Tracy*, 519 U.S. 278, 283-297 (1997); *Tennessee Gas Pipeline Co. v. Urbach*, 96 N.Y.2d 124 (2001).

Order No. 636[3] ("Order 636") which required the interstate pipeline companies to "unbundle" the sale of the gas commodity from its distribution and to act solely as common carriers and no longer sell gas (the "Federal Restructuring"). The Federal Restructuring opened up the sales of gas by the producers as an unregulated commodity, the price of which was subject to market competition.

4. Even after the Federal Restructuring, it was still impractical for home owners or small businesses to arrange for their own purchase and transportation of gas because the quantities used by them were too small[4] and they did not have the expertise to make the necessary arrangements. The states responded by beginning to restructure the local gas industries to enable small customers also to obtain the benefit of market competition in the price of gas.

5. The agency that regulates gas sales and distribution in the State is the New York Public Service Commission ("NYPSC"). The NYPSC requires the LDCs to prepare tariffs setting forth their rate schedules and business practices. These tariffs must conform to NYPSC requirements to be approved by the NYPSC. In the mid 1990s, the NYPSC instituted a proceeding to consider and evaluate possible responses to Order 636, *supra*, at the State level.[5] The NYPSC held

[3] 57 Fed. Reg. 13267 (April 16, 1992) codified at 18 C.F.R. Part 284.

[4] A home uses about 100 decatherms a year and a commercial business uses about 2,000 decatherms, whereas most LDCs required a quantity of 5,000 decatherms a year to transport gas owned by someone else.

[5] Official notice is taken of: *Proceeding on Motion of the Commission to Address Issues Associated with the Restructuring of the Emerging Competitive Natural Gas Market*, 1994 N.Y. PUC LEXIS 118 (N.Y. PUC 1994) ("NYPSC December 20, 1994 Order"); *Proceeding on Motion of the Commission to Address Issues Associated with the Restructuring of the Emerging Competitive Natural Gas Market*, 1996 N.Y. PUC LEXIS 66 (N.Y. PUC 1996) ("NYPSC March 28, 1996 Order"); *Proceeding on Motion of the Commission to Address Issues Associated with the Restructuring of Emerging Competitive Natural Gas Market,* 1996 N.Y. PUC LEXIS 533 (N.Y. PUC 1996) ("NYPSC September 28, 1996 Order") (collectively, "NYPSC Orders").

hearings and settlement discussions among various segments of the gas industry, including the marketers, the LDCs, the large industrial customers, consumer advocates and various government interests including the City. The purpose of these proceedings was to create a structure under which the gas industry could operate which would deal with the various practical problems of permitting small customers to purchase gas from someone other than an LDC.

In 1996, the NYPSC restructured the gas industry in the State to enable small customers to purchase gas in the free market from marketers such as Petitioner and required the LDCs to transport gas for those customers (the "State Restructuring"). The NYPSC was concerned, *inter alia*, with protecting the safety of the gas distribution system and the consumer while, at the same time, providing for a competitive gas market.[6]

In order to deal with the various administrative problems that made individual purchases of small volumes of gas impractical, the NYPSC permitted the marketers to create "aggregation pools" of customers such that the aggregate quantity of gas used by the pool was large enough to minimize various administrative problems. The NYPSC noted that "[t]he goal [of aggregation groups] is to enable smaller customers to enjoy some of the benefits of competition that have only been available to the larger gas users."[7]

6. The State imposed a tax on utility services, Tax Law §186-a (the "State UT"), which is known in the gas industry as the "State Gross Receipts Tax." The State UT is very similar to the

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[6] NYPSC December 20, 1994 Order, fn.5, *supra,* at 3.

[7] NYPSC March 28, 1996 Order, fn. 5, *supra*, at 25.

City UT and is imposed on retail sales of gas within the State. The Utilities and others selling gas at retail in the City passed the cost of both the State UT and the City UT through to the gas consumer by including it in the cost of gas on the bills remitted by the seller of gas to the customers. When large customers bought gas for their own use, they generally purchased it outside the State and thus avoided the State UT and the City UT. Tr. pp. 511-512.[8]

7. In an attempt to impose a comparable State tax burden on gas consumers purchasing gas out-of-state, in 1991, the State enacted a tax known as the "Gas Importer Tax" pursuant to Tax Law §189 (the "State GIT") on the importation of gas purchased outside the State for the purchaser's own use within the State. This tax required consumers who purchased gas outside the State for consumption within the State to bear a State tax cost comparable to consumers who purchased gas within the State.[9] To date, a comparable City gas importer tax ("City GIT") has not been enacted, although the City attempted, in 2005, to obtain such a tax.[10]

8. The NYPSC and the participants in the State Restructuring process anticipated that as a result of such restructuring, increased sales would take place outside the State and City resulting in possible additional losses of tax revenues. The marketer groups believed that this would give them a competitive

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[8] *See Penn York Energy Corporation*, 1992 NY Tax LEXIS 507 (State Tribunal, October 1, 1992); TSB-A-96(85)S (December 26, 1996); TSB-A-96(13)C (May 8, 1996); TSB-A-95(8)C (April 20, 1995); TSB-A-91(11)C (April 29, 1991). State Department of Taxation Advisory Opinions are not binding on this forum and are being cited merely to corroborate Petitioner's witnesses' testimony that large gas purchasers were able to purchase gas out of State and avoid certain taxes.

[9] *See* L. 1991, c. 166, §149.

[10] S4780, T. Ex. 11.

advantage over the LDCs. Tr. pp. 530-534. Because the Utilities' sales took place in the City, the Utilities had to pass along the cost of the City UT at 2.35 percent of their revenues to those customers who bought gas from the Utilities. By selling gas outside the City, the gas marketers could avoid the City UT and could offer lower prices than the Utilities, placing the Utilities at a competitive disadvantage. For this reason, during the State Restructuring Proceeding, BUG requested that the NYPSC impose some sort of "affordability fee" on the sales by the gas marketers so that those marketers would not have a competitive advantage over the Utilities. However, the NYPSC did not agree to this proposal, stating:

> We find that it [the requested affordability fee] is a barrier to lower energy prices for consumers. We would expect that any savings will be shared between marketers and consumers and that as competition develops the sharing will increasingly inure to consumers' benefit.
>
> **The tax law is not of our making and, in this instance, presents an issue that the Legislature may wish to address.** [Emphasis added.][11]

9. Petitioner is a limited liability company formed pursuant to the Delaware Limited Liability Company Act and is a wholly owned subsidiary of Castle Oil Corp. Petitioner was formed after the State Restructuring went into effect and it entered the gas marketing business as that business had been restructured by the NYPSC.

10. Petitioner neither owned nor operated any property within the City. Petitioner neither sought nor received any franchise,

[11] NYPSC March 28, 1996 Order, fn. 5, *supra*, at 40.

consent, permit or other authorization from the City to do or conduct business in the City; nor was any claim asserted that any such franchise, consent, permit or other authorization was required by Petitioner. Petitioner's only office in the State was located outside the City in Harrison, New York (the "Harrison Office"). All of Petitioner's employees in the State were located in the Harrison Office. However, occasionally some of Petitioner's employees would visit customers in the City to solicit business.

11. During the Tax Years, Petitioner entered into written sales contracts (the "Sales Contracts") with its retail customers. The terms and conditions of the Sales Contracts were developed and approved in the Harrison Office; no Sales Contract was binding on Petitioner until it was executed by an officer in the Harrison Office.

12. Petitioner was not affiliated directly or indirectly with either of the Utilities or with any of the interstate pipeline companies that transported gas for use by its customers in the City. Nor did Petitioner own, operate, lease or control any gas pipelines, mains, services or related equipment.

13. Petitioner purchased gas from various producers and arranged for that gas to be delivered to the place where the producers' pipelines intersect with the interstate pipelines (the "Transfer Points"). These are the points at which gas purchased near the production areas first enters the interstate pipelines. There are meters at the Transfer Points so that a purchaser of gas from a producer can confirm that the amount of gas delivered to an interstate pipeline matches the quantity purchased. The Transfer Points involved in this case were located in Mississippi and Louisiana. Petitioner arranged for the interstate pipelines to

deliver the gas to the city gates. There are also meters at the city gates which are used so that the owner of the gas and the Utility that will be transporting the gas locally know how much gas was delivered through the interstate pipeline to the city gate. The Utilities took possession of the gas at the city gates and delivered it to Petitioner's customers' premises. There are meters at the customers' premises which measure the actual amount of gas burned by the customers at those premises. The meters at the customers' premises are owned by the Utilities and meter readings are taken by the Utilities for billing purposes.

14. The NYPSC publishes tariffs which are issued by an LDC under the authority of an order of the NYPSC. These tariffs control the activities the LDCs may engage in, including their rate structures and also indirectly control certain transactions that a gas marketer such as Petitioner may engage in, to the extent that the marketer's activities rely on services provided by the LDCs. The Utilities' tariffs apply to various service classifications (designated "SC" in the tariffs). Under some service classifications, a retail customer purchases gas directly from the Utility and the Utility also transports the gas to the customer's premises. This type of customer receives one gas bill from the Utility that covers both the gas commodity and its transportation. This type of "bundled" service is what was historically available before the State Restructuring and it continues to be the service used by most small retail customers following the State Restructuring. These transactions are not at issue here.

In connection with the State Restructuring, the Utilities issued tariff provisions covering other service classifications mandated by the restructuring. Under certain service classifications, the retail customer purchases gas and certain related services from a marketer (referred to as the "Seller" in the tariffs) who also arranges for transportation of the gas to the city gate and purchases transportation of the gas from the city gate to the customer's premises and certain other related services from the Utility. This type of customer is referred to as receiving "Transportation Service" from the Utilities. This type of customer receives two gas bills, one from the marketer for the gas commodity and related services, and another from the Utility for the cost of transporting the gas from the city gate to the customer's premises and related services. The portions of the Utilities' tariffs which apply to customers receiving Transportation Service are SC 9 in the case of Con Edison customers and SC 16, 17, or 18 in the case of BUG customers. Petitioner's customers were billed by the Utilities for transportation service charges as provided by BUG under SC 16, 17, or 18 and by Con Edison under SC 9.[12] It is this type of transaction that is at issue in this matter.

15. Under Con Edison's SC 20, a "Seller" is defined as "a supplier of natural gas to an SC 9 Customer or Small Customer Aggregation Group who meets the requirements of this Service Classification and submits an application for SC 20 service," and a "Customer" is defined as one that receives SC 9 transportation

[12] Both Petitioner and Respondent used Arabic numerals when preparing their respective exhibits for the hearing. Exhibits will be identified as "T" (for "Taxpayer/Petitioner") Ex. -; "C" (for "City/Respondent") Ex. -; "J" (for "Joint") Ex.; - and "Trib." Ex. - (for "Tribunal"). Petitioner and Respondent each provided a version of these various tariff provisions to be entered into the record as exhibits. The tariff provisions are amended from time to time and various pages are updated. Petitioner's version of Con Edison SC 9, T Ex. 7A, contains Tariff Leaves 50-B and 51 with effective dates of May 9,1997 and May 1, 1996, respectively. Subparagraphs C and D on those pages are substantively identical to Subparagraphs C and D that appear on Respondent's version of Con Edison SC 9, C Ex.2, Tariff Leaf 305, Subparagraph C, (effective August 1, 2001). Both versions state they are applicable both to individual customers and to customers "that are part of a Group." *Id*.

service.[13] Similarly, the BUG SC 19 tariff defines a "Seller" as "a person or entity that meets the Seller qualifications under this Service Classification and is selling gas to a Pool." A "Pool" is defined as:

> A group of customers to whom a Seller is selling gas, who are receiving transportation service pursuant to [SC 16, 17, or 18] whose gas usage is aggregated by the Seller for the purpose of providing service under this Service Classification.[14]

During the State Restructuring Proceeding, the NYPSC made it clear that the LDCs' tariffs would be required to provide that the LDCs were transporting gas owned by the small customer, rather than that the LDCs would be transporting gas owned by the marketers. As stated by the NYPSC, under the State Restructuring, the gas marketers:

> simply arrange for the purchase of the commodity in a competitive market and the transportation of that commodity from the wellhead to the customer. **Indeed, end users remain the customers of the utility for transportation. . . . n.3**
>
> **n.3 [A portion of a prior NYPSC Order] should not be read to make marketers/aggregators the customers for transportation; the LDCs' tariffs make the end users the transportation customers.** [Emphasis added.][15]

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[13] T Ex. 7(B), Leaf 97 (effective May 9, 1997); C Ex. 1, Leaves 364 and 365. (effective dates 2001 and 2002).

[14] T Ex. 7F, Leaf 144, (effective May 1, 1996); C Ex. 7, Leaf 400 (effective October 1, 1998).

[15] NYPSC September, 1996 Order, fn. 5, *supra*, at 35.

The interstate pipeline companies understood that Petitioner was acting as the agent for a pool of customers when it arranged for a quantity of gas to be delivered by the interstate pipeline to the city gate of the Utilities.[16] The Utility took possession of the gas and transported gas to each of Petitioner's customers and provided balancing service (discussed in Finding of Fact 21, *infra*) to those customers such that each customer received the amount of gas actually needed.

16. In connection with the State Restructuring and with input from the gas industry, the NYPSC developed a sample gas contract (the "NYPSC Sample Contract")[17] to reflect industry practice and to serve as a model so that marketers who wanted to sell gas to small customers in the State would know that they could get their contract approved by the NYPSC if they followed such form of contract. The NYPSC Sample Contract also served as a model for consumers to know that their particular marketer's business practices were not out of the ordinary. The NYPSC Sample Contract was eventually posted on the NYPSC website. Prior to the State Restructuring, large customers who purchased gas directly from marketers generally used agents (most often the marketers themselves) to handle various administrative matters such as arranging for the transportation of the gas for the customer to the city gate. The NYPSC adopted this common industry practice of the use of agents to the small customers in an aggregation pool. The NYPSC Sample Contract provides in part that:

[16] The City's Department of Finance (the "Department") was made aware of this agency arrangement during the course of the audit of Petitioner in this matter. The City's audit workpapers contains a remittance advice showing payment to Transcontinental Gas Pipe Line Corp. from "Castle Power Corp. A/A for Pooled Customers." *See* Ex. D, p. 3 of 5 of C Ex. 24.

[17] T Ex. 12.

> Buyer authorizes (marketer) to act as Buyer's designated agent for the arrangement for delivery and transportation of natural gas from the transfer point(s) to the respective LDC's City Gate. (Marketer) will act on Buyer's behalf to provide coordination functions thereunder, including but not limited to nominating,[18] scheduling and balancing.[19]

17. Petitioner's Sales Contracts designated Petitioner as that customer's agent[20] and authorized Petitioner to aggregate or pool the customer's gas supply with those of its other customers. Petitioner, as the pooled customer's agent, generally scheduled with the interstate pipeline transporters the quantity of natural gas to be delivered to the Utilities based on estimates derived by the relevant Utility from the customer's historical usage. Most of Petitioner's retail customers were pooled customers.

18. Con Edison provided a form for a separate agency agreement (the "Con Edison SC 9 Agency Agreement", T Ex. 13) that it required to be executed by a customer who wished to appoint an agent. That agreement was used to confirm the designation of a marketer, such as Petitioner, as the customer's agent to perform various functions, including:

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[18] "Nominating" involves prearranging the scheduling for transportation of gas with a pipeline.

[19] "Balancing" is the process under which the Utility delivers to the customer only the amount of gas used by that customer in a particular time period, which amount can be more or less than the amount the Utility required the marketer to cause to be delivered for the customer's use.

[20] While Respondent stipulated that Petitioner's Sales Contracts designated Petitioner as its customers' agent, she did not stipulate to any of the specifics regarding that agency relationship.

> (1) arrange gas transportation services from Con Edison; (2) nominate, schedule, and perform other gas control functions in connection with Con Edison's gas transportation services; . . . [and] (6) pay the pipeline for all applicable charges associated with the use of released capacity[21] to serve my account(s).

The Con Edison Agency Agreement went on to state:

> Con Edison should consider the nominating, scheduling, and other gas control functions performed by Agent as those of Customer. Customer will indemnify Con Edison and hold it harmless from any liability . . . that Con Edison incurs as a result of Agent's negligence or willful misconduct in its performance of agency functions on Customer's behalf.

When Con Edison requested that Petitioner do so, Petitioner obtained this document from its customers and provided it to Con Edison.

19. The NYPSC Sample Contract (T Ex. 12) also provides that the "(Marketer) will supply the Buyer's full requirements for natural gas on a firm[22] basis and will be responsible for any

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[21] The Utilities have arrangements with the interstate pipeline companies guaranteeing the Utilities the capacity to transport certain quantities of gas on those pipelines. The Utilities could release a portion of their capacity to an authorized marketer such as Petitioner and the marketer could enter into an agreement with the relevant pipeline company for use of that capacity. *See* T Ex. 14 and C Ex. 14.

[22] "Firm customers" are customers whose gas service was not to be interrupted. A marketer was required to insure that each firm customer received the necessary amount of gas each day. Firm customers are to be distinguished from "interruptible customers" who may have an alternative fuel source, such as oil, that can be used if the amount of gas delivered for their use is insufficient at a particular time.

penalties imposed by the LDC for failure to deliver." Most of Petitioner's City customers during the Tax Years were "firm" customers. Petitioner was required to demonstrate sufficient interstate pipeline delivery capacity to the Utility within whose service area the firm customer was located in order to assure that required quantities delivered by the interstate pipelines would not be interrupted. Petitioner also sold natural gas to some "interruptible" customers during the Tax Years.

20. Under the applicable tariffs, the Utilities required Petitioner to schedule deliveries of specified quantities of natural gas to the city gate based upon estimates provided by the Utilities for each customer (derived from the customer's historical consumption data). Petitioner had no discretion regarding the amount of gas it scheduled for delivery to the city gate. Accordingly, Petitioner caused to be delivered to the Transfer Points on the interstate pipelines the sum of all its customers' requirements as determined by the Utilities, increased by the amount required for fuel and line loss.[23]

21. Under the applicable tariffs, Petitioner could provide only the quantity of gas estimated by the Utilities for each customer. However, the quantity of gas that Petitioner undertook to supply to its customers under its Sales Contracts generally was the customers' actual usage of gas increased by certain percentage amounts for fuel and line loss.[24] With respect to Petitioner's

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[23] A certain amount of gas is needed to be burned in the pipeline as fuel to transport the gas. Some small percentage of gas is also lost in transit.

[24] In the case of certain of Petitioner's large customers, the transactions with whom have not been separately quantified for purposes of this matter, Petitioner caused to be delivered the quantities specified or estimated by such customers.

pooled customers, the Utilities provided “Balancing Service” such that where deliveries to the city gate: (a) were less than the quantity required to be delivered to the city gate; or (b) less than the quantity of gas delivered by the Utility and consumed by the customer, the Utility generally provided the difference and assessed an Imbalance Charge. Where deliveries to the city gate: (a) exceeded the quantity required to be delivered to the city gate; or (b) exceeded the quantity of gas delivered by the Utility and consumed by the customer, the Utility retained the excess and generally provided an Imbalance Credit. The pooling of customer gas supplies permitted positive customer imbalances for certain customers to be offset against negative customer imbalances for other customers, thereby minimizing or eliminating Imbalance Charges.

22. Under their tariffs, the Utilities had the authority to assess certain imbalance and cash out charges, credits, and penalties (“Imbalance Charges/Credits”) where: (a) actual deliveries of gas to the Utility at the city gate for transportation by the Utility to the customer, adjusted by a certain percentage for fuel and line loss, did not correspond to the quantity of gas delivered by the local utility and consumed by the customer during the relevant billing period; and/or (b) actual gas deliveries to the city gate for transportation by the Utility to the customer, adjusted by a certain percentage for fuel and line loss, did not correspond to the quantity required to be scheduled and delivered to the city gate for the account of the customer during the relevant billing period.

23. With respect to pooled customers, the Utilities look to the Seller in the first instance for payment of Imbalance Charges. Thus, Con Edison SC 9 (the service classification that applies to

Petitioner's customers in aggregation pools in Con Edison's service area), provides that:

> For a Customer that is a participating member of a Small Customer Aggregation Group . . . the Company shall aggregate the daily surplus and deficiency imbalances for all members for purposes of determining net imbalances and the Seller shall be responsible for applicable Imbalance, Minimum Delivery and Cashout Charges under SC 20.[25]

However, these tariffs also provide that if the Seller does not pay the Imbalance and other charges, the customer is ultimately liable for those charges. "The Company may add any applicable SC 20 rates or charges to the next bill of the customer when its Seller is late in its payments by sixty days or more."[26] Thus, it is clear that a Seller is billed for balancing and Imbalance Charges as agent for its pooled customers. Tr. p. 71-72. The Utilities do this because they do not consider it cost-effective or feasible to bill the individual customers in pooled groups for such charges. Tr. pp. 72-73, 124, 126, 529. Petitioner was billed for charges as provided under SC 19 and SC 20 including Imbalance Charges, received Imbalance Credits discussed in Finding of Fact 21, *supra*, and paid such charges to the Utilities.[27]

24. Petitioner's Sales Contracts in effect during the Tax Years took various forms. The durations of the Sales Contracts, included as exhibits in the record, ranged from two months to one

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[25] T Ex. 7A, Seventh Revised Leaf 51 Subparagraph D (effective date May 1, 1996); C Ex. 2, Leaf 305, Subparagraph D (effective date 8/1/2001).

[26] T Ex. 7A, Third Revised Leaf 50B Subparagraph C (effective date May 9, 1997); C Ex. 2, Leaf 305, Subparagraph C (effective date 8/1/2001).

[27] J Ex. 1, ¶12.24.

year. The Sales Contracts generally provided for a fixed price per unit of gas for the duration of the contract. Petitioner's customers generally[28] were billed based upon actual or estimated meter readings furnished by the Utilities during the relevant billing period, with the quantities adjusted, in some instances by a certain percentage for fuel and line loss. In other instances, the price paid by the customer, set in advance for a specified period, was designed to reflect the percentage fuel and line loss quantities supplied to the customer by Petitioner and retained by the transporters. Each customer paid the Utility directly for its own local transportation under the Utility's tariff.

25. The prices Petitioner charged its customers in its Sales Contracts were also designed to reflect, *inter alia*, the charges assessed by the interstate pipeline companies for transportation to the city gate and the Imbalance Charges and Imbalance Credits Petitioner paid.[29] Because the Imbalance Charges and Credits were not based on fixed prices, but rather fluctuated with market conditions, and Petitioner's Sales Contracts provided for a fixed price per unit of gas for the time period covered by the particular Sales Contracts, to maintain its contractual obligation of charging its customers a fixed price for gas, Petitioner needed to bear the economic risk (as well as possible benefit) of the difference in price between the price charged by the Utilities in computing the Imbalance Charges and Imbalance Credits and the price Petitioner charged its customers under each of the Sales Contracts. However, Petitioner minimized this risk because the Sales Contracts

[28] This does not apply in those instances where the quantities to be supplied were specified by certain of Petitioner's large customers.

[29] Certain of Petitioner's large customers entered into "90%/110% Tolerance Contracts" under which their Imbalances were not pooled. Petitioner directly billed those Imbalance Charges to those customers.

terminated at various times, and when Petitioner either renewed a Sales Contract or entered into a new Sales Contract with a different customer, the price charged under the new contract reflected the current cost of the Imbalance Charges and Imbalance Credits.

26. The Utilities periodically furnished meter readings and estimates of individual customer usage to Petitioner. These quantities, as adjusted for fuel and line loss retained by the Utilities, were used by Petitioner for billing purposes and were referred to by Petitioner's witnesses as "billing quantities." These "billing quantities" did not precisely equal the quantities of gas delivered to the Transfer Points for the specific customer, (referred to by Petitioner's witnesses as the "sales quantity").[30] However, over time, the "sales quantities" closely approximated the "billing quantities." The differences between the "billing quantities" and the "sales quantities" were the result of a variety of factors. These factors included the Utilities' inability to precisely match the amounts they required Petitioner to cause to be delivered for a customer's use to that customer's actual consumption, plus fuel and line loss gas retained by the transporters and errors in metering.

27. Petitioner's costs during the Tax Years consisted of the following expense components expressed as a percentage:

[30] The designation of the quantity of gas delivered to the Transfer Point as the "sales quantity" is consistent with Petitioner's view that the sale took place at the Transfer Point. However, since that is the legal issue to be decided in this matter, the term "sales quantity" will be shown in quotation marks to indicate that this is not a legal conclusion.

Cost of Gas	86%
Interstate Transport	7%
Balancing	3%
Other (general & administrative, selling)	4%
Total	100%[31]

28. The NYPSC Sample Contract also had a provision dealing with delivery points, sales points, and where title and risk of loss passed. It stated in pertinent part:

> **Delivery Point, Title and Liability:** Title to, possession of and risk of loss of the gas will pass from the Seller to the Buyer at the applicable Sales Point(s). As between the Parties, Seller will be in exclusive control of the gas and responsible for any damage, injury or loss until the gas has been delivered for Buyer's account at the Sales Point(s), after which delivery Buyer will be deemed to be in exclusive control and possession and responsible for any injury, damage or loss.

29. Petitioner's Sales Contracts stated that title and risk of loss passed from Petitioner to the customer at the "sales point"[32] and that the "sales point" would be at a location outside of the State. Some of Petitioner's Sales Contracts provided that the "delivery point" would be the Utility's city gate but that the customer was authorizing Petitioner, as its agent, to arrange

[31] T Ex. 9.

[32] Whether the location designated by Petitioner as the "sales point" is respected for UT purposes is the central issue in this matter. Accordingly, the term is put in quotation marks to indicate that this is how the Sales Contracts read, but is not necessarily the correct legal conclusion.

transportation of the gas from the "sales point" to the "delivery point."[33]

30. Both the NYPSC Sample Contract and Petitioner's Sales Contracts provided that risk of loss of the gas passed from the seller to the buyer at the "sales point." However, as a practical matter, as between Petitioner's customer and the interstate pipeline, it was the interstate pipeline company that had possession of the gas and bore the risk of loss. Tr. p. 42. Once the gas was tendered to the city gate, as between the customer and the Utility, it was the Utility that had possession and risk of loss. Tr. p. 62. Nevertheless, once Petitioner tendered the gas to the transporting interstate pipeline, Petitioner did not have the ability to recall or redirect the gas to itself or to another market other than the customer for whom it was intended. Tr. p. 51.

31. The NYPSC Sample Contract and Petitioner's Sales Contracts did not specify a particular location for the "sales point." Indeed, the NYPSC Sample Contract referred to the "Sales Point(s)" indicating that there could be more than one such "sales point." In part, flexibility as to the location of the "sales point" was necessary because the interstate pipeline companies selected the specific point used for a transaction. Tr. p. 40. Also, by not designating a particular "sales point" in its contracts, a marketer such as Petitioner had the flexibility to buy gas from any number of producers in different locations, depending upon market conditions at any particular time. For example, after Hurricane Katrina, the cost of Louisiana gas became very expensive.

[33] Others of Petitioner's Sales Contracts had slightly different delivery provisions but also involved Petitioner acting as its customers' agent in arranging delivery from the out-of-state "sales point."

A marketer with a contract that had a flexible "sales point" had the ability to purchase gas from another location less expensively. Tr. p. 519.

32. The Con Edison and BUG tariffs under which Petitioner's customers received transportation service from the Utilities require that the customer own the gas at the time the gas is delivered to the city gate for transportation by the Utilities and contained title warranty provisions to that effect.[34] The Con Edison and BUG tariffs under which Petitioner qualified as a Seller of gas and which authorized Petitioner to serve aggregation groups of customers also contain title warranty provisions.[35]

33. Pursuant to the applicable tariffs governing retail customers who received Transportation Services from the Utilities but purchased gas from marketers such as Petitioner, the Utilities were required to collect the State GIT on gas purchased by consumers out-of-state but transported by the Utilities within the State.[36] The Utilities charged, collected and remitted this State GIT from Petitioner's customers during the Tax Years. Tr. p. 402. In contrast, the Utilities included the cost of the State UT as well as the cost of the City UT in the Imbalance Charges paid by Petitioner. Tr. p. 401.

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[34] *See e.g.* T Ex. 7A, Third Revised Leaf 51G, Subsection H (effective December 20, 1997); T Ex.7C, Third Revised Leaf No. 85, Subsection (c). See also T Ex. 7C, Second Revised Leaf No. 77 (effective July 1, 1996) which defines a "Transporter" as "an interstate pipeline transporting gas owned by Customer to the Company for the Customer's account . . ."; Third Revised Leaf No. 85 Subsection (c)(effective November 21, 1996) (customer warrants title), T Ex. 7B, Second Revised Leaf No. 104, (effective December 1, 1997) Subsection A entitled "Nominating and Scheduling Customer-Owned Gas."

[35] *See e.g.* T Ex. 7B, Original Leaf No. 107, Subsection E, effective May 1, 1996.

[36] See *e.g.* T Ex. 7A, Leaf 50, Section J(2).

34. The State Department of Taxation and Finance conducted an audit covering the years 1998 through 2000 in which the issue was whether Petitioner's sales to customers located in the State should be subject to the State UT. After a complete examination of Petitioner's Sales Contracts, agency arrangements, related industry practices, how the NYPSC viewed these transactions, and the State Advisory Opinions that had previously been issued, the State auditor (after consultation with his supervisor) concluded that the State UT did not apply and that the State GIT had been properly collected from Petitioner's customers.[37] Tr. pp. 385-86.[38]

35. In June, 2000, the State enacted a use tax on natural gas purchased out-of-state.[39] Petitioner collected this tax from its customers. Tr. p. 426.

36. Orlando M. Magnani testified on Petitioner's behalf. Mr. Magnani has a Bachelor of Engineering in Chemical Engineering from Manhattan College and has worked in various capacities in the gas industry for more than thirty-five years. He began his career as a junior engineer for the NYPSC. From 1971 to 1996 he worked for BUG in various capacities. During his employment with BUG he was responsible for federal and state regulatory matters and was required to be familiar with the tariffs and operating procedures of BUG and Con Edison. He also was required to have a working

[37] If the State UT is applicable, then the State GIT cannot be applicable.

[38] Paul Conley, Petitioner's Chief Financial Officer, was involved in both the State and City audits of Petitioner. He testified as to facts within his own knowledge (*i.e.,* whether Petitioner paid a particular tax and whether a taxing authority asserted that Petitioner should pay a particular tax) and not as an expert witness expressing an opinion as to the propriety of the imposition (or non-imposition) of any tax.

[39] L. 2000, c. 63, Pt Y §§28, 29.

knowledge of the taxing practices of the City and the State since these practices would affect whether his employer could do a particular transaction profitably. He worked on hundreds of transactions involving out-of-state purchases of gas for transportation into the State. Mr. Magnani represented BUG at hearings before the Federal Power Commission and then the Federal Regulatory Commission in negotiating sessions with pipeline suppliers. He routinely met with marketers, suppliers, pipelines, and other LDCs. He was a member of the American Gas Association Committee ("AGA").

From 1996 to 1998, Mr. Magnani was the President and CEO of KeySpan Energy Services Inc., an affiliate of BUG, which was a gas marketer that sold gas primarily to retail customers in aggregation groups, primarily in the Utilities' territories. He personally supervised hundreds of these transactions. He participated at the meetings held among marketers, NYPSC staff, consumer advocates and large industrial customers to develop the way the restructured gas business would work in the State. As a result of these activities he became familiar with the business practices of all the gas marketers who participated in the State Restructuring process.

From 1998 to 2001, Mr. Magnani was a principal in Navigant Consulting where he worked on various gas matters. Since 2001, Mr. Magnani has been the Director of Commercial and Industrial Gas Operations for Amerada Hess Corporation where he is responsible for retail natural gas marketing operations in sixteen states.

Based on his extensive professional experience, Mr. Magnani was qualified as an expert in industry practices in the gas marketing industry including, but not limited to, the development of that industry, related regulatory matters and industry contracting practices. As an expert in such matters, Mr. Magnani's opinion testimony about whether Petitioner's method of doing business was similar to the way others in the industry did business was admissible. Mr. Magnani also testified (but not as an expert with respect to tax matters) as to facts within his own knowledge regarding how various taxes had been imposed on segments of the gas industry and how his employer and others reacted to those administrative practices.

37. Mr. Magnani testified that in his expert opinion the provisions in the Sales Contracts transferring title and risk of loss at the "sales point," designating the seller as the buyer's agent to arrange and administer related third party transportation services on the buyer's behalf, providing discretion to the seller to select the precise out-of-State "sales point," and providing for adjustment of the billing quantity to include gas retained by the Utilities for fuel and line loss, are consistent with widespread, and in most cases, long-standing industry practice and usage. Mr. Magnani further testified that it was his opinion that Petitioner's administration of these contracts, including the use of the Utilities' specifications to calculate customer requirements, the inclusion of pipeline and Utilities' fuel and line loss in calculating and determining the quantity delivered for the customer at the "sales point," discharging its agency responsibilities and including the costs of its agency functions in the contract price, pooling the gas of one customer with the gas of others of its customers for certain purposes, using a "billing quantity" that, over time, closely approximated but rarely equaled the "sales quantity" and selecting "sales points" in the Gulf Coast production

area, was consistent with widespread, and in most cases, long-standing industry practice and usage. Tr. pp. 515-526.[40]

38. On June 29, 2004 the Department issued a Notice of Determination to Petitioner asserting a deficiency of City UT taxes, penalties and interest (calculated to September 16, 2004) for the Tax Years as follows:

TAX PERIOD(S)	PRINCIPAL	INTEREST	PENALTY	TOTAL DEFICIENCY
01/01/98 - 12/31/98	$118,404.59	$ 66,660.15	$ 80,691.92	$ 265,756.66
01/01/99 - 12/31/99	208,655.28	93,208.27	130,066.25	431,929.80
01/01/00 - 12/31/00	345,059.08	114,363.90	195,205.58	654,628.56
01/01/01 - 12/31/01	924,796.06	205,019.11	472,427.99	1,602,243.16
01/01/02 - 12/31/02	611,180.27	88,957.67	288,950.95	989,088.89
Total	**$2,208,095.28**	**$568,209.10**	**$1,167,342.69**	**$3,943,647.07**

The deficiency relates to Petitioner's revenues from retail end-users of natural gas that owned or occupied premises located in the City.

[40] Notwithstanding Respondent's attempts to impeach Mr. Magnani's testimony, I found Mr. Magnani's testimony to be highly credible and entitled to great weight. In addition, his testimony about the development of the deregulated gas industry and the industry's understanding of when various taxes would be imposed, as well as his expert opinions regarding industry practice and whether Petitioner's activities were consistent therewith, were supported by the structure of the various applicable tariff provisions discussed above; the NYPSC Sample Contract, T Ex. 12; the Con Edison SC 9 Agency Agreement, T Ex. 13; the language of the preamble to the State GIT (*See*, L. 1991, c. 166, §149), which indicated that as of at least 1991 when that legislation was enacted, "consumers of gas services may avoid the burden of the taxes imposed by sections 186 and 186-a of the tax law by purchasing the service out-of-state and hiring transportation to carry that service to the consumer's premises in this state;" and by the Introducer's Memorandum of Support to S4780, (the proposed City GIT bill that has not been enacted to date) which indicates that the City's attempt to persuade the State Legislature to enact such a tax was based on the City's own argument that it was dealing with an industry-wide structural problem.

39. On September 20, 2004, Petitioner timely filed a Petition with the Administrative Law Judge Division of the Tribunal requesting that the deficiency asserted in the Notice of Determination be cancelled.

40. Respondent stipulated that the penalties asserted of $1,167,342.69 have been withdrawn and are no longer at issue.

41. For the Tax Years, Castle Oil Corporation, Petitioner's parent, filed combined City General Corporation Tax ("GCT") returns that included the results of Petitioner's operations. The parties have stipulated that Petitioner shall be entitled to apply against any City UT deficiency finally determined pursuant to these proceedings for each of the Tax Years the amount of GCT assessed against the combined reports in which Petitioner was a member for each of those same Tax Years, but only to the extent of the GCT that was attributable to Petitioner.

STATEMENT OF POSITIONS

The parties agree that Petitioner is subject to the City UT on any sales of gas it made in the City. However, Petitioner contends that the sales at issue were made outside the City at specific points of sale in the Gulf Coast production area; whereas Respondent asserts that notwithstanding the language of Petitioner's Sales Contracts, under a "substance over form" or "sham transaction" analysis, the sales took place at the meters at the customers' premises in the City. Petitioner contends that the structure of its transactions may not be disregarded for tax purposes because it is based on ample business justifications and established industry practice based on regulatory requirements.

Petitioner further asserts that the territorial limitations of General City Law §20-b precludes the imposition of the City UT on Petitioner's transactions notwithstanding that the Utilities performed Balancing Services in the City for Petitioner's customers. The Commissioner asserts that the limitations of General City Law §20-b are inapplicable because the transactions at issue involve the sale of a commodity that took place at the meters at Petitioner's customers' premises in the City.

Petitioner also claims that Respondent has consistently recognized that transactions such as those at issue are not subject to the City UT and that imposing the City UT here would be an impermissible retroactive change in position. The Commissioner counters that the Department began pursuing gas marketers for the City UT almost as soon as they were authorized to sell gas to pooled customers and never took the position that transactions such as those at issue here are not subject to tax. Petitioner responds that the City's proposed GIT legislation is further proof that the City UT has no application to the transactions at issue. Respondent counters that the proposed GIT legislation was intended as a way of lightening the City's administrative burden by requiring the Utilities to collect the tax directly from the consumer.

Petitioner asserts that construing the City UT as Respondent suggests would result in a double tax at the local level in violation of the Commerce Clause of the United States Constitution. The Commissioner contends that there is no impermissible double taxation because these are purely local sales.

Petitioner also argues that it should recover the costs associated with its challenge of the assessment pursuant to Tax Law §3030 which permits a discretionary award of costs to the prevailing party since it claims that Respondent's conduct here was "nothing short of egregious." The Commissioner contends that this claim is devoid of merit.

<u>CONCLUSIONS OF LAW</u>

For the privilege of exercising its franchise or franchises or of holding property or doing business in the City, the City UT is imposed on: (1) the gross income of every regulated utility; and (2) the gross operating income of every "vendor of utility services" Code §11-1102.a. A "vendor of utility services" is defined as "[e]very person not subject to the supervision of the department of public service who furnishes or sells gas, . . . or furnishes or sells gas . . . service . . .." Code §11-1101.7. Since Petitioner is not a regulated utility but sells gas, it is a vendor of utility services that is subject to the City UT on its gross operating income; *i.e.,* its "receipts received in or by reason of any sale <u>made</u> . . . <u>in the city</u>. . ." Code §11-1101.5 (emphasis added). Therefore, the issue in this case is whether Petitioner's sales of gas to its customers occurred in the City or outside the City. *See also* Code §11-1102.c. (there exists a statutory presumption that the gross operating income of any person subject to the City UT is taxable and is from business conducted wholly within the City) and General City Law §20-b (which precludes the taxation of "any transaction originating or consummated outside of the territorial limits of [the City], notwithstanding that some acts be necessarily performed with respect to such transaction within such limits").

Petitioner asserts that all of its sales to its customers took place outside the City since, under the Sales Contracts, as between Petitioner and its customers, possession and risk of loss passed outside the City and Petitioner was merely its customer's appointed agent to arrange transportation of the gas to the city gate. If the structure of the transactions as set forth in the Sales Contracts is respected, Petitioner would not be subject to the City UT because its sales all will have occurred outside the City at Transfer Points in the Gulf Coast. Any act that took place in the City with respect to these sales would either be an act taken by the Utilities or acts necessary to be performed in the City with respect to sales outside the City which under General City Law §20-b would be insufficient to cause the transactions to be taxable.

Respondent counters that the location of the sales specified in the Sales Contracts should not be respected under the "substance over form" or "sham transaction" principles of tax law.[41] She asserts that the transactions must be recast as sales taking place at the meters located at Petitioner's customers' premises in the City as that is the point at which risk of loss was transferred as demonstrated by the fact that Petitioner did not charge its customers for gas which was not delivered to that point.

Although Petitioner and Respondent both cite authorities which they claim support their respective positions, none of these authorities deal with a case where a marketer, using a form of contract based on a model created by the State agency that regulates that industry and following the structure of the tariffs approved by that State agency, sells gas to small customers in an aggregation

[41] *See, generally*, Boris L. Bittker and Lawrence Lokken, *Federal Taxation of Income, Estates and Gifts* Cum. Supp. No. 1. §4.3.3 (2006).

pool.[42] Therefore, this is a case of first impression where the regulatory scheme is crucial to the determination of the case.

Had the sales occurred outside a regulated framework, Respondent's position that the substance over form doctrine should be applied because the economic substance of the sales did not reflect their contractual form (*i.e.,* that Petitioner in reality sold the gas at its customers' meters in the City) would have had substantially more merit. However, the sales occurred subject to a regulated framework (the tariff provisions) that required Petitioner's customers to own the gas at the time it was delivered to the city gate and required the Utilities to provide transportation service to the end-user customers rather than to the Petitioner.

Petitioner could not freely structure its business relationships with its customers in any manner it saw fit. Prior to the NYPSC's State Restructuring ten years ago, Petitioner could not even have made the sales at issue because it had no ability to deliver the gas to the customers' premises/meters. It was only when the NYPSC restructured the gas industry in the State to require the LDCs to transport gas for small customers by permitting the marketers to create aggregation pools that it even became possible for gas marketers such as Petitioner to enter this business.

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[42] Petitioner has cited one State Tax Appeals Tribunal Decision, *Penn York Energy Corporation*, fn. 8, *supra*, but that case deals with a large customer that itself arranges transportation of its gas into the State. Respondent counters citing a series of cases, which deal with sales of gas in other states with equally inapplicable fact patterns. *See*, *Rio Grande Valley Gas Co. v. Edinburg*, 59 S.W.3rd 199 (Tex. App. 2000), *rev'd on other grounds, Southern Union Co. v. Edinburg*, 129 S.W. 3rd 74 (Tex. 2003); *Dep't. of Revenue, Commonwealth of Kentucky v. Natural Gas Service, Inc.*, 415 S.W.2d 113 (Ky. Ct. App. 1967); *Alabama-Tennessee Natural Gas Co. v. Huntsville*, 275 Ala. 184 (1963); *Alabama Gas Co. v. Montgomery*, 249 Ala. 257 (1947); *Mid-Continent Petroleum Corp. v. Blackwell Oil & Gas Co.*, 159 Okla. 35 (1932).

However, that restructuring was cast in a regulated structure that Petitioner was required to follow.

During the State Restructuring Proceedings, the NYPSC made it clear that the LDCs would have to provide transportation of gas to the small customers rather than to the gas marketers who sold gas to those small customers.[43] The various tariff provisions for gas transportation service describe the rates and requirements for the Utilities to transport "customer owned" gas.[44] The NYPSC created a Sample Contract for marketers such as Petitioner to use in structuring their business arrangements in a manner that was consistent with the tariffs. The NYPSC Sample Contract provides that a gas marketer can be designated the customer's agent to arrange for the delivery and transportation of gas from the transfer point to the applicable LDC's city gate.[45] If the NYPSC wanted the marketer to own the gas at the time when it was delivered to the city gate, there would have been no reason to provide that the marketer could be designated the customer's agent for the purpose of arranging this delivery, since the marketer could arrange for delivery of gas that it, itself, owned without such an agency designation. The NYPSC clearly authorized Petitioner to sell its gas outside the City to its customers and act as their agent in arranging for the transportation of the gas to the City. There is nothing in the record which would indicate that, as a regulatory matter, Petitioner could have structured the contract in the way the Commissioner wishes to restructure it; *i.e.*, that Petitioner could

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[43] *See* Finding of Fact 15, *supra*.

[44] See Finding of Fact 32, *supra*.

[45] *See* Finding of Fact 16, *supra*.

have owned the gas, obtained transportation of the gas from the Utilities, and sold the gas at the customers' meters.

Accordingly, Petitioner's Sales Contracts and mode of doing business, being entirely consistent with the requirements of the tariffs and the NYPSC Sample Contract, were compelled by regulatory realities. In addition, Petitioner's business arrangements were also consistent with the way in which its entire segment of the gas industry functioned.[46] As the U.S. Supreme Court noted in *Frank Lyon Co. v. U.S.,* 435 U.S. 561, 583-84, (1978) regulatory, as well as business realities, should preclude the application of the substance over form doctrine:

> [W]here . . . there is a genuine multiple-party transaction with economic substance which is **compelled or encouraged by business <u>or</u> regulatory realities**, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached, the Government should honor the allocation of rights and duties effectuated by the parties. [Emphasis added.]

A substance over form analysis presupposes, at a minimum, that a taxpayer has the ability to structure its business dealings in the form in which the taxing authority wishes to recast the transaction and that the taxpayer chose a structure for the transaction solely for tax avoidance reasons that were devoid of economic and regulatory reality. However, in structuring its business dealings, Petitioner was limited by the regulatory framework of the NYPSC and the tariffs governing the manner under which the Utilities would deliver the gas to Petitioner's

[46] *See* Finding of Fact 37, *supra*.

customers. Under these circumstances, it is not the function of this forum to disregard the form of Petitioner's business arrangements as mandated by the State agency that regulated its industry.

While Respondent makes a number of additional arguments to attempt to alter this conclusion, these arguments are not persuasive. To the contrary, several of these arguments serve to support Petitioner's position that it could not have structured the sales to customers to take place at the customers' meters, as Respondent wishes to recast the transactions.

Respondent first contends that Petitioner's bearing the business risk or benefit of price fluctuations as reflected in the Imbalance Charges and Imbalance Credits was indicative of Petitioner's being a principal, rather than an agent of its customers. She asserts that Petitioner, therefore, owned the gas that was subject to the Imbalance Charges/Credits and sold that gas, as well as the rest of the gas it sold to the customers, at their meters. Where Petitioner marketed itself to customers by offering a fixed price for gas sold, passing through Imbalance Charges/Credits to customers would have made no business sense as it would have effectively changed the price of gas from a fixed price to a variable price in a manner that its customers would have been unlikely to understand and would have been difficult, if not impossible, for Petitioner to have implemented. Absent Petitioner's bearing the risk and benefit of the Imbalance, customers who used more gas than estimated would have received an additional bill for the cost of that gas above the fixed price and customers who used less gas than estimated would have received a credit for the appreciated value of the gas not used. This is a highly complicated arrangement that customers who seek merely price stability in their cost of gas would likely not want, yet alone understand.

In addition, it is not at all clear that Petitioner could have passed those charges along to its customers, while complying with the NYPSC's mandated aggregation pool requirements. The NYPSC has provided for a pooling system where the Imbalance Charges and Credits are netted within the pool of Petitioner's customers to reduce these Imbalance Charges/Credits. Any attempt to try to bill individual customers for their share of the Imbalance would be contrary to the purpose of the NYPSC's arrangement to net Imbalances within the pool. Under these circumstances, Petitioner's decision to bear any cost or receive any benefit of the Imbalance is a rational, if not necessary, business decision which is supported by regulatory compliance concerns.[47]

In addition, the Utilities, which are highly regulated, treat the sales of gas provided for Balancing as retail sales by the Utilities to Petitioner's customers. This is evidenced by the way the Utilities imposed various taxes on the Imbalance Charges. In accordance with applicable State and City tax law and the relevant tariff provisions, in the bills for Imbalance Charges that the Utilities rendered to Petitioner, the Utilities included both the State UT (Tax Law §186-a) and the City UT.[48] Since both of these taxes are imposed on retail sales in the State and/or City and not on sales for resale,[49] these charges indicate that, with respect to gas provided by the Utilities for Balancing, the Utilities

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[47] Petitioner also adjusted the pricing of subsequent contracts to take, in part, these Imbalance Charges into account.

[48] *See* Finding of Fact 33, *supra*.

[49] Tax Law §186-a(2)(c); Code §11-1102.b.

characterized Imbalancing as their making retail sales of gas directly to the end-users (rather than selling gas to Petitioner for resale to the end-users.)

Respondent also claims that various provisions in the tariffs dealing with meter readings support her position that the sales by Petitioner must have taken place at the meters at the customers' premises. The tariffs state that the purpose of the meter readings is to measure the quantity of gas sold.[50] From this language, Respondent asserts that the quantity of gas sold by Petitioner is the amount that registers on the meter at the customer's premises and that, as a result, the customer's meter is the location for the sale. However, since the Utilities themselves sell that portion of the gas needed for Balancing, it is perfectly appropriate for the tariffs that regulate the Utilities' billing practices (but do not regulate Petitioner's billing practices) to refer to a "measure of gas sold" in connection with the fees charged by the Utility for Balancing, since this is the amount of gas sold to the customer by the Utility under the Balancing Service. This reading of the tariffs is consistent with the requirement of the NYPSC that the transportation customers (the customers who bought gas from a marketer and bought transportation of that gas from the LDC) would be required to have meters at their premises for the purpose of measuring Balancing.[51]

The Commissioner further asserts that because Petitioner's customers bore no risk of loss on the transportation of the gas, they could not have been the owners of the gas while it was in the

[50] *See e.g.* C Ex. 8A, Leaf 19, Section 7.A, effective date 10/01/1998.

[51] NYPSC December 20, 1994 Order, fn. 5, *supra,* at 19.

pipeline. However, Petitioner also bore no risk of loss for gas in the pipeline. Instead the interstate pipelines and then the Utilities bore the risk of loss. Since neither Petitioner nor its customers bore the risk of loss in the pipeline, risk of loss cannot be indicative of whether Petitioner or its customers owned the gas during its transportation.

Similarly, the Commissioner asserts that because the tariffs required Petitioner to warrant title to the gas when it reached a city gate, Petitioner must have been the owner of the gas. However, Petitioner's customers also were required under the tariffs to warrant title to the same gas at the same location.[52] Since both Petitioner and its customers were required to warrant title to the Utilities, and both cannot have been the owners of the gas, the warranty of title cannot be indicative that Petitioner owned the gas during its transportation. To the contrary, the only rational explanation for why both would be required to warrant ownership of the same gas at the same point is that the customers were doing so as the owners of that gas and Petitioner was doing so as their agent.

Respondent next relies on the Uniform Commercial Code ("UCC") to assert that the sales of gas could not have taken place before the gas reached the meters at the customers' premises in the City. She claims that the UCC requires that either an exact quantity of gas or a specific portion of the gas in a given quantity must be identified before title can pass. *See* UCC §2-401(1): "[t]itle to goods cannot pass. . . prior to their identification to the contract. . .." *See also* UCC §2-105(2), which provides that:

[52] *See* Finding of Fact 32, *supra.*

"[g]oods must be both existing and identified before any interest in them can pass;" and UCC §2-105(4) which provides that:

> [a]n undivided share in an identified bulk of fungible goods is sufficiently identified to be sold although the quantity of the build is not determined. Any agreed proportion of such a bulk or any quantity thereof agreed upon by number, weight or other measure may to the extent of the seller's interest in the bulk be sold to the buyer who then becomes an owner in common.

Petitioner asserts that it is unclear that the UCC even applies to these transactions. However, even if the UCC does apply, Respondent's argument is not persuasive because a precise amount of gas was identified for every customer. That is the amount that the Utilities determined Petitioner had to provide for that customer, grossed up for fuel and line loss, which amount Petitioner calls the "sales quantity." To the extent that one of Petitioner's customers used more or less gas than estimated, it was the Utility which either purchased the excess or sold the shortfall to the customer. This transaction was a separate transaction between different parties (the Utility and Petitioner's customer) and it has no effect on the amount of gas sold originally by Petitioner to its customer at the Transfer Point.

It also is noted that the Commissioner's position in this matter is inconsistent with the manner in which the State GIT is currently imposed and also with her own attempt to get a City GIT enacted. The State GIT was enacted precisely because out-of-state purchases of gas were not subject to the State UT.[53] During the course of the State Restructuring Proceedings, the participants

[53] *See* Finding of Fact 7, *supra*.

were aware that out-of-city purchases of gas also would not be subject to the City UT. The NYPSC suggested that this problem was one to be addressed by the State Legislature.[54] The City prepared draft legislation for a City GIT which was introduced into the State Senate in 2005, but which has not yet been enacted. It is not the function of this Tribunal to second guess the State Legislature with respect to the desirability of taxing these types of transactions.

Petitioner additionally claims that pursuant to Tax Law §3030 of the Taxpayers' Bill of Rights it is entitled to recover its cost of challenging the proposed assessment. However, Tax Law §3030 provides no remedy with respect to proceedings against the City Commissioner of Finance. It provides a remedy only with respect to proceedings against the State Commissioner of Taxation and Finance. Accordingly, Petitioner may not recover its costs.[55]

ACCORDINGLY, IT IS CONCLUDED THAT:

A. Petitioner is not liable for the City UT as all the sales made by Petitioner during the Tax Years took place outside the City in accordance with Petitioner's Sales Contracts, the form of which, being based on regulatory and economic concerns, may not be disregarded.

B. Petitioner may not recover from the City for the costs of contesting this matter because Tax Law §3030 provides no remedy

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[54] *See* Finding of Fact 8, *supra*.

[55] All other arguments have been considered and are deemed to be unpersuasive, including Petitioner's arguments (now moot) that: (a) there was no nexis to tax it; (b) the assertion of the claimed liability was barred under the doctrine of impermissible retroactivity; and (c) the assertion that the claimed liability would result in impermissible double taxation.

with respect to proceedings against the City Commissioner of Finance.

The Petition of Castle Power, LLC, filed on September 20, 2004, is granted with respect to the redetermination of deficiencies asserted by Respondent and is denied with respect to the request for costs.

DATED: October 6, 2006
New York, New York

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MARLENE F. SCHWARTZ
Administrative Law Judge