STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.	:	DETERMINATION DTA NO. 807122
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1979 through May 31, 1986.	:	

Petitioner, Consolidated Edison Company of New York, Inc., 4 Irving Place, New York, New York 10003, filed two petitions for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1979 through May 31, 1986.

A hearing was commenced before Marilyn Mann Faulkner, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on October 24, 1990 at 1:30 P.M., and continued to conclusion on October 25, 1990 at 3:45 P.M., with all briefs to be submitted on April 10, 1991. Petitioner submitted its brief on January 10, 1991. The Division submitted a brief on March 19, 1991, and petitioner filed a reply brief on April 10, 1991. Petitioner appeared by David M. Wise, Stephen Ianello and James F. McMahon, Esqs. The Division of Taxation appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel).

ISSUES

I. Whether, for purposes of the New York City 4% sales tax imposed pursuant to Tax Law § 1107, the delivery of natural gas purchases was made outside of New York City.

II. Whether the natural gas purchases were subject to use tax under Tax Law § 1107.

III. Whether the charges for transporting natural gas by pipeline carriers were subject to tax under Tax Law § 1107.

FINDINGS OF FACT

Petitioner submitted proposed findings of fact that have been incorporated in the following findings of fact unless otherwise indicated.[1]

Petitioner, Consolidated Edison Company of New York, Inc. ("Con Ed"), is a New York public utility engaged in the manufacture, distribution and sale of gas, steam and electric service and is subject to regulation by the New York State Public Service Commission ("PSC").

Con Ed purchases natural gas both for resale to consumers and for use in the generation of electricity and steam in generators located in New York City. Natural gas purchased for the latter purpose is commonly referred to as "boiler fuel".

During the period in question, Con Ed purchased natural gas in two primary ways:

(a) it purchased gas from the four publicly-regulated pipeline companies ("pipeline gas") which have direct interconnections with Con Ed's facilities in New York State: Tennessee Gas Pipeline Co., Inc. ("Tennessee"), Transcontinental Gas Pipe Line Corporation ("Transco"), Texas Eastern Transmission Corporation ("TETCO"), and Algonquin

Pipeline Company ("Algonquin"). Rates for pipeline gas were regulated by the Federal Energy Regulatory Commission ("FERC"); and

(b) it purchased gas directly from gas producers, marketers and distributors ("direct purchase gas") that did not have direct interconnections with Con Ed's facilities. In order to transport the gas from these locations, Con Ed entered into separate contracts with the regulated pipeline companies for the delivery of such gas into Con Ed's system. Rates for direct purchase gas were unregulated and generally were lower than the rates for pipeline gas.

While FERC does not regulate the rates of direct purchase gas, it does regulate the interstate transportation of all gas by the pipeline companies. From the beginning of the period

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[1]The amounts stated in petitioner's proposed finding of fact 42 were not accepted because those numbers did not accurately correspond with amounts stated in the refund applications and attached workpapers or with paragraph E as stipulated by the parties (see Finding of Fact "22", footnotes "6" and "7", infra).

in question through November 1983, transportation of direct purchase gas by the interstate pipelines was permitted only under special FERC programs authorizing such transportation. From 1979 through 1983, Con Ed purchased most of its direct purchase gas under FERC's Order 30 program.

FERC's Order 30 program was effective from May 17, 1979 through November 1983. Its purpose was to reduce the nation's reliance on oil imports by facilitating the use of natural gas to displace fuel oils (FERC's Order 30, 7 FERC 61,170; 18 CFR part 284, 44 FR 30323; 10 CFR 595.1). At this time, FERC regulations were promulgated pursuant to FERC's Order 30 authorizing the transportation of natural gas that was purchased directly by certain industrial users and electric utilities from gas producers (18 CFR 284, Subpart F). Thus, in these instances, the interstate pipelines would no longer act as gas merchants who both purchased and transported natural gas for resale to local distribution companies, but would act only as transporters or carriers of natural gas that was purchased by the local distribution companies directly from the producers.

Under FERC regulations, the purchasers of the natural gas needed to qualify as "eligible users", i.e., users who consumed gas for "fuel oil displacement", as certified by the Administrator of the Economic Regulatory Administration ("ERA") of the Department of Energy (10 CFR 595.3; 595.4; 18 CFR 157.200; 157.202[e]). In order to obtain certification of eligible use from the ERA, eligible users were required to demonstrate that the intended natural gas purchase would be "used to displace fuel oil that would otherwise be consumed in [the] end-user's facilities during the period of certification" (10 CFR 595.4). They also were required to submit monthly statements detailing the "total volume of natural gas obtained and used at each facility pursuant to the ERA certification to displace fuel oil" throughout the 12-month life of the certificate (10 CFR 595.7).

Con Ed obtained certificates of eligible use from the ERA relative to all its Order 30 purchase contracts. Under these contracts, Con Ed's sole "eligible use" for natural gas was as boiler fuel in its electric and steam generators and it filed the appropriate monthly reports with

FERC and the ERA stating that it had used all Order 30 gas as boiler fuel.

Con Ed's only non-Order 30 purchases for the period prior to November 1983 were under four contracts entered into pursuant to FERC emergency regulations which, under the specific circumstances involved, likewise required Con Ed to use the gas solely to displace oil in its electric and steam generators (18 CFR 157.45 et seq.).

When the FERC Order 30 program terminated in November 1983, the pipelines continued to transport direct purchase gas contingent upon their own restrictions. For example, Transco (which shipped over 75% of Con Ed's direct purchase gas) demanded as a precondition for shipment proof by way of affidavit that Con Ed would use the gas it transported only to displace oil and not to resell the gas to customers. This affidavit requirement remained in effect until the implementation of FERC's Order 436 which was issued on October 9, 1985 (FERC Order 436, 50 Fed. Reg. 42,408).

FERC Order 436 envisioned a complete restructuring of the natural gas industry by requiring pipeline companies to transport direct purchase gas on a nondiscriminatory basis, i.e., lifting all restrictions on the transportation of natural gas. The essence of FERC Order 436 was to "unbundle" the pipelines' transportation and merchant roles thereby allowing other gas sellers to freely compete with the pipelines (Associated Gas Distributors v. FERC, 824 F2d 981, 994 [D.C. Cir 1987], cert denied 485 US 1006 [1988]).[2] In Order 436, FERC found that, despite the growth of a competitive wellhead market, interstate pipelines retained market power in gas transportation; that pipelines had generally declined to transport gas in competition with their own sales; and that such pipeline discrimination denied consumers access to gas at the lowest reasonable rates (see, id. at 996).

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[2]In Associated Gas Distribution the court generally approved of Order 436 but vacated it on the ground that the Commission failed to address some problems associated with the open access rule; however, the Commission quickly promulgated a substitute rule (Order No. 500, 52 Fed. Reg. 35,334 [August 14, 1987]) so that open access transportation could continue without interruption (see, American Gas Association v. FERC, 912 F2d 1496, 1503 [D.C. Cir 1990], cert denied ___ US ___, 111 S Ct 957).

It was within the regulatory context described above that Con Ed entered into the direct purchase gas contracts and related transportation contracts that are the focus of this proceeding. Con Ed entered into 49

direct purchase gas contracts ("purchase contracts") with gas vendors in the period in question for the purchase of gas to be used as boiler fuel. Transportation of direct purchase gas was provided for in 43 separate associated transportation contracts between Con Ed and the pipeline companies.

Under the purchase contracts in question, Con Ed purchased gas on an "interruptible" rather than "firm" basis; that is, the vendors had the right, under certain criteria, to discontinue or "interrupt" service, whereas vendors delivering firm gas were obligated to deliver the gas when requested by the purchaser. Most of the gas originated from wells in Louisiana and Texas. The actual quantity of gas sold under the individual purchase contracts and transported under the individual transportation contracts was determined daily through oral communication among dispatchers. Typically, Con Ed would forecast, early in the morning, its gas needs for the next 24-hour period based on weather conditions, etc., and then telephone various vendors and pipeline transporters requesting gas until the daily gas requirement could be met.[3]

Vendors of the direct purchase gas were capable of making purchase contract deliveries to Con Ed only where they, or their designees, had interconnections with interstate pipelines that had interconnections to Con Ed's system. According to credible testimony, none of the vendors in

question or their designees had interconnections within New York City, and only one of those, Sulpetro Limited, made deliveries within New York State (Niagara Falls) in accordance with its

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[3]Because the purchase and transportation contracts involved "interruptible gas", the dispatchers might have to call various vendors and transporters before locating gas available for that 24-hour period. The availability of the gas and its transportation depended upon whether the vendors or transporters were meeting the gas demands of their higher priority customers.

contract with Con Ed (Pet. Ex. 144). With that one exception, all vendor deliveries to the pipelines occurred outside both New York City and New York State.

As evidenced by the purchase contracts and the associated transportation contracts, as well as by testimony, title to the gas passed from the vendors or their designees to Con Ed at the points of interconnection between the vendors or their designees and the pipeline companies who acted as agents for Con Ed. These interconnections were identified in the contracts as "points of delivery" and, with the exception of the Sulpetro Limited contract (see Finding of Fact "14") and a National Fuel Gas Distribution Corp. contract (Pet. Ex. 121) (see Finding of Fact "16"), title passed, under these purchase contracts, at these points of delivery outside of New York State.

At the hearing, Mr. Marc Richter, a senior regulatory attorney for Con Ed who was responsible for negotiating the purchase and transportation contracts, testified that in the National Fuel Gas contract for the period March 17, 1979 through March 17, 1981 (Pet. Ex. 121[a]), the points of delivery from the vendor to the three pipelines (Transco, Texas Eastern and Tennessee) all occurred outside New York State. However, the contract language, as amended (Pet. Ex. 121[b]), also states that:

> "All of National Fuel's rights and title to the gas made available on the Transco pipeline system shall pass to Con Edison at the existing interchange between Supply Corporation and Transco at the Wharton Storage Field in Potter County, Pennsylvania. All of National Fuel's rights and title to the gas made available on the Texas Eastern and Tennessee pipeline systems shall pass to Con Edison at the New York State border."[4]

The purchase contract also states that:

> "Con Edison shall be solely responsible for arranging for the transportation of the nominated quantities to its service area. Con Edison shall be responsible for the payment of all pipeline charges for such transportation, and for the provision of any required compression and fuel associated therewith." (Pet. Ex. 121[a]).

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[4] A map submitted by Con Ed into the record (Pet. Ex. 23) indicates that the Tennessee pipeline enters New York State in Rockland County, whereas the Texas Eastern pipeline enters into Richmond County, which is located in New York City, where it interconnects with Brooklyn Union Gas Co.

The associated transportation contract between Texas Eastern and Con Ed contains a provision delineating who has control and possession of the gas while being transported. This provision provides the following:

> "As between Texas Eastern and Consolidated Edison, Texas Eastern shall be deemed to be in control of the gas to be received and delivered hereunder until it shall have been delivered to Consolidated Edison at the point of delivery and Consolidated Edison shall be deemed to be in control and possession of such gas after such delivery to or for the account of Consolidated Edison" (Pet. Ex. 224).

The transportation contract identified the point of receipt of the gas by Texas Eastern from National Fuel Gas Supply Corporation at a meter station in Greene County, Pennsylvania and the two points of delivery to Con Edison or its agents at meter stations located in Richmond County, New York and in Lambertville, New Jersey.

Mr. Richter testified that the pipelines required that Con Ed obtain documents establishing that it had title to the gas before the pipelines would accept the gas from the vendors for transportation. He noted that Con Ed's obligation to pay vendors was based entirely upon the

quantities of gas delivered to and accepted by the pipelines as metered at the points of interconnection between the pipelines and vendors and that this obligation was not contingent on whether the pipelines in fact ultimately delivered the gas to Con Ed. This testimony was supported by various contract provisions contained in the purchase and transportation contracts indicating that the sale and/or transfer of title and the passing of liabilities and risks would take place at the delivery points between the vendor and pipeline.

Con Ed's obligations under the transportation contracts were separate from its obligations under the purchase contracts. Under the purchase contracts, Con Ed had the responsibility to arrange and pay for transportation of the gas to Con Ed's system. Once the vendors delivered the gas to the pipeline, the pipeline would accept the gas for the account of Con Edison. The transportation contracts between the pipelines and Con Edison generally provided that the pipelines had exclusive control and possession of the gas until delivery into

Con Ed's system or a designee such as Brooklyn Union Gas Co.

Once the vendor delivered the gas to the pipelines, the gas commingled with and was indistinguishable from the other gas flowing through the pipelines. In addition, inasmuch as Con Ed would order certain quantities of gas based upon a projection of its needs for a 24-hour period (see Finding of Fact "13"), the gas accepted by the pipelines would not physically be the same gas delivered to Con Ed's system with regard to the order for that 24-hour period. Thus, consistent with industry practice, the parties documented deliveries by vendors to the pipelines and by the pipelines to Con Ed for billing purchases based not on a physical tracing of gas molecules, but on metering connections wherein that quantity of direct purchase gas delivered by a vendor to a pipeline for Con Ed's account on a given day was deemed delivered by the pipeline to Con Ed into its system that same day. Any underdeliveries or overdeliveries by either a producer or pipeline would be adjusted on a monthly basis for billing purposes.

Throughout the period in question, Con Ed paid New York City taxes pursuant to Tax Law § 1107 with respect to all gas purchases and related transportation costs for gas consumed in its New York City steam and electric generators, including all the direct purchase gas it allocated for use as boiler fuel.[5] Tax Law § 1107 imposes a 4% sales and compensating use tax for sales or uses of tangible personal property or services where the property sold or the property upon which the services were performed is or will be delivered to the purchaser within New York City. Con Ed reported all taxes described above on its monthly New York State sales tax returns (Forms ST-803) and paid such taxes with its returns.

Con Ed filed five applications for refund of the sales and use taxes paid pursuant to Tax

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[5]The direct purchase gas used for boiler fuel was relatively cheaper than the gas Con Ed purchased for use for customer resale. The gas costs for customer resale and for the generation of steam and electricity can be recovered in service rates through operation of a "fuel rider" whereby the PSC permits service rates to be adjusted monthly for fluctuations in fuel costs. The fuel rider adjustments are nonetheless subject to PSC review. Mr. Ronald Blake, who worked in Con Ed's Rate Engineering Department during the period in question, testified that the PSC did not challenge any of the gas allocations Con Ed used in computing the fuel rider adjustments for the three types of services during the period in question.

Law § 1107 with respect to the direct gas purchase contracts and related transportation contracts for the period in question. In these five refund claims, Con Ed stated that at the time of the gas purchases from sources outside New York State, it remitted the 4%

tax on the purchase price of the gas and related transportation costs in the belief that the use tax imposed pursuant to Tax Law § 1107 was applicable. Con Ed argued that under Tax Law § 1107(b)(7) the term "use" is defined as the exercise of any right or power over tangible personal property and that Tax Law § 1101(b)(6) specifically excludes "gas" from the definition of tangible personal property.

The five refund claims were for the following amounts:

(a) a claim application dated June 1982 in the amount of $6,595,925.84 covering sales taxes on natural gas purchases from March 1, 1979 through February 28, 1982;

(b) a claim application dated September 20, 1982 in the amount of $1,067,758.08 covering sales taxes on natural gas transportation expenses from March 1, 1979 through February 28, 1982;

(c) a claim application dated April 5, 1985 in the amount of $3,260,598.88 covering sales taxes of $3,110,684.72 and $149,914.16 paid on natural gas purchases and natural gas transportation expenses, respectively, from March 1, 1982 through June 30, 1984;

(d) a claim application dated April 29, 1987 in the amount of $10,590,174.13[6] covering sales taxes on natural gas purchases from July 1, 1984 through May 31, 1986; and

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[6]At the close of the hearing held on October 25, 1990, Mr. David Wise, one of the attorneys for Con Ed, requested an opportunity to amend the two claim applications for the period July 1, 1984 through May 31, 1986. He stated that due to a change in allocation methods in 1986, the claims may have been overstated. Thus, on May 9, 1991, the parties signed a stipulation whereby Con Ed reduced the amount requested in this claim application by $562,774.81 to $10,027,399.32.

(e) a claim application dated May 8, 1987 in the amount of $1,176,218.47[7] covering sales taxes on natural gas transportation expenses from July 1, 1984 through May 31, 1986.

By letter dated January 26, 1988, the Division of Taxation denied the refund claims dated June 1982, September 20, 1982 and April 5, 1985. The Division rejected the refund claim dated June 1982 with regard to gas purchases stating that possession and title to gas transferred within New York State was subject to sales tax. With regard to the refund claim dated September 20, 1982 concerning gas transportation expenses, the Division stated that the charges were for pumping natural gas to Con Ed gas pipelines within New York State and are considered as part of the cost of acquiring the natural gas for use in the production of electricity and steam. The Division denied the refund claim dated April 5, 1985 concerning both gas purchases and transportation expenses stating that:

> "an examination of the contracts revealed that the possession of the natural gas purchased was transferred to Con-Ed in New York State subjecting it to the sales tax per Section 1101(b)(5) of the tax law rather than the use tax."

By letter dated March 7, 1988, the Division of Taxation denied the refund claim dated April 29, 1987 concerning gas purchases stating that:

> "A review of the contracts involving the purchases of the natural gas revealed that Con Edison did not have control or possession of
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> the gas until it reached Con Edison facilities in New York State and therefore the purchases are subject to sales tax imposed by Section 1105(b) of the Tax Law."

By letter dated May 25, 1988, the Division of Taxation denied the refund claim dated May 8, 1987 concerning sales taxes on transportation expenses stating that:

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[7]The amount of this claim was subsequently reduced by $85,862.10 to $1,090,356.37 (see footnote "6"). Although the stipulation stated that this claim was reduced by $85,862.10 to $1,027,399.32, this statement was clearly a typographical error inasmuch as the original refund application was for $1,176,218.47 and the reduction of $85,862.10 would compute to $1,090,356.37. Moreover, the total amount of refund stated in the stipulation was $22,042,038.49 which corresponds to the total amounts stated on the face of the original refund applications for Claims 1 through 5 minus the above-stated stipulated reductions to Claims 4 and 5.

> "[t]he basis for this denial is the fact that Con Edison did not have control or possession of the natural gas involved until it reached your facilities in New York State."

It appears that Con Ed timely appealed the refund denials before the Bureau of Conciliation and Mediation Services, but discontinued the appeal by letter dated April 27, 1989 (see, correspondence attached to petitions [Div. Ex. D]).

By petition dated July 14, 1989, Con Ed challenged the refund denials alleging that by definition gas is not tangible personal property for purposes of the use tax and that, inasmuch as title and possession of the natural gas purchased by Con Ed was transferred to it outside of New York State, the sales tax did not apply.[8]

On September 26, 1989, the Division of Taxation filed an answer to the petition stating that the contracts at issue evidenced that Con Ed did not obtain possession of the gas until it was delivered in New York and

that, therefore, Con Ed was liable as a customer for sales tax due on these sales.

At the commencement of the hearing, the Division's counsel stated that the issue was whether the sales occurred in New York State and whether Con Ed was "entitled to a refund of sales tax paid on natural gas which was used in the State." Counsel also stated the following in his introductory remarks:

> "Just briefly, for some background, I believe the parties concede that the law in that particular time, does not impose use tax upon a natural gas. However, there is a separate liability, customer liability for sales tax under Tax Law Section 1133, Subdivision B" (Tr. at 10).

In his introductory statement of the issue, Con Ed's counsel reiterated the point that the case did not involve use tax. He stated:

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[8]Con Ed also filed a second petition, dated July 14, 1989 challenging the denial of its refund claim in the amount of $36,192.93 alleging that a private telephone system installed by Coradian constituted a capital improvement that was exempt from sales tax under Tax Law § 1105(c)(3). The two petitions were consolidated for the hearing which commenced on October 24, 1990; however, the parties entered into a Stipulation of Discontinuance in December 1990 with regard to the petition concerning the telephone system.

> "[a]s Mr. Della Porta indicated, there is no question about use tax. There simply is no use tax on gas in New York State, because Section 1107 embraces all the definitions and exemptions of the general sales use tax provisions of New York State" (Tr. at 13).

No objection was raised to this statement by the Division's counsel.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner argues that the points of delivery at which possession of the gas was transferred by the vendors to Con Ed occurred with the vendors' delivery of the gas to the pipelines acting as carriers and agents of Con Ed. Petitioner argues that, under both the Uniform Commercial Code and the purchase and transportation contracts in question, both title and risk of loss passed upon delivery by the vendors to the pipeline. The fact that the gas molecules commingled with and became indistinguishable from other gas flowing through the pipeline did not negate, argues petitioner, the passage of title or risk of loss provisions contained in the purchase contracts. Petitioner concludes that:

> "the delivery and title provisions of the contracts were dictated by, and conformed to, the underlying physical, commercial, and regulatory realities and there are no grounds to disregard them for sales tax purposes."

Petitioner also argues that the separate transportation charges, in any event, are not subject to sales tax under the Tax Law inasmuch as they, in contrast to the gas purchases, were set forth on entirely separate invoices and payable to separate persons.

The Division argues that sales tax is a destination tax and that, regardless of the contract language, actual delivery of the gas did not occur until the pipeline delivered it to Con Ed's system in New York City. The Division emphasizes that natural gas is a fungible commodity and, therefore, until it reaches Con Ed's system, no particular molecules in the pipeline system can be identified as belonging to Con Ed. The Division concludes that although the contracts accommodate the needs of parties by maintaining the fiction that the vendor transferred the gas over to the pipeline carrier which transported it to Con Ed, this fiction was created for legal and accounting purposes and did not control the tax incident.

The Division also raised, for the first time, in brief that Con Ed's purchases of natural gas were, in any event, subject to use tax. In raising this issue, the Division's counsel states

that:

> "[t]he fact that I erroneously stated in my opening remarks at hearing that no use tax liability exists, cannot bind the Division if in fact a use tax liability exists" (Div. Brf. at 10).

Counsel notes that because the facts are not in dispute, petitioner is not prejudiced by the Division's raising of the use tax issue after the hearing. Counsel further requests that if petitioner alleges prejudice, that the hearing be reopened.

On the merits, the Division argues that natural gas is tangible personal property for purposes of tax imposed under Tax Law § 1105(b) and that Tax Law § 1110 states, in pertinent part, that:

> "Except to the extent that property or services have already been or will be subject to tax <u>under this article</u>, there is hereby imposed on every person a use tax for the use within this state...except as otherwise exempted under this article, (A) of any tangible personal property purchased at retail, (B) of any tangible personal property manufactured, processed or assembled by the user, if items of the same kind of tangible personal property are offered for sale by him in the regular course of business..." (emphasis added by Division).

Citing this portion of Tax Law § 1110, the Division argues that because Tax Law § 1101(b)(6) defines gas as tangible personal property for purposes of Tax Law § 1105(b), it directly defines gas as tangible personal property within the article to which Tax Law § 1110 refers (Div. Brf. at 12).

In response to the Division's use tax argument, petitioner contends that gas is exempt under the definition of tangible personal property under Tax Law § 1101(b)(6) except for the purposes of sales tax imposed under Tax Law § 1105(b).[9] Petitioner argues that the clear intent of the language of Tax Law § 1101(b)(6), removing gas from the definition of tangible personal property, was to exempt gas from use tax under section 1110.

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[9]Tax Law § 1101(b)(6) defines tangible personal property as:

> "Corporeal personal property of any nature. However, except for purposes of the tax imposed by subdivision (b) of section eleven hundred five, such term shall not include gas, electricity, refrigeration and steam."

CONCLUSIONS OF LAW

A. Tax Law § 1107 imposes a 4% temporary municipal assistance sales and compensating use tax for cities of one million or more. Subdivision (a) of section 1107 provides that the taxes imposed shall be identical to the taxes imposed by Tax Law §§ 1105 and 1110 and that those sections as well as other sections under Article 28:

> "including the definition and exemption provisions, shall apply for purposes of the taxes imposed by this section in the same manner and with the same force and effect as if the language of those sections had been incorporated in full into this section and had expressly referred to the taxes imposed by this section."

Therefore, with the exception of the exceptions set forth in subdivision (b) of section 1107,[10] discussions concerning the application of Tax Law §§ 1105 and 1110, as well as other sections under Article 28, are relevant to the application of section 1107.

B. Subdivision (b)(3) of section 1107 provides that tax will not be imposed where the property sold is delivered to the purchaser outside the taxing municipality and that:

> "[f]or purposes of this section delivery shall be deemed to include transfer of possession to the purchaser and the receiving of the property by the purchaser."

The question is at what point delivery or transfer of possession of the gas was made to the purchaser. In Matter of Savemart, Inc. v. State Tax Commn. of the State of New York (105 AD2d 1001, 482 NYS2d 150, appeal dismissed 64 NY2d 1039, 489 NYS2d 1029, lv denied 65 NY2d 604, 493 NYS2d 1025), the Appellate Division confirmed the former State Tax Commission's decision that the seller's delivery of televisions to a common carrier in New York State for an out-of-state purchaser was the location of the sales transaction inasmuch as the

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[10]One of the exceptions enumerated in this subdivision is Tax Law § 1115(c) which provides an exemption from sales and use tax under Tax Law § 1105(a) and (b) and Tax Law § 1110 for such items as follows:

> "Fuel, gas, electricity...for use or consumption directly and exclusively in the production of tangible personal property, gas, electricity, refrigeration or steam, for sale, by manufacturing, processing, assembling, generating...."

Thus, although the natural gas at issue was exempt from sales and use tax for State purposes, the same exemption was not available under section 1107.

carrier was acting as the designee of the purchaser (id., 482 NYS2d at 152, citing Matter of Schaefer Brewery Co. v. Gerosa, 4 NY2d 423, 176 NYS2d 276).

In Matter of Bloomingdale Brothers v. Chu (70 NY2d 218, 519 NYS2d 347), the Court of Appeals stated that "the ultimate destination of the goods is not necessarily the location of a particular sale" inasmuch as delivery may occur before the merchandise reaches its final destination. The Court noted that although delivery, "in the sense that physical custody is transferred, may take place several times during the course of a transaction, ...it is only that delivery which transfers control of the merchandise for consideration which marks a taxable event" (id. at 348). The Court further noted that when delivery of goods was made to a common carrier, the sale was completed and the purchaser exercised control over the merchandise, in contrast to the situation where the sales contract itself required delivery by the seller at his expense to the purchaser in which case the purchaser exercised control only after delivery was completed by the seller (id.).

A purchaser exercises control over merchandise when title passes to him or her to the extent that the purchaser, rather than the seller, bears the risk of loss during shipment. The New York Uniform Commercial Code provides that:

> "unless otherwise explicitly agreed title [to goods] passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods" (UCC 2-401[2]).

If the contract requires the seller to send the goods[11] to the buyer, title passes to the buyer at the time and place of shipment unless the contract requires delivery to a particular destination, in which case title passes when delivered to that destination (UCC 2-401[2][a], [b]; see, Castle Coal & Oil Co., Inc. v. Frank's Fuel, Inc., 69 AD2d 795, 415 NYS2d 237; Matter of Harbor Petroleum Corp., Tax Appeals Tribunal, September 21, 1989). With respect to the risk of loss, the UCC also provides that when the contract requires or authorizes the seller to ship the goods by carrier, the risk of loss passes to the buyer when the goods are delivered to the carrier (UCC

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[11]The term "goods" under the UCC applies to natural gas (see, UCC 2-107).

2-509[1][a]; see, A. M. Knitwear Corp. v. All American Export-Import Corp., 41 NY2d 14, 390 NYS2d 832; Fertico Belgium S.A. v. Phosphate Chemicals Export Assoc., Inc., 100 AD2d 165, 473 NYS2d 403).

Here, with the exception of one contract discussed below (Conclusion of Law "D"), the gas purchase contracts specifically provided either that title passed or that the sale would take place when the gas was accepted by the pipeline carriers for the account of Con Ed. It was at the delivery points between the vendors and pipeline carriers that Con Ed was obligated to pay the vendor regardless of whether the pipeline completed delivery to Con Ed. The risk of loss shifted from the seller to the buyer or the buyer's

designees at these delivery points. Based on these purchase and transportation contracts, it is clear that the pipeline carriers acted as agents or designees of the buyer -- Con Ed. Due to the change in the regulatory environment, the pipeline carriers no longer acted as gas merchants brokering natural gas on behalf of vendors (see, Findings of Fact "6" and "11"). The fact that Con Ed entered into transportation contracts with the pipeline carriers separate from its purchase contracts with vendors was the effect of this changed relationship. Thus, the taxable events with regard to these contracts all took place outside of New York City at the delivery points between the vendors and pipeline carriers (see, Finding of Fact "14").

C. The Division argues that because the gas molecules delivered to the pipelines were not the same gas molecules ultimately delivered by the pipelines to Con Edison, the taxable event did not occur until the pipelines delivered the gas to Con Edison's system. The Division, therefore, argues that the contract accommodated the needs of the parties by maintaining the fiction that the vendor supplied the gas to the pipeline carrier which transported it to Con Ed and that while this fiction was created for legal and accounting purposes, it did not control the tax incident. This argument is rejected. The fact that the gas delivered by the vendors to the pipeline carriers commingled with other gas flowing through the pipelines did not negate the fact that the vendors actually delivered a measurable amount of gas to the pipeline carriers

which in turn transported such gas through its pipelines and delivered a measurable amount as required by contract to Con Edison. Under the UCC, "[g]oods must be both existing and identified before any interest in them can pass" (UCC 2-105[2]). The fact that the gas purchased is a fungible good does not mean that it cannot be identified and sold prior to receipt by Con Edison at the interconnections between the pipelines and Con Edison's system (see, UCC 2-105[4]). That a vendor delivers a measurable amount of natural gas to a pipeline carrier is no fiction and if, at that point, the vendor relinquishes control and possession of the gas to an agent of the purchaser and the purchaser has a concomitant obligation to pay for the gas, a sale or taxable event occurs.

D. The contract between Con Edison and National Fuel Gas Distribution Corp. for the period March 17, 1979 through March 17, 1981 (Pet. Ex. 121 [a], [b] and [c]) stated that all of National Fuel's rights and title to the natural gas made available on the Texas Eastern and Tennessee pipeline systems shall pass to Con Edison at the New York State border (see, Finding of Fact "16"). While the Tennessee pipeline does not enter the New York State border in New York City, the Texas Eastern pipeline does (see, Finding of Fact "16," footnote "4"). The question is whether this contract language controls where the gas sale occurred for sales tax purposes.

While parties to a commercial contract are free to readjust their rights and risks by mutual agreement (see, UCC 2-509[4]), the substance of the transaction must be viewed in its totality for sales tax purposes. Here, the contract language in question is problematic in light of other conflicting contract provisions contained in the same purchase contract and the related transportation contract and in light of the practical realities involved in the total course of dealings in direct gas purchases.

As noted in Finding of Fact "16", the purchase contract provided that Con Edison was solely responsible for arranging and paying for transportation of the gas on the three pipelines designated in the contract; moreover, under the transportation contract between Texas Eastern and Con Edison, Texas Eastern was deemed in control of the gas once it was received by

National Fuel at the interchange between the vendor and pipeline in Pennsylvania until the delivery points in Richmond County and in New Jersey at which point Con Edison was deemed in control and possession of such gas. Having the title pass from National Fuel to Con Edison at the New York border was atypical of the other direct purchase contracts including subsequent contracts between National Fuel and Con Edison. Moreover, using the New York border as a demarkation point appears to be artificial inasmuch as the gas cannot be identified at that point. The only points at which a determination could be made that gas was actually delivered from the vendor to the pipeline and from the pipeline to Con Edison was at meter stations located at the "points of receipt" (Greene County, Pennsylvania) and the "points of delivery" (Richmond County, New York and Lambertville, New Jersey) (see, Finding of Fact "16"). As noted by Mr. Richter's testimony, it was at the point of receipt that Con Edison incurred its obligation to pay the vendor for the gas whether or not the gas was delivered by the pipeline to Con Edison (see, Finding of Fact "17"). This normal course of dealing with regard to the obligation to pay was not contradicted by the National Fuel contract.

Thus, notwithstanding the anomalous contract language, other provisions in the National Fuel purchase contract and related transportation contract, along with the course of dealings established by testimony and documentary evidence concerning the regulatory environment, indicate that once the gas was delivered by Supply Corp.[12] to Texas Eastern at the point of receipt in Pennsylvania, the sale was complete and that any risk of loss had passed from Supply Corp. to Texas Eastern as agent for Con Edison. Thus, the gas sales under the National Fuel contract for the period March 17, 1979 and March 17, 1981 were made outside New York State for sales tax purposes.

E. Petitioner argues that the transportation charges paid to the pipeline carriers for the transportation of the natural gas were not subject to tax. The Division has not specifically

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[12]National Fuel Gas Supply Corp. (Supply Corp.) is an affiliate of National Fuel Gas Distribution Corp. (see, Pet. Ex. 224).

addressed this issue in its pleadings, brief or at hearing. Inasmuch as these transportation charges were not part of the purchase price and were separately determined by contract with the pipeline carriers who had no ownership interest in the gas but merely transported the gas on behalf of Con Edison, Tax Law § 1107 does not apply to these charges (see, Tax Law § 1101[b][3]).

F. Subsequent to the Division conceding in the refund denials and at hearing that use tax is not applicable in this case (see, Findings of Fact "23", "28" and "30"), the Division's counsel raised in brief that use tax liability exists in the facts of this case (see, Finding of Fact "33"). Petitioner did not challenge the procedural posture in which this issue was revived, however, it argued the merits in its reply brief. Therefore, inasmuch as petitioner does not object and is not prejudiced, in any event, by the Division's post-hearing argument because the facts upon which this legal argument rests have already been developed at the hearing, this issue will be addressed.

G. On the merits, the Division argues that the natural gas in question is tangible personal property and, thus, is subject to use tax under Tax Law §§ 1110 and 1107. The Division comes to this conclusion by reading sections 1101(b)(6) and 1110 together, arguing that because gas is tangible personal property by definition under section 1101(b)(6) for purposes of sales tax under section 1105(b), then gas must also be tangible personal property under section 1110 inasmuch as section 1110 refers to property subject to tax "under this article". However, this logic does not comport with the language of section 1101(b)(6) which clearly states that gas is not tangible personal property except for purposes of Tax Law § 1105(b). If the Legislature had intended that gas be tangible personal property for purposes of use tax under section 1110, it would have extended the exception to section 1110 as well as section 1105(b). The phrase "under this article" in section 1110, to which the Division refers, does not provide an exception to the exclusion of gas from the definition of tangible personal property under section 1101(b)(6). Section 1110 merely provides that:

> "[e]xcept to the extent that property or services have already been or will be subject to the sales tax under this article, there is hereby imposed on every person a use tax

> for the use within this state...except as otherwise exempted under this article, ...[of any tangible personal property purchased at retail]."

The language in question does not redefine gas as tangible personal property under section 1110 so as to supercede section 1101(b)(6). The exclusion of gas from the definition of tangible personal property for purposes of the use tax under section 1110 comports with the decision of the former State Tax Commission in Matter of Tenneco, Inc. (January 17, 1986).

The Division also argues, however, that a thorough reading of Tenneco reveals that Conclusions of Law "A" and "C" can only be read harmoniously by concluding that the former State Tax Commission erred in Conclusion of Law "D" "to the extent of its holding that natural gas could not be subject to the use tax imposed by Tax Law § 1110" (Div. Brf. at 12). Under Conclusion of Law "A", the Commission, citing to 20 NYCRR 526.8(b) and 527.2(a)(2), stated that, under certain circumstances, gas may be subject to the section 1105(a) tax as tangible personal property. Under Conclusion of Law "C", the Commission stated that the absence from section 1110 of language directly parallel to that contained in section 1105(b) leads to the conclusion that the purchased gas was not subject to use tax. In Conclusion of Law "D", the Commission held that the transactions with respect to the natural gas petitioner received as consideration for the transportation of gas for others constituted taxable exchanges under Tax Law § 1105(b). From these Conclusions of Law, the Division's counsel concludes that because the natural gas in question was purchased by Con Ed in bulk, it would be taxable under section 1105(a) as tangible personal property and, thus, if not subject to sales tax under section 1105(a), would be subject to the complementary use tax under section 1110.

This analysis is faulty because the natural gas at issue was not sold in "bulk" within the meaning of 20 NYCRR 526.8(b) as implied by the Division. That regulation provides that gas sold in containers or in bulk for purposes other than heating, cooking or lighting is considered tangible personal property. This regulation refers to 20 NYCRR 527.2 which states, in pertinent part, that:

> "Where gas service or gas is sold and delivered, in a truck from which the gas is transferred to a container on the premises of the purchaser, such transaction is taxed as a sale in a bulk container having a capacity of 100 or more pounds of gas subject

to tax as in paragraph (1) of this subdivision"[13] (20 NYCRR 527.2[b][2]).

Thus, inasmuch as the natural gas at issue was not sold in containers but was sold through pipes or mains to a utility for use in its generators to produce steam or electricity for utility customers, it would be taxed, if at all (see, footnote 10), under subdivision (b) and not subdivision (a) of section 1105 (see, Matter of Tenneco, Inc., supra). Thus, the gas purchases were not subject to use tax pursuant to Tax Law § 1107.

H. The petition of Consolidated Edison Company of New York, Inc. is granted.

DATED: Troy, New York

10/17/91

ADMINISTRATIVE LAW JUDGE

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[13] Subdivision 1 of 20 NYCRR 527.2(b) states that:

> "All types of gas...sold through pipes or mains, or in containers with a capacity of 100 pounds of gas or more, for heating, cooking, refrigerating or lighting purposes by residential[,] commercial or industrial users are subject to the tax imposed under subdivision (b) of section 1105 of the Tax Law."