February 21, 2002

Hon. Richard J. Grossi
Chairman, Board of Directors
New York Independent System Operator, Inc.
c/o William J. Museler
President & CEO
New York Independent System Operator, Inc.
3890 Carman Road
Schenectady, NY 12303

Re: LIPA Appeal of the Management Committee Approval of a Congestion Reduction Proposal

Dear Chairman Grossi:

Pursuant to Section 5.07 of the ISO Agreement and the Procedural Rules of Appeals to the ISO Board, the Long Island Lighting Company d/b/a LIPA (LIPA) hereby submits its notice of appeal of actions taken during the February 7, 2002, Management Committee meeting. LIPA appeals the Management Committee's approval of the Congestion Reduction Proposal (CRP) and related rejection of amendments offered by LIPA during the consideration of the CRP. Pursuant to Section 5.02 of the Procedural Rules of Appeal, LIPA requests that a hearing on this matter be conducted by the Governance Committee of the ISO Board.

Sincerely,

James J. Parmelee
Director of Power Market Contracts

Enclosure

cc: NYISO Board of Directors:

Richard E. Schuler
Alfred F. Boschulte
Peter A. A. Berle
Harold N. Scherer, Jr.
Thomas F. Ryan, Jr.
Erland E. Kailbourne
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John W. Boston
William J. Museler

James Schmidt, NYISO, Asst. General Counsel
Richard J. Bolbrock, LIPA, Vice President of Power Markets
Joseph B. Nelson, Van Ness Feldman

Summary of Notice of Appeal

Decision Being Appealed: Management Committee approval of the Congestion Reduction Proposal and the rejection of amendments to the Congestion Reduction Proposal offered by LIPA.

Meeting Date: February 7, 2002

Appellant: Long Island Lighting Company d/b/a LIPA ("LIPA")

Grounds for Appeal: LIPA requests that the Board of Directors for the New York Independent System Operator ("NYISO Board") overturn the February 7, 2002 decision by the Management Committee rejecting LIPA's motions #1 and #2 amending the Congestion Reduction Proposal ("CRP") as well as its final approval of the CRP. The CRP, among other matters, proposes the establishment of "counter-flow TCCs" which would be assigned to transmission owners taking an outage anticipated to result in a Congestion Rent Shortfall of $250,000 or more. As presently drafted, the CRP will adversely affect grandfathered TCC rights held by transmission owners and is contrary to the transmission owners' requirement to maintain transmission lines consistent with Good Utility Practice. LIPA requests that the NYISO Board reverse the Management Committee's approval of the CRP and direct the Management Committee to re-open discussions on an appropriate program for congestion reduction.

APPEAL

I. Introduction

On February 7, 2002, the Management Committee for the New York Independent System Operator ("NYISO") "conceptually" approved a Congestion Reduction Proposal ("CRP") offered by Niagara Mohawk Power Corporation ("NMPC"). A centerpiece of the CRP is the creation of counter-flow transmission congestion contracts ("Counter-Flow TCCs") which are assigned to transmission owners for certain transmission outages. In particular, Counter-Flow TCCs are assigned for transmission outages which are forecasted to, or actually, result in a congestion rent shortfall during a six month TCC auction period of more than $250,000. A Counter-Flow TCC would be opposite to the prevailing direction of TCCs supported by a particular line. This will expose the transmission owner to pay congestion rent for each day of the outage where congestion occurs (i.e. LBMP price differential over the prevailing direction of TCCs). This proposal, however, will adversely affect grandfathered rights held by certain transmission owners, result in discriminatory treatment of transmission owners and, perversely, create disincentives to prudent maintenance practices. During consideration of the CRP at the Management Committee, LIPA proposed two motions addressing the most significant flaws in the proposal (see Appendix A; LIPA Motions #1 and #2). In addition, LIPA supported a separate motion offered by Consolidated Edison of New York ("Con Ed"). The Management Committee's rejection of these amendments was unwarranted and results in a program that is significantly flawed.

II. The CRP Selectively Vitiates the Original Business Arrangement Under Which Transmission Owners Entered the NYISO

The creation of the NYISO was based, in part, upon an arrangement between the New York utilities (often referred to as the "Member Systems") which addressed certain revenue and financial considerations related to the Member Systems' participation in the

NYISO. One of the matters addressed was the allocation of both surplus and shortfalls in the collection of day-ahead and actual congestion rents.

Under the present methodology, day-ahead congestion revenue surpluses and shortfall congestion costs are allocated in proportion to Surplus TCC auction revenues. This results in an allocation to LIPA of a relatively small share of potential surpluses and, similarly, a relatively small share of shortfalls. This allocation is not location-specific such that surplus and shortfalls occurring only within the LIPA service territory are still allocated statewide by this mechanism. Real-time surplus congestion revenues and shortfall congestion costs are allocated in proportion to a megawatt ("MW") miles approach. This methodology while locationally specific allocates a very limited share of both surplus and shortfalls to LIPA.

The present allocation methodology reflects a business arrangement between the Member Systems that allocated benefits and risks commensurately. The CRP, however, will now reallocate how congestion costs (but not surpluses) are shared for day-ahead congestion and only when such congestion shortfalls are significant. The practical fact is that the CRP targets downstate transmission outage effects which primarily are present in the day-ahead market while upstate congestion, which often occurs in the real-time market, continues to be treated under the present methodology.

When LIPA agreed to participate in the NYISO, LIPA did so with an understanding of the obligationss and benefits of the underlying business arrangement. In some instances that business arrangement was expected to work to LIPA's deteriment on specific issues and to its benefits in others. In fact, when the surplus/shortfall allocation was discussed, it was primarily expected that surpluses--not shortfalls would occur. NMPC is now seeking to use the NYISO to selectively reallocate obligations agreed to between the Member Systems. The NYISO should not be in the business of reallocating the original business arrangement of the Member Systems.

In addition, the reallocation proposed under the CRP remains premature. No comprehensive study has been undertaken on the overall extent of the CRP such that it is unclear what new biases could be created by these changes. Furthermore, there are alternative ways to provide incentives for transmission owners for proper maintenance practices without interfering with the fundamental business arrangement of the Member Systems.

III. Amendment of the CRP is Necessary to Protect Grandfathered TCCs

The CRP fails to recognize and protect grandfathered transmission rights. Upon the creation of the NYISO, transmission owners holding existing facilities use agreements for transmission lines such as the Y49 and Y50 cables between New York City and Long Island, were granted grandfathered TCCs in recognition of these existing contractual arrangements. *See Attachment L, Table 1-A, Contract # 9 and #14.* Such grandfathered rights are protected against material or adverse changes pursuant to Section 3.04 of the NYISO/TO Agreement, which provides:

> The ISO responsibilities set forth in Article 3 of this Agreement, are granted by each Transmission Owner to the ISO only so long as each of the conditions set forth below is met and continues to be met throughout the term of this Agreement:
>
> . . .
>
> c. The ISO does not materially and adversely affect the right of any Transmission Owner concerning transitional arrangements set forth in the ISO Tariffs, pertaining or relating to Existing Transmission Agreements which are in effect at the commencement of ISO operations . . .

NYISO/TO Agreement, Section 3.04. One such transitional arrangement is that, under the NYISO OATT, existing transmission agreements were "grandfathered" upon implementation of the ISO. *NYISO OATT, Attachment K, Section 1.* As a "grandfathered" contract, the parties were granted the right to convert their prior contractual rights to firm transmission service over particular facilities to grandfathered

TCCs. In this manner, parties holding grandfathered rights were held harmless from the change to the NYISO market and introduction of congestion rent that would otherwise apply to their grandfathered service. Moreover, under Section 3.04, the NYISO is under a direct obligation to respect the full legal scope of the existing agreements and the resulting grandfathered TCCs. Failure to do so is an explicit violation of the terms of the NYISO/TO Agreement and the NYISO OATT.

A Counter-Flow TCC will create a parallel "negative" TCC that eliminates any TCC revenue the transmission owner would otherwise receive under its grandfathered TCC. In particular, LIPA holds grandfathered TCCs supported by the Y50 cable, such that, if there is congestion rent occurring during a transmission outage of the Y50 cable, LIPA has the right to receive that congestion rent. Under the CRP, however, that congestion rent revenue would be negated by the assignment of counter-flow TCCs to LIPA over that same line. This formulation unequivocally violates the NYISO's obligation under Section 3.04 of the NYISO/TO Agreement to protect against material and adverse changes to grandfathered rights.

LIPA's motion #1 proposed to correct this flaw by providing that the present treatment of outages over facilities fully subscribed by grandfathered TCCs remain in place until a new congestion rent shortfall allocation could be developed pursuant to Objective 4 of the CRP. This would have allowed the NYISO the opportunity to develop an allocation methodology which would not result in adverse impacts to grandfathered TCCs. By offering this motion, LIPA was not denying that the present congestion rent shortfall allocations has flaws, rather, LIPA was seeking to allow for a rational development of a program that addresses those flaws without placing grandfathered rights in jeopardy.

IV. The CRP Results in Discriminatory Treatment of Transmission Owners with Underground and Underwater Cables

Under the CRP, all transmission outages are not treated as equals. The reality of the CRP is that transmission owners, like LIPA and Con Ed, with transmission cables that are both underground and underwater are significantly disadvantaged. Transmission outages over underground and underwater cables typically require longer periods of time and cannot be as easily managed to only occur in low congestion periods. Further, underground and underwater cables also have increased maintenance requirements that are not required of overhead lines. Accordingly, parties with underground and underwater transmission cables are more likely to be subject to assignment of Counter-Flow TCCs and the extent of their exposure may be more significant due to nothing more than the type of maintenance activities required on that particular line.

A further concern regarding the discriminatory nature of the CRP is that transmission lines like the underwater cables (primarily between Long Island and New York City) connect areas where LBMP differentials can be extreme and may not be solely related to the existence of a particular transmission outage. These circumstances will result in an inordinate amount of financial liability being placed on LIPA for adhering to good utility practices in the maintenance of its lines. In this manner, regardless of the merit or necessity of a transmission outage, LIPA will be assigned a financial penalty in the form of a Counter-Flow TCC. At the same time, a transmission owner in upstate New York will have limited cost exposure for maintenance activities on its lines—even if such activity is unwarranted and/or performed inefficiently.

The methodology proposed in the CRP will result in different financial assessments to transmission owners for the same activity based on regional and factual situations such as whether the transmission line is above ground, below ground or

underwater and whether it is located in area that experiences extreme or minor LBMP price differentials. Sections 205 and 206 of the Federal Power Act bar the granting of undue preferences and/or discriminatory treatment under the terms of a tariff. *See 18 U.S.C. § 824d(b) and § 824e(a).* This bar against discriminatory treatment is not only applicable with respect to transmission customers but also, under an ISO environment, to transmission providers operating under a single ISO tariff. The CRP would implement a program that clearly discriminates against particular transmission owners with respect to similar actions being taken. As such, the NYISO Board should reject the CRP and direct the Management Committee to develop a proposal that meets the FPA's anti-discrimination standards.

V. The CRP Must Accommodate Actions Taken by Transmission Owners Consistent with Good Utility Practice

An additional flaw of the CRP is that it creates a perverse disincentive for prudent maintenance practices by the assignment of Counter-Flow TCCs. Section 2.07 of the NYISO/TO Agreement provides that:

> Each Transmission Owner shall comply with the provisions of [the NYISO/TO Agreement] and all Reliability Rules, ISO Procedures and Good Utility Practice with respect to the design, maintenance and rating [of] the capabilities of the NYS Transmission System facilities.

Section 2.07 of NYISO/TO Agreement. Furthermore, transmission owners must coordinate with the NYISO in the scheduling and conduct of transmission outages over their transmission facilities including seeking approval of outage schedules by the NYISO. *See Section 2.08 of NYISO/TO Agreement.*

Under the CRP, however, a transmission owner will now be penalized for taking a facility out of service even if good utility practice dictated that the outage take place. The CRP establishes a unique system where a transmission owner, using principles of good utility practice, schedules a transmission outage and receives approval of such

outage by the NYISO will now be subject to financial penalties in the form of Counter-Flow TCCs in the event that such line happens to be a highly utilized transmission facility (thus creating the potential of congestion rent shortfalls during an outage). Under this proposal then, transmission owners will not only have the expense of undertaking maintenance on their facilities, but they will now be subject to Counter-Flow TCCs—even though the action that they are taking is necessary to maintain a reliable electric transmission system.

The New York transmission owners have an obligation to schedule and coordinate transmission outages with the NYISO and to conduct maintenance of their lines in accordance with good utility practice. The fact that a transmission outage, necessary to maintain reliability, scheduled and coordinated with the NYISO and undertaken consistent with good utility practice will result in an assignment of Counter-Flow TCCs and their resultant financial penalties is antithetical to NYISO/TO Agreement and a fair and functioning ISO environment. The CRP must be amended to recognize and hold harmless transmission owners for actions taken pursuant to their responsibilities under the NYISO/TO Agreement and good utility practice.

VI. Conclusion

While characterized as a congestion management tool, the CRP's sole purpose is to reallocate congestion rent shortfall (while, cynically, maintaining the existing allocation of any congestion rent surpluses that may occur). The present allocation of both congestion surpluses and rent shortfalls admittedly has fallen disproportionately on certain transmission owners. In the initial year of NYISO operations, upstate transmission owners such as NMPC received a windfall from congestion rent surpluses. Since that time, market conditions have result in underfunding of TCCs thus creating significant congestion rent shortfalls that likewise have affected NMPC more than other

transmission owners. However, the problem inherent in congestion rent surplus and shortfall allocations cannot and will not be solved by the CRP. That solution will be found in the process suggested in Phase 2 of the CRP where a "new relatively simple cost allocation method" is to be investigated. However, the level of commitment for that effort is, at best, ephemeral. The Management Committee's Motion for approval notes that there should be an "analysis" of Phase 2 with presentation of status reports or motions "if and when appropriate." LIPA has serious reservations that any real efforts will take place and that any new cost allocation method will ever be developed. Rather, the CRP's proponents are seeking the NYISO Board's acquiescence in a premature approval and rush to develop a cost-shifting measure that will address none of the underlying causes of congestion rent shortfalls.

For the reasons stated above, LIPA urges the NYISO Board to reject the CRP in its present formulation and direct that the Management Committee re-open discussions on how to address the underlying problem of excessive congestion rent shortfalls and surpluses.

Exhibit A

Congestion Management

LIPA Motion 1

Motion to amend the congestion reduction proposal to include the following provision.

Counter-Flow TCCs shall not be assigned to facilities that were fully subscribed by grandfathered TCCs that were in effect at the beginning of the ISO operations (Y-49 and Y-50 Facilities). Congestion rent shortfalls caused by outages on these facilities would initially be allocated to TOs using the current congestion rent shortfall methodology. Once the new cost allocation methodology specified in Objective 4 is developed, the Objective 4 methodology would be applied to these facilities.

LIPA Motion 2

Motion to amend the congestion reduction proposal to include the following provision.

Counter-Flow TCCs shall not be assigned to facilities that were taken out of service in accordance with good utility practice.