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June 19, 2001

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

**Re: NYSEG's Appeal and Conditional Request For Stay of the
Management Committee's June 6, 2001 Decision To File The
Stage II ICAP Tariff**

Dear Chairman Grossi:

Pursuant to the "Procedural Rules for Appeals to the ISO," enclosed please find three copies of the Notice of Appeal of New York State Electric & Gas Corporation ("NYSEG") of the June 6, 2001 Decision of the New York Independent System Operator's ("NYISO's") Management Committee to approve the filing of the Stage II ICAP Tariff (the "June 6 Decision"), which would dramatically modify the NYISO installed capacity ("ICAP") market including decreasing the obligation procurement period for ICAP from six months to one month and requiring a generator's ICAP to be converted to Unforced Capacity ("UCAP") each month.

NYSEG requests that the Board of Directors defer consideration of the June 6 Decision for two reasons. First, it is fundamentally inconsistent with the NYISO's established

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commitment to eliminate “seams” issues with PJM and ISO-NE and the ongoing effort to define common installed capacity principles for all Northeast ISOs to adopt. To the contrary, the June 6 Decision would create new seams issues and divergent market rules. Second, the shorter obligation procurement period could destabilize the NYISO’s capacity markets. Based on its actual experience with a shorter procurement period, PJM very recently rejected its short-term procurement period and replaced it with a longer FERC-approved seasonal Interval (i.e., PJM’s corollary to the NYISO’s obligation procurement period for installed capacity). For these reasons, NYSEG requests that the Board defer action on the June 6 Decision until after: (a) resolution of this appeal; (b) the exercise of a good faith effort on the part of the NYISO to arrive at common ICAP principles with the other Northeast ISOs; and (c) consideration of the potential significant degradation of reliability that would result from a shortened procurement period, the reason PJM recently abandoned its short term period for the seasonal Interval.

NYSEG further requests that the Board of Directors direct the NYISO to work diligently with PJM Interconnection, LLC and ISO-New England to complete, on an expedited basis, the common installed capacity principles for all Northeast ISOs to adopt. On the eve of FERC’s technical conference on interregional coordination, the NYISO must stand behind its commitment to develop common business practices to overcome seams issues. Intentionally adopting such dramatic changes to ICAP rules independently without attempting common resolution on ICAP principles with PJM and New England is irreconcilable with the NYISO’s stated commitment.

Moreover, NYSEG has for many weeks now proposed resolving outstanding ICAP issues at the July 9, 2001 Northeast ISO Memorandum of Understanding (“MOU”) Business Practices Working Group meeting.¹ Based on the NYISO’s commitment to resolving seams issues, adoption of the June 6 Decision cannot be reconciled with the NYISO’s commitment, including the NYISO’s intention to resolve ICAP issues at the July 9 meeting.

If the Board does not grant this request to defer action on the June 6 Decision until after resolution of this appeal, then NYSEG requests a Stay because implementation of the new obligation procurement period for ICAP will cause irreparable harm.

¹ Consistent with section 7.11(f) of the Independent System Operator Agreement, actions of the Management Committee are not to take effect for thirty (30) days. Were the June 6 Decision to go into effect, it would be on the business day immediately prior to the MOU BWG meeting scheduled with the intention of addressing common ICAP principles throughout the Northeast.

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NYSEG will serve a copy of this filing to each Member of the Management Committee via email. If the Board of Directors requires any additional information, please call Stuart A. Caplan at (212) 455-5505 or Bill Booth at (212) 455-5514.

Respectfully submitted,

Stuart A. Caplan, Esq.

William D. Booth, Esq.

Huber Lawrence & Abell

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Enclosure

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**NOTICE OF APPEAL AND CONDITIONAL REQUEST FOR STAY OF NEW YORK
STATE ELECTRIC & GAS CORPORATION TO THE NEW YORK INDEPENDENT
SYSTEM OPERATOR’S BOARD OF DIRECTORS OF THE MANAGEMENT
COMMITTEE’S DECISION TO APPROVE THE STAGE II ICAP TARIFF FOR
FILING**

I. PRELIMINARY STATEMENT

Pursuant to § 5.07 of the ISO Agreement, New York State Electric & Gas Corporation (“NYSEG”) hereby appeals the New York Independent System Operator’s (the “NYISO’s”) Management Committee (“MC”) Decision approving Motion #2 of the NYISO’s June 6, 2001 MC Meeting (the “June 6 Decision”) to the NYISO Board of Directors (the “Board”). The June 6 Decision, *inter alia*, decreased the obligation procurement period (“OPP”) for installed capacity (“ICAP”) from six months to one month and required gener to Unforced Capacity (“UCAP”) each month.¹

NYSEG requests that the Board defer consideration of the MC’s June 6 Decision for two reasons. First, approving the June 6 Decision is fundamentally inconsistent with the NYISO’s established commitment to eliminate “seams” issues with PJM Interconnection, LLC (“PJM”) and ISO-New England (“ISO-NE”) and participate in the ongoing effort to define common installed capacity principles for all Northeast ISOs to adopt. To the contrary, the June 6 Decision would create new seams issues and divergent market rules. Second, the shorter OPP could destabilize the NYISO’s capacity markets. Based on its actual experience, PJM very recently rejected its short-term procurement period and replaced it with a longer Federal Energy Regulatory Commission (“FERC” or the “Commission”)-approved seasonal Interval (i.e., PJM’s

¹ The NYISO intends to calculate, each month for each generator, the amount of UCAP the generator is qualified to supply to New York based on a rolling twelve-month calculation and application of an Equivalent Demand Forced Outage Rate (“EFOR_D”). Under the ISO’s proposal, the UCAP value, once calculated, will be fixed for the Obligation Procurement Period (“OPP”), which the proposal defines as one month. The OPP is the period over which a load serving entity must commit generating resources it has acquired to meet its capacity obligations to New York. Consequently, the UCAP value will now be subject to correction each month based upon fluctuations in the generator’s EFOR_D.

corollary to the NYISO's obligation procurement period for installed capacity).² For these reasons, NYSEG requests that the Board defer action on the June 6 Decision until after: (a) resolution of this appeal; (b) the exercise of a good faith effort on the part of the NYISO to arrive at common ICAP principles with the other Northeast ISOs; and (c) consideration of the potential significant degradation of reliability that would result from a shortened procurement period, the reason PJM recently abandoned its short term period for the seasonal Interval.

NYSEG further requests that the Board direct the NYISO to work diligently with PJM and ISO-NE to complete, on an expedited basis, the common installed capacity principles for all Northeast ISOs to adopt. On the eve of FERC's technical conference on interregional coordination, the NYISO must stand behind its commitment to develop common business practices to overcome seams issues. Intentionally adopting such dramatic changes to ICAP rules independently and without attempting common resolution of ICAP principles with PJM and New England is irreconcilable with the NYISO's stated commitment.

If the Board does not grant this request to defer action on the June 6 Decision until after resolution of this appeal, then pursuant to § 3.01 of the Procedural Rules for Appeals to the ISO Board, NYSEG requests a Stay because implementation of the new obligation procurement period for ICAP will cause irreparable harm.

² In an order dated June 1, 2001, the Federal Energy Regulatory Commission ("FERC" or the "Commission") approved the decision of PJM's Reliability Committee revising the Reliability Assurance Agreement ("RAA") to require Load Serving Entities ("LSE") to commit capacity resources to PJM on a seasonal rather than on a daily basis. PJM Interconnection, LLC, 95 FERC ¶ 61,330 (2001).

II. ARGUMENT

A. The NYISO Should Not Transition to a One Month Obligation Procurement Period For ICAP

1. To Fulfill Its Obligation to Eliminate Interregional Seams Issues With Neighboring ISOs, the NYISO Must Coordinate With PJM and ISO-NE To Develop Common ICAP Principles Including a Common Procurement Period for ICAP

In Order No. 2000,³ FERC required transmission-owning entities to make a filing exemplifying how they would fulfill the required characteristics and functions of a Regional Transmission Organization (“RTO”). The NYISO and the transmission-owning entities within its control area made a joint RTO compliance filing on January 11, 2001.⁴ In that filing, the NYISO argued that the current NYISO control area was sufficient to fulfill the scope requirement for an RTO, but also contemplated eventually merging with neighboring ISOs, including PJM, to form a single Northeast RTO.

Regardless of whether the NYISO eventually merges with PJM or the other neighboring ISOs, Order No. 2000 obligates it to coordinate its reliability practices with neighboring ISOs. In particular, the NYISO must fulfill the required RTO function of Interregional Coordination, whereby the “RTO must ensure the integration of reliability practices within an interconnection” and “must ensure the integration of market interface practices among regions.”⁵ On numerous occasions, the NYISO has expressed its commitment to fulfilling this FERC-mandated obligation and to going above and beyond that obligation to coordinate with neighboring ISOs, including PJM.

³ Regional Transmission Organizations, Order No. 2000, 65 FR 809 (January 6, 2000), FERC Stats. & Regs. ¶ 31,089 (2000).

⁴ New York Independent System Operator, Docket No. RT01-95-000, (“NYISO RTO Filing”) (January 16, 2001).

For example, in its Order No. 2000 compliance filing, the NYISO made several statements describing its general commitment to coordinating with neighboring ISOs. The NYISO touted its “leading role in furthering the integration of reliability and market interface practices among transmission entities in the Northeast.”⁶ The NYISO stated that it was “actively pursuing inter-regional coordination arrangements that the NYISO intends to have in place by, or soon after, December 2001...[and which would] result in the creation of a ‘virtual RTO’ in the

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More specifically, in its RTO filing, the NYISO described the ISO Memorandum of Understanding (“ISO-MOU”), which formalized the collaboration of the NYISO, PJM, ISO-NE and the Ontario IMO to address seams issues and make their markets more compatible.⁸ The NYISO’s RTO Filing stated that such coordination would include the coordination of the capacity markets. The NYISO described the work of the Planning Working Group’s Task-Force on Capacity Planning, which was created pursuant to the ISO-MOU process and was charged with “coordinat[ing] practices and processes in order to achieve, to the extent feasible, commonality of procedures in administering installed capacity markets.”⁹ The NYISO recently went further in stating its commitment to coordinating its capacity markets with those of its neighbors. When describing the “Best Practices” proposal that arose from the ISO-MOU process, the NYISO stated that the proposal sought to “creat[e] common ICAP market rules.”¹⁰

⁵ American Bar Association Presentation, “The FERC’s Rule on Regional Transmission Organizations, FERC Order 2000: Status of Regional Collaboration and Hot Issues” June 8, 2000, Douglas W. Smith General Counsel, Federal Energy Regulatory Commission, <http://www.ferc.fed.us/electric/abajune.pdf>.

⁶ NYISO RTO filing at 5.

⁷ *Id.* at 18.

⁸ *Id.* at 44

⁹ *Id.* at 52.

¹⁰ Initial Comments of the New York Independent System Operator, Inc. to the Proposed Technical Conference [to address Seams issues], Docket No. RM99-2-000 (April 27, 2001) at 4.

By seeking to change its ICAP market in the opposite manner in which PJM has just changed its ICAP market, the NYISO is taking an action, which directly conflicts with the obligations placed upon it by FERC and undertaken on its own to resolve seams issues and not to create new seams issues. Moreover, it disregards the valuable experience gained by PJM's operation of a shorter term ICAP market. This shift by the NYISO from its existing OPP for ICAP to a shorter period at the same time PJM has established a longer Interval for ICAP procurement actually recreates a seams issue shortly after PJM took steps to resolve it. Increasing these seams issues will hinder the development of common market rules and energy products, which will, in turn, increase transaction costs and slow down the creation of vibrant, liquid regional markets. Moreover, as PJM has recognized in establishing a longer Interval for ICAP procurement, and as discussed below, shortening the OPP for ICAP will only serve to increase the risk of a shortage of capacity in the short-term and long-term.

It is particularly ironic that the June 6 Decision, if approved by the Board, would take effect thirty (30) days after the MC vote was held - - one business day before the July 9, 2001 MOU Business Practices Working Group ("WG") meeting, which is scheduled to be held in New York and hosted by the NYISO. This meeting was scheduled with the intention of addressing common ICAP principles throughout the Northeast.¹¹

Not only would approval by the Board to adopt the June 6 Decision be impossible to reconcile with the NYISO's stated commitment to resolving seams issues, including the resolution of ICAP issues, but it would further demonstrate the NYISO's willingness to act independently and refuse to coordinate with its neighboring ISOs in addressing seams issues.

¹¹ For over six weeks, NYSEG has coordinated with numerous market participants and the NYISO to include, as a proposed agenda item for the July 9 meeting, the review of common ICAP principles to be adopted by all three ISOs.

2. Decreasing the OPP for ICAP Will Contribute to the Destabilization of the NYISO ICAP Market

The Commission has already acknowledged that a short-term OPP is detrimental to control area reliability. On April 5, 2001, PJM filed a complaint with FERC (the “PJM Complaint”) requesting to amend its RAA which governs the procurement periods for ICAP obligations.¹² PJM sought to “adjust the time period over which a load serving entity must commit generation resources to PJM to meet its capacity obligations under the RAA from a daily commitment to a seasonal commitment.”¹³ PJM recognized that the daily procurement commitment had caused market flaws in the PJM ICAP market.¹⁴ In looking to resolve those flaws, PJM Staff explained that it looked to the NYISO’s ICAP market and perceived the NYISO’s six month OPP to be a model superior to its own.

In its complaint, PJM quoted the Commission’s statement that “[t]he ability of PJM members to pool their resources for purposes of reserve sharing has generated significant reliability and cost savings benefits for the PJM members over the years.”¹⁵ The PJM Complaint argued that a short procurement period for ICAP requirements prevented PJM from reaching these goals by decreasing the incentive for LSEs to acquire capacity and for generators to sell capacity within PJM. Because generators within PJM, which are not LSEs, were not required to sell capacity to LSEs within PJM beyond a single day’s commitment, those capacity owners could “delist” their capacity daily. Such delisted capacity was no longer available for use in meeting PJM LSE’s obligations and reduced the firm energy available to serve PJM load, thereby reducing reliability.

¹² Docket No. EL01-63-000.

¹³ Id at 1.

¹⁴ Id at 2.

¹⁵ Id at 5 (quoting PJM Interconnection, LLC, 81 FERC ¶ 61,257, ¶ 62,275 (1997)).

FERC recognized the detrimental effect on reliability that is caused by a short procurement period when it observed that as “market-based sales of energy were permitted within and outside of PJM, generation owners acquired incentives to sell energy on any given day into the market offering the highest price, regardless of location.”¹⁶ FERC continued by agreeing with PJM’s proposal for increasing the Interval as “[t]he longer-term capacity commitment, coupled with commensurate charges for capacity deficiencies, will not only encourage LSEs and capacity holders to contract in advance for adequate capacity over the summer season, but will discourage the delisting of capacity during the summer.”¹⁷

If the NYISO moves to a shorter OPP for ICAP, the same adverse affects on reliability observed in PJM and recently corrected by the revision to its RAA will likely occur in the NYISO. Generators will have less of an incentive to engage in long-term capacity transactions with LSEs, thereby hindering the LSEs from meeting their capacity requirements. By withholding such capacity from long-term transactions or from sales within the NYISO, the price for capacity will become prone to short-term market fluctuations. Potential price increases and decreased available capacity will contribute to the destabilization of capacity markets and the increased possibility that during a peak month, capacity resources within the NYISO will be insufficient.

The NYISO has no experience in a short term ICAP market. Here is an opportunity to avoid an experiment, which both the Commission and PJM have already concluded is a failure.

¹⁶ PJM Interconnection LLC, 95 FERC ¶ 61,330, slip op. at 4 (2001).

¹⁷ Id at 10.

3. Decreasing the OPP for ICAP Will Degrade Reliability By Dramatically Reducing the NYISO's Ability to Acquire Replacement Capacity During Times of Deficiency

Pursuant to the NYISO's Market Administration and Control Area Services Tariff ("Services Tariff"), each LSE is obliged to acquire sufficient, qualifying ICAP to satisfy its ICAP requirements. If an LSE fails or is unable to acquire sufficient resources to satisfy its ICAP requirement, the NYISO will impose a deficiency charge and use the revenue from that charge to attempt to purchase alternate sources of ICAP ("Replacement ICAP").

With a six month OPP, the NYISO will know one week before an OPP begins, whether or not alternate sources of ICAP are required to meet reliability requirements. Since the six month OPPs do not begin during a peak load period, the NYISO will likely have one month, if not two, to acquire Replacement ICAP. For example, the NYISO will know by the last week in April whether insufficient ICAP is available for the Summer OPP. If so, the NYISO has May, and possibly part of June, to acquire Replacement ICAP before the summer peak is reached.

In contrast, with a one month OPP, the NYISO would have a significantly reduced opportunity to acquire Replacement ICAP. Under the proposed scheme, the NYISO would not know until near the end of July if its LSEs had sufficient ICAP for August. If sufficient ICAP were not available, the NYISO will be trying to acquire Replacement ICAP at a time when New York State load would be peaking and most if not all sources of ICAP would already be committed elsewhere.

B. The NYISO Should Calculate Each Generator's UCAP Value Consistent With The OPP

The NYISO has proposed to recalculate generators' UCAP values each month. UCAP should be calculated consistent with the OPP (e.g., once every six months). Adjusting UCAP

every six months will still provide a reliable indicator of generator forced outage rates. In addition, it will: (a) reduce the administrative burden placed on the NYISO to frequently readjust each generator's UCAP value; (b) reduce the risk that a buyer or seller of ICAP/UCAP will be short during an OPP; and (c) eliminate any need for the NYISO to assess UCAP deficiencies, during an OPP, that are associated with minor forced outage rate fluctuations. A twelve-month rolling average will still be used to accurately reflect each generator's history and appropriately adjust its UCAP value. The principal difference is that adjustments to UCAP will be made twice a year, instead of twelve times per year.

C. The Board Should Grant a Stay of the June 6 Decision Pending the Outcome of this Appeal

If the June 6 Decision is permitted to stand, and the OPP for ICAP is reduced from six months to one month, the NYISO will suffer immediate and irreparable harm from decreased reliability. Generators will have less of an incentive to enter into long-term contracts with LSEs and may sell their capacity outside the NYISO, thereby reducing the available capacity in the NYISO. This reduction in capacity during the year's peak period will have immediate reliability implications, which can cause irreparable harm, thereby, necessitating the granting of a Stay pending the outcome of this appeal.

III. Conclusion

For the reasons set forth above, NYSEG requests that the Board defer consideration of the MC's June 6 Decision until after: (a) resolution of this appeal; (b) the exercise of a good faith effort on the part of the NYISO to arrive at common ICAP principles with the other Northeast ISOs; and (c) consideration of the potential significant degradation of reliability that would result from a shortened procurement period.

NYSEG further requests that the Board direct the NYISO to work diligently with PJM ISO-NE to complete, on an expedited basis, the common installed capacity principles for all Northeast ISOs to adopt.

If the Board does not grant this request to defer action on the June 6 Decision until after resolution of this appeal, then NYSEG requests a Stay of Board action.

Respectfully submitted,

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