June 26, 2002

VIA AIRBORNE EXPRESS
Richard J. Grossi
Chairman
New York Independent System Operator
3890 Carman Road
Schenectady, NY 12303

c/o William J. Museler
President and Chief Executive Officer
New York Independent System Operator
3890 Carman Road
Schenectady, NY 12303

Re: Notice of Appeal of the Management Committee's Decision With Respect to the Final Bill Challenge Amendment

Dear Chairman Grossi:

Pursuant to the "Procedural Rules for Appeals to the ISO Board," Consolidated Edison Company of New York, Inc., LIPA, Niagara Mohawk Power Corporation, a National Grid Company, New York State Electric and Gas Corporation, Rochester Gas and Electric Corporation and the City of New York (collectively, the "Appellants") respectfully submit three copies of their appeal of the Management Committee's decision at its June 13, 2002 meeting to approve the revised Final Bill Challenge Amendment (the "Amendment"). The Amendment was listed on the agenda as item number 3.

A copy of this appeal has been electronically transmitted to Kristen Kranz who has agreed to serve it on the members of the Management Committee. Thank you.

Sincerely,

Neil H. Butterklee
Attorney for Consolidated Edison Company
of New York, Inc.
(212) 460-1089

cc: Kristen Kranz (via e-mail)
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NOTICE OF APPEAL OF
CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.,
LIPA, NIAGARA MOHAWK POWER CORPORATION,
NEW YORK STATE ELECTRIC AND GAS CORPORATION,
ROCHESTER GAS AND ELECTRIC CORPORATION
AND THE CITY OF NEW YORK
OF THE MANAGEMENT COMMITTEE'S DECISION WITH RESPECT TO
THE REVISED FINAL BILL CHALLENGE AMENDMENT

I. SUMMARY OF ARGUMENT

In accordance with Article 5 of the ISO Agreement and Section 1.02 of the NYISO's "Procedural Rules for Appeals to the ISO Board," Consolidated Edison Company of New York, Inc., LIPA, Niagara Mohawk Power Corporation, a National Grid Company, New York State Electric and Gas Corporation, Rochester Gas and Electric Corporation and the City of New York (collectively, the "Appellants") hereby file this notice of appeal of the Management Committee's decision at its June 13, 2002 meeting to approve the revised Final Bill Challenge Amendment (the "Amendment"). The Amendment was listed on the agenda as item number 3.

The Amendment adopted by the Management Committee provides that all adjustments to a final bill shall be funded through Rate Schedule 1 of the NYISO's Open Access Transmission Tariff ("OATT") and its Market Administration and Control Area Services Tariff ("Services Tariff," collectively, the "NYISO Tariffs"). The fundamental problem with the Amendment is that it unfairly allocates 100% of the costs of any final bill challenge adjustment to transmission owners and other load serving entities (collectively, "LSEs") and their respective customers. As such, an LSE will receive a pro rata share from the NYISO of any successful final bill challenge. Since generators, marketers and other suppliers (collectively, "Sellers") do not pay Rate Schedule 1

charges[1] they are exempt from all of the costs associated with a final bill challenge although they may receive 100% of the benefits of a challenge they initiate.

In order for this process to work and withstand FERC scrutiny, the costs associated with final bill challenges must be fairly and non-discriminatorily allocated to those market participants who are parties to the transactions being corrected.

Thus, the Appellants respectfully request that the NYISO Board overturn the decision of the Management Committee and direct the committee process to develop a method to allocate the costs of successful final bill challenges to those parties responsible for the transaction in question.

II. BACKGROUND

The NYISO Tariffs currently provide for a final bill to be issued 24 months after service. Prior to the issuance of the final bill, market participants can challenge aspects of their initial bills and settlement data and, if it agrees with those challenges, the NYISO can make adjustments directly with affected parties. The NYISO Tariffs, however, do not provide for bill adjustments after the initial 24-month period even though market participants have 12 months from receipt of the final bill to challenge that bill (the "Challenge Period"). Nor do the NYISO Tariffs provide a funding mechanism for any successful challenges made during the Challenge Period.

The Amendment adopted by the Management Committee provides that all adjustments to a final bill be funded through Rate Schedule 1 of the NYISO Tariffs.[2] As a result of this action, all successful final bill challenges will be paid solely by LSEs.[3]

[1] The recent tariff change to allocate 15 percent of Schedule 1 charges to sellers in the NYISO market applies only to administrative charges and would not apply to final bill challenges.

[2] This issue was not previously addressed because it was not until November 2001 that the first final bill was issued.

III. ARGUMENT

A. The Amendment is Unreasonable in That it Allocates All Costs to Transmission Owners and Load

The fundamental problem with the Amendment is that it allocates 100% of the costs of any final bill challenge to LSEs. This is true even if the successful challenge is brought forth by an LSE. For example, if an LSE that has approximately 20% to 30% of the energy consumption in the NYISO control area successfully challenges a bill, 20 to 30% of the money needed to pay that LSE will come from that LSE by way of the Rate Schedule 1 uplift. Thus, that LSE will only receive 70 to 80 cents on the dollar as a result of its successful challenge. If that challenge were made prior to a final bill being issued, however, the LSE would have received 100 cents on the dollar.

In addition to receiving a reduced return on successful challenges, LSEs, along with their customers, will wind up paying even for adjustments that are totally unrelated to their transactions. For example, adjustments made for a transaction in one part of the state will be paid for by load throughout the state according to the usage based formula used to allocate Rate Schedule 1 charges.

On the other hand, Sellers who stand to benefit from making final bill challenges are immunized from all of the costs associated with a final bill challenge. This is because they do not pay any of these Rate Schedule 1 charges. As such, they stand to collect and retain 100% of every successful final bill challenge, and, consequently are incented to challenge as many bills as possible, regardless of merit, on the off chance that they may win a challenge. Further, they are also incented both individually and as a

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[3] Even though the NYISO's recent filing with FERC provides that generators and other suppliers will pay 15% of the NYISO's administrative charges, such charges do not include the costs associated with final bill challenges.

market sector group to wait until the Challenge Period to initiate any meritorious challenges so that the adjustment amounts are paid for solely by LSEs. Similarly, parties that are external to the NYISO (i.e., generators and marketers operating in PJM or ISO NE) which also avoid the NYISO's Rate Schedule 1 charge will also have the perverse incentive to wait for the Challenge Period to make meritorious claims.

1. The Amendment Should Be Rejected In That It Unduly Discriminates Against LSEs

The Federal Power Act ("FPA") sets forth the basic standard for prohibited discrimination in FERC-jurisdictional matters. Specifically, the FPA states that "[n]o public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of customers." *16 USC § 824d*; *See Wisconsin Electric Power Co. v. Northern States Power Co. et al*, 86 FERC ¶ 61,121 at 61,415 (1999) ("the Commission's comparability policy prohibits [Northern States Power] Transmission from unduly discriminating against or providing preferential treatment to [Northern States Power] Merchant or any other customer.") In this case, the NYISO is the entity charged with providing non-discriminatory service.

The cornerstone of the Amendment is that it treats certain market participants more favorably than others. As a result of the Amendment, Sellers and external parties will receive 100% of their successful bill challenges while paying nothing towards the successfully bill challenges of others. LSEs, on the other hand, will receive as little as 70 cents on the dollar for successful challenges while paying 100% of the costs of all

challenges. This disparate treatment of LSEs and Sellers is unduly discriminatory and in violation of the FPA. There is no non-discriminatory logical reason for this disparity.[4] Thus, the Amendment is nothing more than a large cost shift from market participants who do not pay Rate Schedule 1 charges to those that do.

If these bill challenges would be required to be initiated prior to the issuance of a final bill, the NYISO would be able to make the adjustments directly with the affected partiesin a fair and non-discriminatory manner. Thus, there is no reason for the NYISO adopting an unduly discriminatory manner of processing bills when it has a fair and reasonable one readily at its disposal.

2. The Costs Associated With Successful Final Bill Challenges Should Be Borne By the Responsible Parties

One of the basic principles associated with electricity pricing is that customers who are responsible for certain costs should pay for those costs. Specifically, electric rates should "fairly track the costs for which [the customers] are responsible." *Pennsylvania Electric Co. v. FERC*, 11 F. 3d 207, 211 (D.C. Cir. 1993), citing *Town of Norwood v. FERC*, 962 F. 2d 20, 25 (D.C. Cir. 1993); *Union Electric Co. v. FERC*, 890 F.2d 1193, 1198 (D.C. Cir. 1989). Furthermore, principles of cost causation require that rates should accurately reflect and recover costs. *See Public Service Company of N.H. v. FERC*, 600 F.2d 944, 959 (D.C. Cir.), *cert. denied*, 444 U.S. 990 (1979).

[4] Siginficantly, the policy was approved by the Management Committee in substantial part, by the votes of parties that do not pay Rate Schedule 1 charges,,and, therefore prefer a policy under which they can avoid responsibility for the additional charges. As the Commission recognized in *Bangor-Hydro Electric Company*, 95 FERC ¶ 61,149 at 61,479 (2001), "the fact that the provision was 'widely supported' does not, in and of itself, make it reasonable or require its acceptance." The Board should see the Amendment for what it is, a vote by 67% of the market participants to impose cost burdens on the other 33%.

With respect to final bill challenges, the NYISO should be able to determine which market participants owe or are owed money as it does for any bill challenges on bills issued prior to the final bill. As such, the monies needed to pay for successful final bill challenges should come from the specific market participants on the other side of a transaction. Thus, if an LSE believes that the price it was billed for energy was in error (e.g., it was too high because the NYISO misstated the amount of megawatts purchased by that LSE), and it successfully challenges that bill, then the money used to provide that LSE with a refund should not be socialized across all the load in the state. Rather, well-settled law would have the refund money come from either a specific generator (if the NYISO can so determine) or from the generator class which directly benefited from the initial over-collection of energy charges. In short, those parties that benefited from the over-collection should pay for the refunds necessitated by that over-collection. Any other outcome would result in the Sellers being unjustly enriched at the expense of LSEs and their respective retail customers.

B. The Appellants' Alternative Solution Is Reasonable And Should Be Adopted

The Appellants agree that the final bill challenge process needs to be improved. However, passing all the costs associated with a successful bill challenge onto loads does not constitute an improvement. An immediate improvement, however, would be to modify the NYISO Tariffs to provide for a mechanism to allow adjustments to be made directly with the affected market participants.

To facilitate this process a minimum threshold could be established above which costs would be specifically assigned and below which the NYISO would have discretion as to how to pay for the successful challenge. At the Management Committee meeting,

certain of the Appellants proposed that Challenge Period adjustments in excess of $50,000 be made directly with affected parties, instead of through Rate Schedule 1, with an appropriate process so that these adjustments would be final. For adjustments less than $50,000, the Appellants proposed that the NYISO could decide on a case-by-case basis if the adjustment should be charged directly to an affected party or thorough Rate Schedule 1. This would allow the NYISO to maintain efficient staff operations by allowing it to weigh the costs necessary to identify directly affected parties against the overall amount of the adjustment. This proposed solution is more equitable than the Amendment approved by the management committee because it ensures that significant adjustments (i.e., those greater than $50,000) would be paid for by the affected parties.

A longer-term solution is to shorten the billing cycle so that a final bill can be issued sooner -- a process that the Final Bill Task Force is working on separately.

In the interim, the NYISO Board must not allow the imposition of unjustified costs upon consumers through Rate Schedule 1. Customers should not and must not be burdened with billing adjustments that provide no additional value but result in unnecessarily higher costs.

IV. CONCLUSION

For the reasons set forth herein, the Appellants respectfully request that the NYISO Board reject the Amendment adopted by the Management Committee and instead direct the NYISO to implement a method of allocating the costs associated with a successful final bill challenge to those market participants who are directly involved in the transactions in question as described herein.

Dated: June 26, 2002

Respectfully submitted,

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Re: Request for Hearing Before NYISO Board Governance Committee

Dear Messrs Grossi and Museler:

Pursuant to Rule 5.02 of the "Procedural Rules for Appeals to the ISO Board," Consolidated Edison Company of New York, Inc., LIPA, Niagara Mohawk Power Corporation, a National Grid Company, New York State Electric and Gas Corporation, Rochester Gas and Electric Corporation and the City of New York (collectively, the "Appellants") respectfully request that a hearing be established before the NYISO Board Governance Committee with respect to Appellants' appeal of the Management Committee's decision at its June 13, 2002 meeting to approve the revised Final Bill Challenge Amendment (the "Amendment"). The Amendment was listed on the agenda as item number 3.

Appellants are appealing the Amendment because it provides that all adjustments to a final NYISO bill made shall be funded through Rate Schedule 1of the NYISO's Tariffs. The fundamental problem with the Amendment is that it unfairly allocates 100% of the costs of any final bill challenge adjustment to transmission owners and other load serving entities (collectively, "LSEs") and their respective customers. As such, an LSE will receive a reduced amount of any successful final bill challenge. Since generators, marketers and other suppliers (both internal and external to the NYISO markets) not pay Rate Schedule 1 charges they are exempt from all of the costs associated with a final bill challenge although they may receive 100% of the benefits of a successful challenge they initiate.

In order for this process to work and withstand FERC scrutiny, the costs associated with final bill challenges must be fairly and non-discriminatorily allocated to those market participants who are parties to the transactions being corrected.

Appellants are requesting this opportunity to be heard before the Governance Committee because we believe that our concerns with the Amendment can be more fully demonstrated by an in person presentation and a dialogue between the Committee and Appellants. Thank you.

Sincerely,

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Of New York, Inc.

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