March 5, 2003

<u>VIA AIRBORNE EXPRESS</u>
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 and Request For Oral Argument With Respect to the Management Committee's Decision to Approve the Congestion <u>Reduction Proposal</u>

Dear Chairman Grossi:

Pursuant to the "Procedural Rules for Appeals to the ISO Board," Consolidated Edison Company of New York, Inc. ("Con Edison") respectfully submits three copies of its appeal of the Management Committee's decision at its February 20, 2003 meeting to approve the Congestion Reduction Proposal (the "Proposal"). The Proposal was listed on the agenda as item number 9. 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.

Additionally, pursuant to Rule 5.02 of the "Procedural Rules for Appeals to the ISO Board," Con Edison respectfully requests that a hearing be established before the NYISO Board Governance Committee on this matter. Con Edison requests this opportunity to be heard before the Governance Committee because it believes that its concerns with the Proposal can be more fully demonstrated by an in person presentation and a dialogue between the Committee and Con Edison. Thank you.

Sincerely,

<u>/s/Neil H. Butterklee</u>
Neil H. Butterklee
Attorney for Con Edison
(212) 460-1089

cc: Kristan Kranz (via e-mail)
Mollie Lampi, Esq. (via e-mail)
Ira Frielicher, Esq. (via e-mail)

NOTICE OF APPEAL OF
CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.,
OF THE MANAGEMENT COMMITTEE'S DECISION WITH RESPECT TO
THE SUPPLEMENTAL CONGESTION REDUCTION PROPOSAL

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. ("Con Edison" or the "Company") hereby files this notice of appeal of the Management Committee's decision at its February 20, 2003 meeting to approve the "Supplemental Congestion Reduction Proposal" (the "Proposal"). The Proposal was listed on the agenda as item number 9.

Con Edison has four concerns with the Proposal. First, the Proposal is not consistent with the NYISO Board of Director's ("BOD") decision issued on April 17, 2002 in response to the February 20, 2002 appeal of Con Edison, the City of New York, and Consumer Power Associates ("April 17th Decision"). The April 17th Decision required the development of "a comprehensive proposal that would reduce congestion rent shortfalls to a more reasonable level," which this proposal does not do. Instead the Proposal merely modifies the method of allocating congestion rent shortfalls without addressing the central issue of TCC availability. As such, the Proposal fails to meet the objective of the April17th Decision to address the root cause of the congestion shortfall problem. Second, the Proposal unduly discriminates against owners of underground and underwater facilities. Third, the Proposal does not present a comprehensive plan to eliminate congestion shortfalls. Finally, Con Edison points out that the Management Committee and BIC vote included many abstentions, particularly in the generation sector, which resulted in one party carrying 21.5% of the vote at the Management

Committee. This gave that one party the ability to skew the results of the vote such that it appeared that consensus was achieved.

Accordingly, implementation of this Proposal does not comply with the April 17th Decision and should be overturned, as described herein.

II. BACKGROUND

On February 20, 2002, Con Edison, the City of New York and Consumer Power Associates ("CPA," collectively the "Appellants") filed an appeal on a prior Management Committee vote to approve a Congestion Shortfall Reallocation Proposal. At that time, the Appellants expressed five concerns, including that the Proposal is discriminatory in that it inherently favors the owners of transmission facilities that incur planned outages more frequently than forced outages, that the Proposal alters the method of allocating congestion rent shortfalls while leaving unchanged the manner in which congestion rent surpluses are allocated, that the Proposal violates the terms of the ISO/TO Agreement, that the Proposal would have a chilling effect on the construction of new downstate transmission lines, and that the Proposal does not address the cause of congestion rent shortfalls and surpluses and mitigate their occurrences. An additional appeal was submitted by LIPA. Several parties submitted motions in opposition to those appeals, including Niagara Mohawk (NIMO) and New York State Electric and Gas/Rochester Gas and Electric. On April 17, 2002, the BOD issued its decision, which stated that:

> The reason we decline to file the CRP under Section 205 at this time is that we agree with all the parties to this appeal that there are a number of flaws with the current TCC provisions of the tariff, including a basic deficiency that makes it likely there will be significant congestion rent shortfalls in the future, and possible inequities in the allocation of both congestion rent surpluses and shortfalls. The CRP provides an ostensibly equitable "quick fix" for only one symptom of a larger problem. The Board is reluctant to approve this "quick

> fix" to patch the congestion rent shortfall symptom. The problems identified by the parties with the TCC provisions of the tariff <u>may require more fundamental improvements to prevent the underlying problem – excessive levels of congestion rent shortfalls</u>[1] (emphasis added).

Since the April 17th Decision, nearly a year has passed. Large shortfalls in excess of $40 million per month persist. The NYISO Staff began a stakeholder process to develop a proposed solution that would comply with the BOD Order. At the September 27, 2003 of the Congestion Reduction Task Force ("CRTF") meeting, the NYISO's consultant, LECG, presented the results of an investigation requested at an earlier meeting on the causes of shortfalls. LECG identified a number of changes between the TCC auction and the DAM models that contribute to shortfalls, including transmission out of service (outages), changes in transmission limits (derates), Phase Angle Regulator ("PAR") settings, unscheduled loop flows, and modeling errors between the day-ahead market model and TCC auction model (i.e. location of Astoria) and billing and accounting errors. NYISO staff found an error in the Billing and Accounting System that accounted for nearly all the $3,846,000 shortfall reported on April 17, 2002. However, most shortfalls are due to transmission outages and derates. Both of these must be expected to happen in any mechanical system such as a transmission line. However, without an auditing methodology, the root cause of shortfalls will continue to go unidentified.

At the very next meeting of the CRTF, on January 29, 2003, LECG described an exact method for determining shortfalls due to transmission outages and derates, including transmission outages within zones (intra-zonal). In addition, Niagara Mohawk Power Corporation ("NIMO") described a coarse and approximate method for allocating shortfalls based on reduced interface capacity between zones (inter-zonal). The LECG method requires

---

[1] NYISO BOD Order, April 17, 2002, page 2.

a bit more software implementation effort than NIMO's. In both cases, not 100% of the shortfalls will be accounted for, since, as the LECG investigation showed, there are other lower-effect causes for shortfalls that are considered very difficult to evaluate on an on-going basis.

At the January 29 meeting, a market participant suggested that a process for reducing shortfalls could work as follows: (a) The NYISO would retain a percentage of the capacity of all transmission facilities from the six-month strip auctions to account for known or expected transmission outages and derates during the period; and (b) at each monthly reconfiguration auction, the NYISO would make available capacity that is expected to be in service during the particular month, reserving only a smaller amount for expected outages or derates. This method would provide the NYISO with a design basis to make realistic TCCs available to market participants while not overselling the contracts. The intent is for there to be surpluses in the Day-Ahead Market to counteract the shortfall caused by outaged lines. A method for allocating surpluses to owners of facilities that contribute to creating the surpluses still needs to be developed.

A compromise was worked out and accepted by Con Edison and NIMO in which the six-month retention and monthly release would be implemented together consistent with what the BOD ordered. Whatever shortfall still remains would be allocated by the NIMO method that would be implemented first. After the LECG's more exact method is developed and compared to the NIMO method, the NYISO would keep the one it considered most equitably allocates shortfalls. However, an important consideration for the LECG method will be its ability to facilitate NYISO audits of TCC shortfalls. In the original proposal the availability adjustment and the new allocation would be implemented at the same time.

At the February 11, 2003 Business Issues Committee meeting, a market participant suggested that the availability adjustment must be developed through a stakeholder process, and that it needs more time to be developed. A suggestion was made that this component be implemented later, perhaps by Fall 2003. While this amendment to the motion was accepted as friendly, a second proposal to move the cost allocation formula modification to the same time was rejected as a non-friendly amendment. That amendment to the motion failed, while the underlying motion with the "friendly amendment" passed. The now modified proposal was brought to the Management Committee on February 20, 2003, exactly one year after the initial appeal of the February 2002 motion. Once again a motion to amend so that both parts of the proposal are implemented simultaneously was presented, considered non-friendly, and then failed. Once again, the underlying motion passed.

As discussed herein, Con Edison believes that the implementation of this proposal is deficient as it does not adequately address the requirements of the April 17th Decision, namely to reduce congestion shortfalls in the first instance[2]. To accomplish this, the availability adjustment is the component of the proposal requiring immediate implementation. The cost allocation modifications will NOT reduce the overall shortfall amount, especially for underground and underwater facilities. Furthermore, the current methodology for cost allocation has not been shown to be flawed.

III. ARGUMENT

A. The Proposal Ignores The April 17th Decision

The April 17th Decision clearly directed NYISO Staff to continue to work with the

---

[2] Since the availability adjustment is intended to produce surpluses from congestion rents to counteract shortfalls caused by outages, it is also imperative that a process be developed to allocate surpluses to owners of facilities causing the surpluses (A broader discussion on this important element is found in Section III.C.1).

Committees to develop a comprehensive proposal that would reduce congestion rent shortfalls to a more reasonable level. Further, it stated that it would consider, as part of the overall solution, provisions on the allocation of the remaining congestion rent shortfalls that are consistent with the CRP. Clearly, the April 17th Decision intended that a method that reduces congestion shortfalls outright be developed. The only part of the proposed solution that accomplishes the goal set forth by the BOD, the proposed availability adjustment, was the part that was ultimately delayed in the Proposal.

As developed, the availability adjustment would reduce the number of TCCs sold based on planned and forced outage rates. This is similar to the concept by which installed capacity is reduced to reflect outage rates. The availability adjustment reduces the amount of TCCs sold for 6-month or longer periods, but allows most of those TCCs to be available to market participants on a monthly basis. This limits the duration of the market's exposure to congestion revenue shortfalls, as the NYISO would be able to adjust the amount of TCCs sold in monthly auctions. Clearly this portion of the proposal would have addressed the root cause of shortfalls when complemented with a method to allocate surpluses. Unfortunately, as approved by the Management Committee, it is this part of the proposal that will be delayed in implementation.

The part of the proposal that will be implemented now is a reallocation of the shortfall amounts. This was clearly a secondary consideration of the BOD. There is no reason for this part of the proposal to be implemented ahead of the availability adjustment, as this part of the proposal does not address the central issue that a greater number of TCCs have been sold than are actually available. Furthermore, the current methodology for cost allocation has not been shown to be flawed.[3]

B. The Proposal Is Discriminatory In That It Unduly Discriminates Against Owners Of Underground and Underwater Facilities

The Federal Power Act ("FPA") sets forth the basic standard for prohibited discrimination in FERC jurisdictional cases. 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.

Without the availability adjustment, the proposal unduly discriminates against owners of underground and underwater facilities. This is because underground and underwater facilities operate in a different manner than overhead facilities. Specifically, in regards to this issue, underground and underwater facilities generally require extended outages for repair once a forced outage has occurred. The availability adjustment eliminates this problem by taking into account the different outage periods associated with different types of facilities.

C. Only A Comprehensive Solution Should Be Approved

[3] Con Edison now has an allocation of around 70% of shortfalls when the NYPA NTAC share is also considered.

1. The Current Proposal Is Incomplete

There are three major problems with the current Proposal. First, a major defect of the Proposal is that it simply reallocates rather than eliminates congestion rent shortfalls. Congestion rent shortfalls (and surpluses) occur when less (or more) transmission capacity is scheduled in the day-ahead market than the amount of TCCs sold at auction. Currently, the NYISO does not account for historic outages in determining the amount of TCCs to be sold at auction. Instead, the NYISO auctions off TCCs equal to 100% of the transmission capacity, which is tantamount to saying that transmission is always 100% available, which is obviously not the case. To solve this problem in a non-discriminatory manner, the NYISO must adjust the amount of TCCs sold at auction to account for transmission outages and known planned transmission outages, and it must do so in advance of, or concurrently with modifications to the cost allocation formula.

Second, it is also essential that the NYISO develop a method to offset surpluses with shortfalls caused by outages. Most of the capacity withheld in the six month auction will be made available in the monthly auction, except from lines that are known to be outaged. However, TCCs that are sold for the outaged lines in the six-month auction may produce shortfalls. Therefore, if the allocation method makes owners of the outaged facilities responsible for the shortfalls their facilities cause, these same owners must receive the offsetting surpluses from all other lines they own. It is this netting of shortfalls and surpluses that reduce the overall shortfall.

Also, while some may argue that since many of these facilities are subscribed with grandfathered contracts, an availability adjustment is not workable. However, if availability adjustments are complemented by an appropriate surplus allocating process, lines with partial or full subscriptions with grandfathered contracts will not be harmed if surpluses are funneled back to the owners of the facilities.

Lastly, The NIMO allocation method, approved by the Management Committee, is flawed. It determines the allocation based on shortages that occur on interfaces between zones (inter-zonal). NYISO staff has informed the CRTF that lines ***within*** zones (intra-zonal) cause the greater portion of shortfalls.

It should be noted that neither the NIMO proposal nor the LECG proposal has yet been evaluated. However, the LECG approach provides an additional benefit in identifying the root cause of shortfalls. Since most of the shortfalls are caused by intra-zonal transmission outages, the LECG approach may be the preferred solution.

2. The LECG Method Combined With The Availability Adjustment Would Provide a Valuable Auditing Tool to the NYISO.

An important by-product of using the LECG approach is that it actually accounts for most of the shortfalls in a bottoms-up approach by calculating the contribution of each transmission facility that has been outaged or derated. This would provide the NYISO with an extremely powerful auditing tool that has been lacking up to now, which is to be in a position to validate on a daily basis that most of the shortfalls are explainable and not due to some processing or software error, as was the case on April 17, 2002.

D. True Consensus Was Not Achieved at the Management Committee

Con Edison also urges the BOD to take a close look at the voting record, and specifically the record of votes in the generation sector. Many members of this sector have noted that they do not "have a dog in this fight" and as a result have abstained. Specifically, when the vote was taken at the Management Committee, only one generator voted for the proposal while the rest of the sector abstained. As a result, that single generator carried the full 21.5% vote of the sector. Had this generator abstained, this proposal would have fallen short of the requisite 58 percent threshold.

This part of the proposal does NOT impact any other market participant but transmission owners. Despite that the vote of one generator has allowed an incomplete proposal that is discriminatory and non-responsive to the April 17th Decision to pass, consensus and fairness was not achieved at the Management Committee. The BOD, however, can easily rectify this situation by taking into consideration an apparent flaw in the voting rules and request the By-laws Committee to review and make recommendations.

IV. CONCLUSION

Con Edison respectfully requests that the NYISO Board reject the decision of the Management Committee to adopt the Proposal in its current form. Rather, the NYISO BOD should require both elements of this proposal to be implemented simultaneously and as soon as practicable. Further, the NYISO BOD should direct staff to continue working on the critical method for allocating surpluses.

Dated: March 5, 2003
New York, N.Y.

Respectfully submitted,

Consolidated Edison Company
of New York, Inc.

By:____________________

Neil H. Butterklee, Esq.
4 Irving Place, Room 1815-S
New York, N.Y. 10003
(212) 460-1089
butterkleen@coned.com
Its Attorney