National Grid

National Grid Transmission USA

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VIA AIRBORNE EXPRESS
Richard J. Grossi
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c/o William J. Museler
President and Chief Executive Officer
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Re: Reply to Appeals of Con Edison and LIPA of the NYISO Management Committee Approval of the Supplemental Congestion Reduction Proposal

Dear Chairman Grossi:

Pursuant to the "Procedural Rules for Appeals to the ISO Board", National Grid USA respectfully submits three copies of its Response to the appeals of the Consolidated Edison Company of New York, Inc. and the Long Island Power Authority of the NYISO Management Committee's decision at its February 20, 2003 meeting to approve National Grid's Supplemental Congestion Reduction Proposal.

A copy of this appeal has been electronically transmitted to Ms. Kristen Kranz for service on the members of the Management Committee. Thank you.

Sincerely yours,

Jerry Ancona

Copies e-mailed to:
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OPPOSITION OF NATIONAL GRID TO APPEALS OF CONSOLIDATED EDISON COMPANY AND LIPA OF MANAGEMENT COMMITTEE APPROVAL OF SUPPLEMENTAL CONGESTION REDUCTION PROPOSAL

National Grid USA submits this Opposition to the Appeal of Consolidated Edison Company ("Con Edison") and the Long Island Power Authority ("LIPA") of the Management Committee's Approval of National Grid's Supplemental Congestion Reduction Proposal ("Supplemental CRP") pursuant to Article 5 of the NYISO Agreement and Sections 1.03 and 4.01 of the NYISO's Procedural Rules for Appeals to the ISO Board"

BACKGROUND

The NYISO's financial market design employs Transmission Congestion Contracts ("TCCs") to provide market participants with a means of hedging their congestion costs in the Day-Ahead Market ("DAM"). When actual congestion revenues resulting from the operation of the DAM are less than the payments which the NYISO is required to make to the TCC holders, a TCC revenue shortfall results.

The TCC revenue shortfalls produced by the NYISO's current rules have been substantial. The NYISO's consultant, Dr. Susan Pope, reported in September of 2002 that the NYISO's cumulative congestion revenue shortfall was an astonishing 19.4 percent of total TCC auction revenues and that there had been approximately $71 million in cumulative congestion rent shortfalls since NYISO start-up.[1] Because the NYISO's TCCs are "fully funded," these revenue shortfalls are presently borne by the Transmission Owners ("TOs") rather than by the TCC holders.

While National Grid remains opposed to the concept of full funding of TCCs,[2] National Grid and certain other TOs have sought for several years to remedy the inequitable allocation of TCC congestion costs produced by the NYISO's current rules. The Management Committee

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[1] Management of Day-Ahead Congestion Rent Shortfall, Concept of Operation at 1 (Draft Sept. 25, 2002) ("Concept of Operations").

[2] In comments filed on January 10, 2003 in response to the FERC's Notice of Proposed Rulemaking on Standard Market Design, National Grid proposed that full funding of congestion rights be phased out over a period not to exceed five years. Docket No. RM01-12-000, Comments of National Grid USA at 91-92 (filed Jan. 10, 2003). To substantiate its position on full funding, National Grid submitted as part of its comments an expert analysis which concluded that the assignment of shortfall obligations to TOs is an inefficient means of inducing enhanced transmission performance." Docket No. RM01-12-000, Comments of National Grid USA at 91-92 (filed Jan. 10, 2003).

approved National Grid's original Congestion Reduction Proposal ("the Original CRP") by a 70.04 percent majority on February 7, 2002. National Grid's Original CRP sought to address TCC shortfalls caused by the scheduled and unscheduled outages of major transmission facilities through the assignment of counterflow TCCs for unscheduled outages, and by reducing sales of TCCs during scheduled outages of major transmission facilities.

On April 17, 2002, the Board issued a decision refusing to join with the Management Committee in filing the Original CRP with the FERC under section 205 of the FPA ("the April 17 Decision"). The Board based this refusal on its belief that the Market Participants should work together to develop a comprehensive congestion reduction proposal.[3]

After ten months of collaborative effort, the Management Committee approved National Grid's Supplemental Congestion Reduction Proposal ("Supplemental CRP") by a 66.79 percent majority on February 20, 2003. The Supplemental CRP has four main elements: (1) a method for allocating TCC revenue shortfalls and surpluses to TOs based on hourly data, including transmission facility outages for each TO for each hour and hourly congestion prices across interfaces;[4] (2) proposed changes to monthly TCC reconfiguration auctions to reflect the same allocation of congestion shortfalls and surpluses; (3) a requirement that the NYISO base full funding of TCCs on a realistic set of TCCs; and (4) a commitment to work towards development and implementation of a Transmission Facility Dynamic Rating process. Con Edison and LIPA have appealed the Management Committee's approval of this proposal to the Board.

SUMMARY OF POSITION

In the ten months since the issuance of the Board's April 17 Decision, National Grid has worked with the other Market Participants and the NYISO's staff and consultants in pursuit of the comprehensive solution to TCC congestion cost shortfalls envisioned in the Board's April 17

[3] NYISO Board of Directors Decision on Con Edison's and LIPA's Appeals of the Management Committee Vote on a Congestion Reductions Proposal at 2 (April 17, 2002).

[4] Under this proposal, the actual congestion revenue surplus or shortfall would be calculated for each hour for each interface in the NYCA. Those numbers would then be compared to the expected values calculated by the NYISO's Security Constrained Unit Commitment ("SCUC") system to determine the shortfall or excess in actual congestion revenues relative to the payments required under existing TCCs. These shortfall or excess congestion revenues would then be allocated to all interfaces based on the rate of the average price for TCCs on that interface times the number of TCCs subject to full funding. Where more than one TO owned facilities comprising a single interface, another similar allocation process would be employed to allocate TCC revenue shortfalls/surpluses among those TOs

Decision. That experience has demonstrated that precise computation of TCC revenue shortfall/surplus cost allocations would be extremely cumbersome. National Grid thus proposed a simpler more straightforward method to allocate these shortfall costs among TOs – a method that had broad Market Participant support. The question before the Board in this case is therefore whether it should join with the Management Committee in making a section 205 filing to implement National Grid's Supplemental CRP to address the inequities in the current TCC revenue shortfall/surplus allocations, while continuing to strive for a consensus solution to other causes of TCC revenue shortfalls, or whether the Board should continue to do nothing to address this serious problem.

National Grid respectfully submits that the contentions advanced by the opponents of the Supplemental CRP are nothing more than pretexts designed to perpetuate the existing inequitable allocation of TCC revenue shortfalls. Accordingly, there can be no excuse for continued inaction on this important issue.

ARGUMENT

I. THE NYISO'S PRESENT TCC RULES IMPOSE AN UNFAIR SHARE OF THE TCC REVENUE SHORTFALLS ON NATIONAL GRID

In its Notice of Proposed Rulemaking in Docket No. RM01-12-000, Remedying Undue Discrimination Through Open Access Transmission Service and Standard Market Design, FERC Stats. & Regs. ¶ 32,563 (2002) ("SMD NOPR"), the FERC made clear its view that, to the extent that congestion revenue rights are fully funded, any congestion revenue shortfalls must be "made up by transmission owners whose transmission facilities are out of service."[5] The NYISO's present rules fall dismally short of this requirement for several reasons.

First, the NYISO presently makes no effort whatsoever to assign TCC revenue shortfalls directly to the owner of the transmission facilities creating those shortfalls. Instead, all TCC revenue shortfalls are aggregated and allocated among the TOs on the basis of TCC residual auction revenues (rather than total revenue received for the sale of all TCCs and other transmission rights) accrued to each TO. Thus, no TO bears the full cost of the congestion caused by outages of its own facilities, and TOs whose transmission systems experience minimal outages continue to bear the costs incurred by transmission facility outages of other TOs.

[5] SMD NOPR P 251.

Moreover, as Con Edison candidly acknowledges in its Appeal, the underground and underwater cables used extensively by Con Edison and LIPA are heavily loaded and tend to have much longer outage times than the overhead facilities predominately used in other parts of New York State. As a consequence, the current method of allocating TCC revenue shortfalls shifts a large portion of the very substantial congestion caused by outages of these highly loaded facilities from Con Edison and LIPA to other TOs, including National Grid.

This improper allocation of congestion costs is exacerbated by the fact that the NYISO exempts transmission capacity that is subject to grandfathered transmission agreements from any allocation of TCC revenue shortfalls whatsoever. Because the customers served under such grandfathered agreements are also eligible to receive TCCs, outages of those facilities contribute to TCC shortfalls even though the owners of those facilities receive no allocation of those TCC shortfall costs. The fundamental unfairness of this result was explained by the NYISO's consultant, Dr. Susan Pope:

> Under [the IMWM] allocation methodology, the portion of the TCC Auction Residual Revenue that a TO receives and, hence, the portion of the congestion rent shortfall it pays, depends on the degree to which there is transmission capacity on its transmission system that is not claimed by grandfathered transmission service. If a transmission interface is substantially "filled" by grandfathered transmission service, the TCC Auction Residual Revenue allocated to the interface would be small, so that a TO will receive little TCC Auction Residual Revenue from that interface, even if it has a high IMWM allocation percentage.[6]

These facts are particularly significant given that certain submarine transmission facilities owned by Con Edison, LIPA and NYPA are fully subscribed under grandfathered agreements. As a result, LIPA and NYPA have borne a disproportionately small share of the substantial congestion shortfall costs caused by the outages of these facilities. Instead, these costs have been shifted to National Grid and other TOs in the NYISO. In addition to imposing an unfair financial burden on National Grid and other TOs, these NYISO rules reduce or eliminate the economic incentives which all New York TOs faced prior to the formation of the NYISO to avoid unnecessary outages and to minimize the length of any required outages. As NYISO consultant Dr. Susan Pope noted in her Report:

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[6] Concept of Operations at 1.

> Many parties feel that the allocation methodology for the cost of the congestion rent shortfall needs to be revised. Under the current formula, a TO that has a transmission outage that creates a significant congestion rent shortfall of its IMWM allocation percentage is small. The view is that congestion rent shortfall costs attributable to a transmission facility outage should be directly allocated to the owner of the transmission facility.[7]

II. THE LAUDABLE GOAL OF APPLYING AVAILABILITY ADJUSTMENTS TO TCC AUCTIONS MUST NOT BE ALLOWED TO DELAY IMPLEMENTATION OF THE SUPPLEMENTAL CRP

As previously noted, National Grid is fundamentally opposed to the concept of funding of TCC. To the extent that TCCs remain fully funded, however, the NYISO must limit its sales of TCCs to realistic levels that can be physically supported by the transmission system. As alluded to by the Board's April 17 Decision, consequential "over-subscribing" of TCCs can result in excessive shortfall being generated. In this context, National Grid's Supplemental CRP includes a provision for the NYISO Staff, in consultation with Market Participant, to develop a method to apply an availability adjustment to TCCs that can be fully-funded in an effort to balance TCCs with the anticipated average transmission capability. The provision calls for the method to be brought back to the BIC for approval to be implemented in time for the Fall 2003 Auctions.

National Grid is cognizant of the highly contentious nature of these issues. As a result, National Grid believes that a solution that meets consensus acceptance is unlikely to be forthcoming soon. Additionally, we fear that some would use continued non-agreement on this issue as a means to block implementation of TCC shortfall/surplus cost reallocation. Furthermore, National Grid sees no advantage and no fundamental necessity for postponing a more equitable cost allocation of shortfalls and surpluses until a consensus method for TCC availability adjustments can be developed and implemented. Indeed, when the Management Committee approved National Grid's Supplemental CRP on February 20, 2003, it specifically rejected (with an affirmative vote of 40.86 percent) an amendment that called for concurrent implementation of TCC shortfall/surplus cost reallocation and TCC availability adjustments. Accordingly, National Grid seeks an unlinked implementation of TCC shortfall/surplus cost reallocation with development of TCC availability adjustments proceeding in parallel.

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[7] Concept of Operations at 1-2.

III. THE OBJECTIONS TO NATIONAL GRID'S SUPPLEMENTAL CRP RAISED BY CON EDISON AND LIPA ARE WITHOUT MERIT

Significantly, neither Con Edison nor LIPA have advanced any proposal of their own to address the defects in the NYISO's present congestion revenue shortfall recovery rules. Instead, these parties merely criticized the proposals advanced by National Grid in what can only be regarded as an effort to perpetuate the benefits they receive under the current inequitable rules for allocating TCC shortfall costs. All of those criticisms are without merit for the reasons noted below.

A. Con Edison's Objections To The Supplemental CRP Are Without Merit

In its appeal of the Management Committee's vote to approve National Grid's Supplemental CRP, Con Edison advances three fundamental claims: (1) that National Grid's Supplemental CRP is not the "comprehensive" solution to congestion revenues which the NYISO sought in its April 17 Decision; (2) that the Supplemental CRP discriminates against owners of underground and underwater transmission facilities; and (3) that National Grid's Supplemental CRP is tainted by alleged voting irregularities. Each of these claims is without merit.

1. Con Edison's proposal that implementation of the Supplemental CRP should be postponed until consensus is reached on all aspects of a "comprehensive solution" is unrealistic.

Con Edison suggests that approval of the Supplemental CRP should be postponed until the Market Participants reach a consensus on an "availability adjustment" to reduce the number of TCCs sold to eliminate congestion shortfalls. As set forth above, this suggested link is unnecessary.

Moreover, as Con Edison is well aware, any prospect for consensus in this area is eliminated by Con Edison's insistence that this adjustment factor be set above the actual outage rates for the transmission facilities owned by National Grid and certain other TOs (Con Ed has proposed an arbitrary ten percent across the board deration of all TCCs) in order to create a pool of funds to offset congestion revenue shortfalls on its own transmission lines that are heavily or fully subscribed by grandfathered agreements and, hence bear little or no allocation of congestion revenue shortfall costs. This proposal to establish a "tax" on transmission customers using National Grid's facilities to subsidize Con Edison's transmission facilities is opposed by a broad spectrum of Market Participants and has been a major obstacle to the achievement of consensus in this area. Con Edison's suggestion that the Supplemental CRP be delayed until this deadlock can be resolved is simply another self-serving effort to perpetuate the current inequitable allocation of TCC congestion revenue shortfalls.

IV. THE SUPPLEMENTAL CRP IS NOT UNDULY DISCRIMINATORY AND IS IN FACT REQUIRED TO AVOID UNDUE DISCRIMINATION.

Despite the Board's express rejection of its prior discrimination claims, Con Edison repeats those claims in its current Appeal.[8] The short answer to such claims is that to the extent that the outage costs of underground and underwater transmission facilities are higher than those of overhead transmission facilities, fundamental principles of cost causation require that those higher costs be recovered from the owners of the facilities which cause them and prohibit the imposition to those costs on other TOs, as occurs under the NYISO's present congestion system.

V. CON EDISON HAS FAILED TO IDENTIFY ANY VOTING IRREGULARITIES IN THE MANAGEMENT COMMITTEE'S APPROVAL OF THE SUPPLEMENTAL CRP.

Con Edison's suggestion that the Management Committee's approval of the Supplemental CRP is tainted by voting irregularities is wholly without merit. Contrary to Con Edison's suggestion, voting on the Supplemental CRP was conducted in all respects in compliance with the NYISO's applicable voting rules. Accordingly, the Management Committee's vote on this issue is valid and binding.

A. LIPA's Objections To The Supplemental CRP Are Without Merit

LIPA states in its Appeal that it "supports the developments of each of [the] elements" of National Grid's Supplemental CRP, provided that "implementation of all such elements must be accomplished contemporaneously."[9] Like Con Edison, however, LIPA offers no concrete proposal on how such contemporaneous implementation of all four phases of the Supplemental CRP could be achieved. Instead, LIPA only objects to the proposals of others in a transparent effort to delay the correction of the present inequitable allocation of TCC revenue shortfalls by attempting to link that needed remedy to the development of unspecified remedies for other

[8] See April 17 Decision at 2.

[9] LIPA Appeal at 8.

concerns that can and should be addressed separately. Such claims provide no basis for rejecting the Supplemental CRP for the reasons noted below.

1. LIPA's concerns about the treatment of intra-zoned congestion are without merit

LIPA's claim that the Supplemental CRP provides "different allocations" for "inter-zonal interfaces" and intra-zonal conditions appears to be based on a misunderstanding of the Supplemental CRP. Contrary to LIPA's claims, nothing in the approach purports to segregate congestion revenues based on whether they were "caused" by inter-zonal constraints or intra-zonal conditions. Instead, the Supplemental CRP would apply the same allocation methodology to all congestion revenue shortfalls and surpluses.

This approach is appropriate for two reasons. First and foremost, it is far more likely that significant amount of congestion will be encountered between zones than within zones, since the fundamental purpose of zones is to recognize the existence of the constrained transmission interfaces that create congestion. Second, until the NYISO acknowledges the existence of such transmission constraints by the creation of a new zone, the metering data and software modeling required to analyze congestion in such areas simply does not exist. In such circumstances, any suggestion that precise measurement of whatever minimal levels of congestion may exist within zones should be made a precondition to any change in the NYISO's current unreasonable congestion revenue shortfall allocation rules would amount to the establishment of a "Catch 22" that would ensure that no changes to those rules could be adopted prior to the full implementation of nodal pricing. The Board must reject any such unreasonable proposal.

2. LIPA's claims with respect to the 50 percent rule are without merit.

LIPA claims that the Supplemental CRP could distort TO outage planning decisions due to the fact that facilities with outages over 3 months are excluded from the Capability Period Auction and, hence, may participate in the monthly auctions for the portion of the Capability Period in which they are available, whereas facilities with outages under 3 months are allowed to participate in the Capability Period Auction, and LIPA speculates that such facilities will be subject to a counterflow TCC during their outage. LIPA asserts that these differences may sometimes cause a TO to needlessly extend a transmission outage that could otherwise be completed in less than 3 months in order to avoid a counterflow TCC.

LIPA's claim that the Supplemental CRP would result in the issuance of counterflow TCCs is completely unfounded. Moreover, LIPA conveniently ignores the fact that at the present time, outages of transmission facilities fully subscribed under grandfathered agreements do not bear any portion of the congestion costs caused by their outage. The perverse economic incentives provided by this exemption from cost responsibility are far more likely to have a material adverse impact on transmission customers than the speculative concerns identified by LIPA.

3. The Supplemental CRP should not be delayed pending resolution of congestion shortfalls in the real-time market.

LIPA also claims that congestion shortfalls should not be addressed in the DAM until procedures are developed to address such shortfalls in the real-time market as well. Once again, however, LIPA makes no effort to put forward a concrete proposal to address its alleged concern. National Grid supports the goal of addressing congestion shortfalls in the RTM as well as in the DAM, and has specifically included this goal as a part of its Supplemental CRP. However, LIPA provides no reason why these laudable goals should be permitted to delay the immediate establishment of similar incentives in the DAM by the adoption of the Supplemental CRP. Nothing in the Supplemental CRP will stand as an obstacle to subsequent efforts to address congestion in the RTM.

CONCLUSION

WHEREFORE, for the above-stated reasons, National Grid USA respectfully requests that the Board reject the Appeals of Con Edison and LIPA in this proceeding and that the Board join with the Management Committee to file the Supplemental CRP with the FERC under section 205 of the Federal Power Act.

Respectfully submitted,

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