

VIA OVERNIGHT UNITED PARCEL SERVICE COURIER

March 7, 2006

Honorable John W. Boston
Chairman of the NYISO Board of Directors
c/o Mr. Mark S. Lynch
President and CEO
New York Independent System Operator, Inc.
10 Krey Boulevard
Rensselaer, New York 12144

RE: Notice of Appeal of the Management Committee's Decision to Reject

Dear Chairman Boston:

Pursuant to the Procedural Rules of Appeals to the NYISO Board, Niagara Mohawk Power Corporation d/b/a National Grid ("National Grid") hereby submits three copies of its notice of appeal of an action taken during the February 28, 2006 NYISO Management Committee meeting. National Grid appeals the NYISO Management Committee's decision to reject Motion #2 (appeal of Operating Committee Motion #86.02a (Amendment to Motion on OC Agenda Item #7)), addressing the proposed revision of the Locational Installed Capacity Requirements ("LCRs") for Zone J and K that satisfy reliability criteria and are consistent with the LCRs associated with the Free Flowing Equivalent Installed Reserve Margin ("IRM") and the proposed establishment of a Statewide Installed Capacity ("ICAP") Requirement for the 2006-2007 Capability Year that corresponds to the Free Flowing Equivalent IRM. A copy of this appeal has been electronically transmitted to the NYISO staff for purposes of service to all members of the Management Committee.

National Grid respectfully requests that it be given the opportunity to present oral argument before the NYISO Board with respect to this appeal.

If you have any questions, please contact me at (315) 428-5187.

Respectfully submitted,

/s/Roxane E. Maywalt

Roxane E. Maywalt

Counsel for

Niagara Mohawk Power Corporation d/b/a National Grid

cc: Jerry Ancona, Chairman, NYISO Management Committee
Robert Fernandez, General Counsel, NYISO
Bart Franey
Colin Owyang

**Notice of Appeal of the Management Committee Decision
to Reject the Proposed Revision of the 2006-2007
Locational and Statewide Installed Capacity Requirements**

Summary

Appellant: Niagara Mohawk Power Corporation d/b/a National Grid (“National Grid”)

Action Appealed: Action on Motion #2 (appeal of rejection of Operating Committee Motion #86.02a (Amendment to Motion on OC Agenda Item #7)): On February 28, 2006, the New York Independent System Operator, Inc. (“NYISO”) Management Committee rejected a motion to (1) revise the 2006-2007 Capability Year Locational Installed Capacity Requirements (“LCRs”) for Zone J and K that satisfy reliability criteria and are consistent with the LCRs associated with the Free Flowing Equivalent Installed Reserve Margin (“IRM”) and (2) establish a Statewide Installed Capacity (“ICAP”) Requirement for the 2006-2007 Capability Year that corresponds to the Free Flowing Equivalent IRM.

Management Committee Meeting Date: February 28, 2006

Grounds for Appeal: For the past several years, National Grid made various presentations and motions against the New York State Reliability Council’s (“NYSRC”) setting the IRM at its current level, given that the NYSRC also identified other IRM levels that are equally reliable. On February 2, 2006, FERC dismissed without prejudice National Grid’s Complaint against the NYSRC and the NYISO regarding the establishment of the IRM and LCRs, and Statewide ICAP Requirement for the 2005-2006 Capability Year. FERC found, over National Grid’s assertions to the contrary, that the NYISO stakeholder committee process was the appropriate process to consider National Grid’s concerns, and explicitly stated that National Grid should exhaust its remedies at NYISO before FERC will hear National Grid’s complaint. Because NYISO’s and NYSRC’s studies continue to indicate the existence of other IRMs and LCRs that will satisfy existing reliability rules, National Grid moved at the NYISO’s Operating Committee and Management Committee to establish LCRs that corresponded to a lower Statewide ICAP Requirement for New York for the 2006-2007 Capability Year. National Grid’s motions at OC and MC failed. Therefore, National Grid submits the instant appeal to the NYISO Board.

National Grid respectfully submits that the NYISO Board should overturn the decision of the Management Committee, and approve (1) the revision of the LCRs for Zone J and K that satisfy reliability criteria and are consistent with the LCRs associated with the Free Flowing Equivalent IRM and, (2) the establishment of the 2006-2007 Capability Year Statewide ICAP Requirement that corresponds to the Free Flowing Equivalent IRM. In contrast to the IRM and LCRs that are consistent with the Free Flowing Equivalent, the current IRM and LCRs establishment methodologies allow intra-regional transmission limitations to influence the region-wide resource adequacy requirement, consequently allocating to upstate unconstrained zones in the state excess capacity resources in order to minimize LCRs of the transmission-constrained downstate Zones J and K. As a result, upstate customers directly subsidize the capacity needs of downstate customers and locational price signals are diminished. As National Grid proposes, the Free Flowing Equivalent IRM more appropriately would allocate capacity requirements to those areas with looming capacity deficiencies, as established in the December 2005 NYISO Reliability Needs Assessment, and thereby establish appropriate locational price signals.

APPEAL

I. Background

On February 2, 2006, the Federal Energy Regulatory Commission (“FERC”) issued an order dismissing without prejudice National Grid’s Complaint against the New York State Reliability Council (“NYSRC”) and the New York Independent System Operator, Inc. (“NYISO”).¹ National Grid’s Complaint challenged NYSRC’s and NYISO’s methodology for establishing the Installed Reserve Margin and Locational and Statewide Installed Capacity Requirements for New York for the 2005-2006 Capability Year. In dismissing the Complaint without prejudice, FERC required National Grid to exhaust its methods of resolving this dispute within NYSRC and NYISO before filing a complaint with the Commission.²

In announcing its decision, FERC stated: “we will exercise our discretion and require that National Grid first exhaust its methods of resolving this dispute within [NYSRC] and NYISO before filing a complaint with the Commission.”³ FERC disagreed with National Grid’s assertion that “the NYISO stakeholder process is not appropriate to redress National Grid’s concerns and would be useful only for determining LCRs. ...”⁴ Instead, FERC agreed with NYSRC that “the appropriate stakeholder committee process to consider National Grid’s concerns is the NYISO Operating Committee”⁵ and concluded that “[t]he IRM and zonal LCRs

¹ See *Niagara Mohawk Power Corporation, a National Grid Company v. New York State Reliability Council and New York Independent System Operator, Inc.*, 114 FERC ¶ 61,098 (2006) (hereinafter referenced by paragraph within the order as “Order at P__”).

² Order at P1. See also Order at P23.

³ Order at P1. See also Order at P23.

⁴ Order at P22.

⁵ Order at P21.

interact to protect electric reliability within New York State and need to be addressed together.”⁶ FERC specifically criticized that National Grid “did not request the [Operating Committee] to establish LCRs based on the Free Flowing Proposal for the current 2005-2006 Capability Year, nor did National Grid appeal the NYISO Operating Committee’s February 2005 decision adopting the current LCRs to the NYISO Management Committee and the NYISO Board of Directors as NYISO governance procedures provide.”⁷

While its Complaint regarding the IRM and zonal LCRs for the 2005-2006 Capability Year was pending, National Grid continued to pursue the NYSRC and NYISO stakeholder processes to argue its position that the IRM and zonal LCRs should be established based upon the Free Flowing Equivalent model for the 2006-2007 Capability Year. Statewide and Locational capacity requirements are inextricably linked, but are established by the NYSRC and the NYISO, respectively. During these stakeholder processes, the NYSRC and NYISO have continued to limit their responsibilities to the confined spheres of IRM determination by NYSRC and LICAP Requirements determination by NYISO, resulting in a continued policy vacuum in which no single entity accepts responsibility for region-wide resource adequacy requirements.

With the issuance of the FERC Order on National Grid’s Complaint, it became clear that FERC favored the use of the NYISO governance process to a circuitous debate created by the bifurcated capacity requirement responsibility. As allowed by NYISO governance, at the February 9, 2006 Operating Committee (“OC”) meeting, National Grid submitted Motion #86.02a (Amendment to Motion on OC Agenda Item #7) to request that the zonal LCRs be based upon the Free Flowing Equivalent model. National Grid’s motion was defeated by the OC on

⁶ Order at P22.

⁷ Order at P21 (footnote in original omitted).

February 9, 2006. Subsequently, as required by the NYISO stakeholder processes, National Grid submitted Motion # 2 at the February 28, 2006 Management Committee meeting, appealing the OC rejection of OC Motion #86.02a, and again requesting that the zonal LCRs be based upon the Free Flowing Equivalent model. However, National Grid's motion was defeated by the MC on February 28, 2006, with 25% of the stakeholders in support of National Grid's appeal and many noted abstentions.

In accordance with NYISO bylaws and in response to FERC's explicit direction, National Grid hereby files this notice of appeal of the Management Committee decision at its February 28, 2006 meeting to reject Motion #2 which proposed to revise LCRs and the Statewide ICAP requirement from what is recommended within the NYISO study on Locational ICAP Requirements for the 2006-2007 Capability Year.

II. Current Requirements Distort Market Signals and Require Upstate Zones to Subsidize Downstate Capacity Constraints.

For the summer 2006 and winter 2007 Capability Year, NYSRC set the IRM at 118 percent (%) of peak load from a range of possible IRMs. Because certain intra-regional transmission limitations impede region-wide deliverability, the NYISO's Market Administration and Control Area Services Tariff ("Services Tariff") also requires that two localities, New York City (Zone J) and Long Island (Zone K), supply a portion of the Installed Capacity Requirement ("ICR") from resources within their respective localities, an amount known as the Locational Minimum Installed Capacity Requirement ("LICAP Requirement"). NYISO has the responsibility to set LICAP Requirements that correspond to a specified IRM and ICR. NYSRC has the responsibility to set the IRM and ICR. These NYSRC obligations arise from the Commission-approved NYISO-NYSRC Agreement.

Rather than rightfully accounting for intra-regional transmission limitations by adjusting the affected zones' LICAP Requirements that the NYSRC report shows exist, NYSRC's current IRM methodology lets intra-regional transmission limitations influence the region-wide resource adequacy requirement. This practice increases the cost to zones which are not import-constrained, but must nevertheless share the costs of additional capacity for zones which are import-constrained. As a result, the unconstrained zones in the state are allocated excess capacity resources in order to minimize LCRs of the transmission-constrained Zones J and K. Moreover, as a result of upstate customers directly subsidizing the capacity needs of downstate customers, locational price signals are diminished.

To illustrate, suppose the New York Control Area ("NYCA") were a free-flowing system with no *binding* intra-regional transmission limits. The regional free flowing resource adequacy requirement would then be approximately 116%. If, however, load were to grow and/or generation were to exit the market in a specific area resulting in a binding transmission limitation that prevented the free flow of capacity into the area for some hours of the year, the constrained area would need some form of supplemental capacity requirement in order to meet Northeast Power Coordinating Council ("NPCC") resource adequacy criteria. For example, the NYCA region could meet reliability criteria and account for the transmission constraints, provided that the constrained zones: (a) secured sufficient locational capacity to eliminate the impact of intra-regional transmission constraints on the free flowing regional requirements; (b) secured a mixture of locational capacity and any incremental capacity in excess of the free flowing regional requirement; or (c) transferred part of their capacity obligations to unconstrained zones by increasing the regional resource adequacy requirement (*i.e.*, IRM), thereby decreasing the constrained zones' locational capacity obligations. New York's current resource adequacy

policy is option (c), above – that is, increase the capacity obligations of Load Serving Entities (“LSEs”) in unconstrained zones by increasing the IRM above the free flowing requirement and reduced the obligations of LSEs downstream of the constraints.

More broadly, NYISO current resource adequacy policy undermines the objectives underlying the locational market which the NYISO and FERC have established for New York. The impact of intra-regional transmission constraints should be taken into account in assigning locational, as opposed to the region-wide, resource adequacy requirements because the stated intent of a *locational* capacity mechanism is to signal through prices a need for capacity in a particular location. Because intra-regional constraints increase the region-wide requirement, current resource adequacy practice uncouples resource adequacy needs from market signals. Consequently, the LICAP prices in transmission-constrained New York City and Long Island are lower than their current and projected capacity needs in the NYISO’s Reliability Needs Assessment would otherwise suggest, while the prices in upstate New York are higher than needed, thus diminishing the signal the LICAP market is purportedly designed to provide.

It is important to note that this appeal specifically addresses the 2006-2007 Statewide and Locational Capacity requirements. National Grid is aware of and is participating in the new stakeholder process in the Resource Adequacy Issues Task Force, focused on developing a resource adequacy policy for the 2007-2008 Capability Year and going forward. While resource adequacy issues are being discussed at the Resource Adequacy Issues Task Force, that group is not considering a change to the current requirements that are the subject of this appeal.

The NYISO Board, therefore, should overturn the Management Committee’s actions by approving for the 2006-2007 Capability Year LCRs that essentially eliminate the impact of transmission constraints from the Statewide ICAP requirement. Furthermore, the NYISO Board

should correct Statewide ICAP requirements that result from the improper influence of minimizing LCRs for the 2006-2007 Capability Year.

III. Recommendation

National Grid respectfully requests that the NYISO Board reverse the decision of the Management Committee and approve (1) the revision of the Locational Installed Capacity Requirements (“LCRs”) for Zone J and K that satisfy reliability criteria and are consistent with the LCRs associated with the Free Flowing Equivalent Installed Reserve Margin (“IRM”) and (2) the establishment of a Statewide Installed Capacity Requirement for the 2006-2007 Capability Year that corresponds to the Free Flowing Equivalent IRM, as proposed by National Grid.

Respectfully submitted,

/s/Roxane E. Maywalt

Roxane E. Maywalt

Counsel for
Niagara Mohawk Power Corporation d/b/a National Grid