

VIA ELECTRONIC MAIL with OVERNIGHT COURIER BACKUP

February 16, 2006

Mr. Ray Stalter
Secretary of the Management Committee
c/o Tori Rabadi
New York Independent System Operator, Inc.
10 Krey Boulevard
Rensselaer, New York 12144

Mr. Robert Fernandez
General Counsel
New York Independent System Operator, Inc.
10 Krey Boulevard
Rensselaer, New York 12144

Mr. Jerry Ancona
Chairman, NYISO Management Committee
National Grid
300 Erie Boulevard West
Syracuse, New York 13202

RE: Notice of Appeal to Management Committee of National Grid

Dear Messrs. Stalter, Fernandez, and Ancona:

Pursuant to Section 7.13 of the New York Independent System Operator Agreement, Niagara Mohawk Power Corporation d/b/a National Grid ("National Grid") hereby appeals to the NYISO Management Committee the NYISO Operating Committee's decision at its February 9, 2006 meeting to reject Motion #86.02a (Amendment to Motion on 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. The appeal of this matter is attached.

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

Respectfully,

/s/Roxane E. Maywalt

Roxane E. Maywalt
Counsel for Niagara Mohawk Power Corporation d/b/a National Grid

cc: Bart Franey

Notice of Appeal

Appellant: Niagara Mohawk Power Corporation d/b/a National Grid

Action Appealed: Action on Motion 86.02a (Amendment to Motion on Agenda Item #7): On February 9, 2006, the Operating Committee rejected a motion to (1) revise 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) establish a Statewide Installed Capacity (“ICAP”) Requirement for the 2006-2007 Capability Year that corresponds to the Free Flowing Equivalent IRM.

I. Grounds for Appeal:

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”). *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__”). National Grid’s Complaint challenged NYSRC’s and NYISO’s methodology for establishing the IRM for New York. 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.” (Order at P1. *See also* Order at P23.) 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” (Order at P22.) Instead, FERC agreed with NYSRC that “the appropriate stakeholder committee

process to consider National Grid's concerns is the NYISO Operating Committee" (Order at P21) and concluded that "[t]he IRM and zonal LCRs interact to protect electric reliability within New York State and need to be addressed together." (Order at P22.) 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." (Order at P21 (footnote omitted).)

Accordingly, in response to FERC's explicit direction, National Grid hereby files this notice of appeal of the Operating Committee ("OC") decision at its meeting of February 9, 2006 to reject Motion 86.02a 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 has set the IRM at 118 percent (%) of peak load. 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, 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 16%. 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 determining 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.

The Management Committee therefore should overturn the Operating Committee's actions by approving LCRs that essentially eliminate the impact of transmission constraints from the Statewide ICAP requirement. Furthermore, the Management Committee should correct Statewide ICAP requirements that result from the improper influence of minimizing LCRs.

III. Recommendation

National Grid respectfully requests that the Management Committee reverse the decision of the Operating 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