

ISO New England White Paper
Rules for the Allocation of Auction Revenue Rights
To Excepted Transactions
March 28, 2003

Purpose

The purpose of this white paper is to describe the process used by ISO-NE to model Excepted Transactions contained in Attachments G and G-2 of the NEPOOL Tariff in the Auction Revenue Rights (“ARR”) allocation. This white paper explains the rules ISO-NE followed, so that those impacted by this allocation process understand how ISO-NE modeled different Excepted Transaction contract situations in as consistent a manner as possible. Below is:

1. A brief discussion of the history of Excepted Transactions and how they are treated under the NEPOOL Standard Market Design (“SMD”);
2. A general description of the process ISO-NE has gone through to model Excepted Transactions under SMD; and
3. A detailed description of issues that arose regarding the modeling of the ARR allocation to Excepted Transactions and how ISO-NE addressed these issues.

Overview of Excepted Transactions and SMD

The Excepted Transactions contained within the NEPOOL Tariff were part of a negotiated agreement effective in 1997 that created a New England Regional Transmission Group and coordinated tariff. A transitional arrangement and continuing service for Excepted Transactions were negotiated to phase in the financial impacts of the change from the historic regime in which uses of the PTF had to be obtained and paid for under the individual tariffs of the Participants to a regime in which the service is now obtained from the Participants through NEPOOL at a regional rate.

Excepted Transactions are the power transfers and other uses of the PTF effected under the transmission agreements in effect on November 1, 1996. Such power transfers continue to be effected under such agreements for the respective periods specified in Attachment G rather than under the NEPOOL Tariff. After the end date specified in Attachment G, such transfers and other

uses will continue to be effected, if still occurring, under the NEPOOL Tariff. The customers under the transmission agreement associated with Excepted Transaction continued to pay for such transmission service; and the load being served by the power sales agreement associated with the Excepted Transaction paid for transmission service under the NEPOOL Tariff as well. For some Excepted Transactions, the customer under the transmission agreement (the “receiver” in Attachment G) and the customer under the power sales agreement (the party identified in the FERC Docket listed in Attachment G), both associated with the same Excepted Transaction, were not the same party.

In July 2002, NEPOOL and ISO-NE filed Market Rule 1 (“MR1”). MR1 provides the structure for implementing the New England SMD, including locational marginal pricing, Financial Transmission Rights, and ARRs. Appendix C to MR1 is entitled “Auction Revenue Rights and Qualified Upgrade Awards” and states that Excepted Transactions included in Attachments G and G-2 to the NEPOOL Tariff be given special consideration during the process of allocating ARRs to load. Specifically, Section 2.1 of Appendix C requires that:

“In the first stage of each ARR Allocation, each entity serving load to which energy is delivered or making an External Transaction sale pursuant to an Excepted Transaction included in the list of transactions in Attachments G and G-2 of the NEPOOL Tariff, and which is the party responsible for paying Congestion Cost associated with energy purchased under the Excepted Transaction shall have the option to be allocated ARRs from the generator to the location of the load or the External Node. Alternatively, each seller delivering energy pursuant to an Excepted Transaction to an entity serving load or making an External Transaction sale and which the seller is the party responsible for paying Congestion Cost associated with energy purchased under the Excepted Transaction shall have the option to be allocated ARRs from the generation source to the location of the load or External Node.”

Thus, Excepted Transactions may be allocated ARRs, in Stage 1 of ARR allocation, prior to the allocation of ARRs to load in general. This Stage 1 allocation requires ISO-NE to incorporate information from the agreements associated with the Excepted Transactions into its ARR modeling process.

Modeling Process for ARR Allocation to Excepted Transactions

ISO-NE began the process to allocate ARRs to Excepted Transactions by considering three main parameters:

1. The requirements of MR1, Appendix C which includes determining the party responsible for Congestion Costs;
2. The terms and conditions of the Excepted Transactions, including the transmission service agreement and the power sales agreement cited in Attachments G and G-2; and
3. The modeling capability of the SMD/ARR software.

The next step was to gather information relating to each Excepted Transaction that was still in effect. Information requirements included:

1. Verifying Providers, Receivers, Buyers and Sellers of Excepted Transactions;
2. Determining the party paying congestion related to the Excepted Transaction to assure ARRs go to that party;
3. Determining Points of Receipt (“PORs”) and Points of Delivery (“PODs”) for each Excepted Transaction;
4. Verifying MW amounts for each Excepted Transaction; and
5. Verifying end dates for each Excepted Transaction.

ISO-NE developed a form, the “Excepted Transaction ARR Allocation Information Form”, to collect the above information. ISO-NE required that all parties listed as either a provider or receiver on Attachments G and G-2, as well as those parties that were associated with the power sales agreement listed on Attachments G and G-2 complete the form. In addition, numerous phone and e-mail contacts were made to parties to verify information. ISO-NE also received and reviewed the transmission service agreements, the power sales agreements, and other pertinent documents associated with each Excepted Transaction.

Based on the information received, ISO-NE developed the election form for “Authorization for Treatment of Excepted Transactions in ARR Allocation” and determined that 48 of the 82 Excepted Transactions in Attachments G and G-2 are no longer in effect. These Excepted Transactions either terminated on the date listed in Attachments G and G-2 or were terminated by the parties to the contract on a date earlier than the date listed in the Attachments. In addition, in reviewing the contract information to develop

the election form, ISO-NE found several inconsistencies in MW amounts and end dates that were listed in Attachments G and G-2. As a result, the NEPOOL Tariff Committee revised Attachments G and G-2:

1. To update and correct these Attachments; and
2. To assure that the Attachments reflect the information used by ISO-NE to allocate ARR to Excepted Transactions.

Identifying the Party to Receive Credit for ARRs

The entity receiving the credit for the ARRs associated with an Excepted Transaction was determined by reviewing the transmission service agreement and power sales agreement associated with the Excepted Transaction. One requirement for being the party allocated ARRs associated with an Excepted Transaction, pursuant to Appendix C of MR1, is that such party is responsible for paying the Congestion Cost associated with the energy delivered/purchased under the Excepted Transaction.

The Excepted Transactions listed in Attachments G and G-2 were the result of negotiations in 1996 to phase in the financial impacts of moving to regional transmission service and the NEPOOL Tariff. Using Excepted Transactions for the purpose of ARR allocation was not envisioned when Attachments G and G-2 were originally developed.

For many Excepted Transactions, neither the terms of the transmission service agreement nor the terms of power sales agreement identifies which party is responsible for paying Congestion Cost. In these instances, an additional input to determining which party will be allocated the ARRs associated with an Excepted Transaction is which party was responsible for paying Congestion Cost under ISO-NE's settlement of the interim market.

ISO-NE has concluded that the appropriate and workable determinant to use for determining Congestion Cost responsibility is who was the party responsible for paying Congestion Cost under ISO-NE's settlement of the interim market. Using the party responsible for paying Congestion Cost under ISO-NE's settlement of the interim market as the entity to receive the credit for the ARRs associated with an Excepted Transaction does not require ISO-NE to interpret:

1. The intent of the agreements associated with the Excepted Transaction or of any subsequent agreements between the parties (Provider, Receiver, Buyer, and Seller); and
2. The potential relationship between a multitude of internal bilateral transaction submittals under SMD to any particular Excepted Transaction.

The party modeled as the entity receiving the credit for the ARR associated with an Excepted Transaction, once established in the ISO-NE settlement process, may not be changed. ISO-NE is not privy to agreements between the parties as to how the energy associated with Excepted Transactions will be submitted to the energy market under SMD or to agreements that may change the responsibility for Real-Time Load Obligation, both of which may impact who the responsible party is for paying Congestion Cost. Therefore, it is the responsibility of the parties involved to determine which party any benefits from receiving credits for ARRs associated with Excepted Transactions should be assigned to outside the ISO-NE settlement of the market.

POR and POD Designations

Key information in the election form is POR and POD designations. A POR and POD needs to be defined for each Excepted Transaction to model each Excepted Transaction in the ARR allocation process; and to determine the value of the ARRs awarded to each Excepted Transaction. All contracts were reviewed to assure that appropriate PORs and PODs were defined. While determining PORs and PODs for many of the Excepted Transactions was a relatively routine procedure, there were several cases where the transmission service agreement and power sales agreement associated with the Excepted Transaction did not contain information to allow definition of a specific POR and/or POD node. In such instances, ISO-NE determined appropriate POR and/or PODs using the rules described below. These rules were consistently applied.

In determining PORs and PODs for each Excepted Transaction, several issues arose where either a POR or a POD or both:

1. Could not be determined from the transmission service agreement and power sales agreement associated with the Excepted Transaction;
or

2. Were not implementable in the SMD modeling used for allocating ARR.

Examples of PORs and PODs that are not implementable are:

1. PORs or PODs that are not PNodes in the network model; and
2. PODs where there is no load in the network model.

The situations below required rules to be developed in order to determine PORs and/or PODs consistently.

1. Excepted Transactions relating to transmission of system power; and
2. Excepted Transactions that did not reflect the provision of transmission service along the entire path from the source to the location of the congestion-paying customer's load.

A further explanation of each of these situations and the rules used for determining the appropriate PORs and PODs are provided below.

Excepted Transactions Relating to Transmission of System Power

Many of the Excepted Transactions with NU as the provider were related to providing transmission service for a system power contract. These system power contracts were constructed to provide transmission service originating from, not one single unit, but rather from the fleet of NU units existing at the time the contracts were signed. Thus, no single bus would be reflective of a POR for such a contract.

For such Excepted Transactions, the PORs will be modeled as the nodes of the units belonging to NU as of March 1, 1997 which was the effective date of the NEPOOL Tariff. ARRs for such Excepted Transactions will be modeled using, as PORs, the nodes representing those units which:

1. Belonged to NU as of March 1, 1997;
2. Are still active; and
3. Have high operating limits of 50 MWs or greater.

Additionally, the share of each unit used to model such Excepted Transactions will reflect the expected ratio of surplus capacity between units in Connecticut, Massachusetts and New Hampshire as described in the system power contracts.

Using the nodes related to the historical unit ownership was chosen for handling this system power issue. This methodology reflects the terms of the transmission service agreements associated with the Excepted Transactions, which provide transmission across the NU system. Also, this methodology reflects the terms and intent of the power sales agreements associated with the Excepted Transactions, which provided for system power from units owned by NU at the time the system power contracts and transmission service agreements were signed.

Excepted Transactions Without a Complete Path to the Load

Several Excepted Transactions are not covered by contractual arrangements reflecting a complete path to the load. There are several reasons for this situation:

1. The transaction was designed to deliver to the border of a service territory, as in the case of several Altresco/Pittsfield and Masspower contracts.
2. The transaction was covered by several contracts in series where one of the contracts over a connecting path between the provider's system and the receiver's system was terminated. Only one such Excepted Transaction reflects this situation.
3. The transaction receiver is a Transmission Dependent Utility ("TDU"), and the contractual arrangement delivers the service to the system of the transmission provider serving the TDU, not specifically to the TDU's node(s).

In all such cases, the zone the load resides in will be modeled as the POD for the Excepted Transaction. Modeling the zone of residence as the POD provides a workable solution to this issue, avoids any discretionary/arbitrary selection of a node to reflect a POD, and follows the provisions of the contracts associated with the Excepted Transactions.

Modifications to Election of Treatment of Excepted Transactions

The ARRs associated with the destination location of load within New England served by an Excepted Transaction may be allocated either:

1. Pursuant to Section 2.1 of Appendix C to MR1 (special treatment in the first stage of the ARR allocation process); or
2. Pursuant to Section 2.2 of Appendix C to MR1 (similar to all other load in the first stage of the ARR allocation process).

The ARRs associated with an Excepted Transaction which is an export over the external ties may only be allocated pursuant to Section 2.1 of Appendix C to MR1.

The party modeled as the entity receiving the credit for the ARRs associated with an Excepted Transaction:

1. Must request the special treatment; and
2. May modify its election in accordance with Section 2.1.1 of Appendix C to MR1.

If the party modeled as the entity receiving the credit for the ARRs associated with an Excepted Transaction does not request the special treatment, then the ARRs associated with the destination location of the load served by such Excepted Transaction will be allocated similar to all other load in the first stage of the ARR allocation process.

For Excepted Transactions over the external ties, until the party responsible for paying the Congestion Cost associated with the energy purchased under an Excepted Transaction listed in Attachment G-3 to the NEPOOL Tariff elects to be allocated ARRs, the Excepted Transaction will have physical scheduling and curtailments rights in accordance with Section 25D(a) of the NEPOOL Tariff. Once the party responsible for paying the Congestion Cost associated with the energy purchased under an Excepted Transaction elects to be allocated ARRs, the party will not be able to revert back to using their contract rights for physical scheduling and curtailment pursuant to Appendix G-3.

Modifications to Data Defining Excepted Transactions

The PORs, PODs, and MW amount used to model an Excepted Transaction, once established, may not be changed except under the limited circumstances described below.

Excepted Transactions With a Complete Path to the Load

If a complete transmission path exists from the source to the service territory where the load resides, then the party to be credited with the ARR associated with the Excepted Transaction may elect that the POD be either the specific nodes where the load is located or the zone in which the load resides. The party to be credited with such ARRs may change the POD(s) from nodes to zones or zones to nodes on a monthly basis until the first long-term FTR Auction. From the first long-term FTR Auction going forward, the POD(s) for such an Excepted Transaction will be frozen.

Excepted Transactions with Right to Change MW Amount

In the agreements associated with some of the Excepted Transactions, the Buyer in the power sales agreement has the right to modify its purchase of capacity and related energy each power year. The associated transmission service agreement reflects the ability of the Buyer in the power sales agreement to make such modification. For such Excepted Transactions, the party to be credited with the ARRs may modify the MW amount used to model the Excepted Transaction when the Buyer makes a change in its purchase of capacity and related energy in accordance with the agreements associated with the Excepted Transaction.

Summary

To comply with MR1 and implement the modeling of ARRs for Excepted Transactions, ISO-NE considered the agreements associated with the Excepted Transaction, the requirements of MR1 which includes determining the party responsible for Congestion Costs and the modeling capability of the ARR allocation software.

For many Excepted Transactions, neither the terms of the transmission service agreement nor the terms of power sales agreement identified which party was responsible for paying Congestion Cost. In these instances, ISO-NE concluded that the appropriate and workable determinant to use for determining Congestion Cost responsibility was who was the party responsible for paying Congestion Cost under ISO-NE's settlement of the interim market. Also, where the agreements did not provide for designation of a specific

location(s) as PORs and/or PODs or provided a designation that was not implementable with the software, consistent modeling rules were applied.

The application of these rules, along with the review of the transmission service agreements and power sales agreements associated with the Excepted Transactions, resulted in the modeling of ARR's consistent with the requirements of MR1, Appendix C.

Disclaimer

The method set forth herein for allocation of ARR's to Excepted Transactions is not intended to influence current discussions regarding points of delivery under either the Excepted Transactions or various related agreements. This method of allocation is being undertaken for administrative purposes due to the immediate necessity to allocate ARR's associated with the Excepted Transactions.