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nationalgrid

March 10, 2011

Honorable Jaclyn A. Brilling, Secretary
State of New York
Public Service Commission
Office of the Secretary
Three Empire State Plaza
Albany, NY 12223

RE: Case 10-E-0050 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules, and Regulations of Niagara Mohawk Power Corporation for Electric Service – Compliance Filing - Commodity Cost Recovery Mechanisms

Dear Secretary Brilling,

Enclosed are the following materials submitted for filing by Niagara Mohawk Power Corporation d/b/a National Grid ("Niagara Mohawk" or "Company") in accordance with the requirements of the New York State Public Service Commission ("Commission").

1. Revised tariff leaves listed in Attachment A for P.S.C. No. 220 Electricity and P.S.C. No. 214 Outdoor Lighting to become effective January 1, 2012.[1]

2. A detailed report document, "Proposed Commodity Cost Recovery Mechanisms," identified as Attachment B, in support of the proposed tariff changes, containing a detailed explanation of the proposed tariff modifications, along with examples.

The purpose of the tariff amendments accompanying this filing is to make a number of modifications, beginning January 1, 2012, to the manner in which Niagara Mohawk recovers its electric supply costs from its customers. The proposed modifications include revising the basis for setting the retail commodity rates charged to the Company's residential and small commercial customers (its "mass market customers"), implementing new reconciliation mechanisms for recovering electric supply costs that are not recovered by the retail commodity rates, and revising the manner in which the Company allocates the costs of procuring capacity to its supply customers.

The timing of these changes coincides with the end of the period covered by the Merger Joint Proposal, which the Commission approved in Case No. 01-M-0075 ("MJP").[2] The MJP, effective February 1, 2002, contains a number of provisions establishing how Niagara Mohawk recovers the costs of power to serve its customers, such as the allocation of

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[1] The revised tariff sheets are being transmitted electronically to the Commission contemporaneously with this filing in accordance with applicable procedures. Copies are included with this transmittal letter.

[2] Opinion No. 01-6, Opinion and Order Authorizing Merger and Adopting Rate Plan, Case No. 01-M-0075, issued and effective December 3, 2001.

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the forecast above-market costs of electricity procured from certain "legacy" supply contracts. The Company is currently compliant with the MJP regarding the manner in which it supplies electricity to its customers and recovers the cost of the electricity, but is undertaking the tariff modifications proposed in this filing in order to ensure that its proposed commodity recovery mechanisms best meet the intent of several Commission orders issued over the past six years that address electric commodity issues. These orders require utilities to: (1) engage in hedging practices that reduce the volatility of the commodity prices charged to mass market customers; (2) eliminate hedging and implement hourly pricing for larger commercial and industrial customers; and (3) allocate the costs of hedging and other commodity costs to the appropriate customers.

Niagara Mohawk originally proposed tariff amendments substantially similar to those included in this filing in its three-year rate case proposal in Case No. 10-E-0050 (the "2010 Rate Case"). However, the 2010 Rate Case became a one-year litigated proceeding setting rates through 2011, and due to the fact that the amendments were proposed to go into effect beginning in 2012, Niagara Mohawk and other parties to that proceeding agreed to defer consideration of these revisions until a future proceeding. Niagara Mohawk agreed, via stipulation, that it would re-file a proposal to adjust its commodity rate mechanisms within 45 days of the issuance of the Commission's order in the 2010 Rate Case. This filing represents the satisfaction of that commitment.

I. Background and Reasons for Tariff Amendments

A. Current Commodity Cost Allocation Mechanisms

One of the core services that Niagara Mohawk offers its customers is Electricity Supply Service, which is defined in Rule 1.27 of its P.S.C. No. 220 Electricity Tariff (the "Tariff") as "the furnishing of the electricity required to meet a Customer's needs, exclusive of the transmission, distribution and delivery service provided by the Company under this tariff and its OATT [Open Access Transmission Tariff]." The Company does not own any electricity generation facilities to serve its supply customers, thus it must procure the power necessary to provide service to these customers from other sources. The Company also enters into physical and financial fixed-price energy procurement contracts to serve as hedges thereby mitigating supply price volatility for certain of its customer classes.

The Company procures electric supply for several classes of customers. These classes can be grouped into two broad types: mass market customers, which consist of residential and small commercial customers, and residential and farm time-of-use, larger commercial and industrial customers (referred to herein as the Company's "C&I customers."). Outdoor Lighting customers receive service pursuant to the Company's P.S.C. No. 214 Electricity Tariff, and also fall under the classification of "C&I customers." Table 1 in Attachment A lists Niagara Mohawk's various service classes, and shows the amount of electricity, in GWh, that the Company procured for each service class in 2010, and the percentage of supply that the Company served for each class relative to its total load.

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Niagara Mohawk's portfolio for providing electricity to its supply customers consists of various unit contingent power purchase contracts with the balance of the portfolio purchased in the New York ISO Day-Ahead Market. Niagara Mohawk also has capacity contracts and utilizes the NYISO installed capacity ("ICAP") auctions to meet the balance of all installed capacity requirements. Prior to the implementation of retail choice in New York, the Company maintained a portfolio of supply contracts, a number of which, known as the "Legacy Contracts" are still in effect. Because these contracts continued to expire going forward, the MJP specified a gradual reduction in the percentage of supply which would be hedged, based on service class, throughout the ten-year period (2002-2011) covered by the MJP. However, in order to cover any differences that may occur over time between forecast and actual available supply, the MJP permitted Niagara Mohawk to "execute reasonable hedges" (known as "New Hedges") in order to meet the target hedging percentages.

The commodity component of supply customers' bills are based on the hourly prices set by the New York ISO Day-Ahead market. All mass market customers and some C&I customers pay a monthly commodity rate based on a 30 day rolling average of NYISO hourly prices, multiplied by their actual monthly consumption. Certain large C&I customers are MHP customers, which means they pay the actual hourly NYISO market prices based on their actual load during those hours.

Supply costs that are reflected in the delivery portion of customers' bills consist of the Competitive Transition Charge ("CTC"), the NYPA Rural and Domestic hydropower benefit, the Delivery Charge Adjustment ("DCA"), and the Commodity Adjustment Charge ("CAC"). The CTC, in part, collects the forecast of the net market value of the Legacy Contracts, known as the over-market variable costs ("OMVC"), which are determined based on a two year forecast of market prices for electricity, required to be updated every two years per the MJP. In addition, for mass market customers, the MJP also provides that the CTC will be adjusted through two mechanisms. First, any differences between the two-year average of forecast market prices of electricity and the actual day ahead market price of electricity are reconciled for mass market customers through the DCA, utilizing hedging percentages established in the MJP. Second, any deviations in the actual costs of the Legacy Contracts, as well as between the actual costs for procuring unhedged energy and capacity and electricity supply revenues realized by the Company are reconciled through the CAC. As with the CTC itself, both of these reconciliation mechanisms are billed as part of the delivery section of mass market customers' bills. C&I customers do not receive these monthly reconciliation adjustments to their CTC.

B. Reasons for Tariff Amendments

The Company believes that the proposed revisions to its commodity cost recovery mechanisms will allow it to best align its allocation of commodity costs with the goals

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articulated by the Commission in its policy statement and subsequent orders issued over the past several years.[3] These Commission goals are: (1) limiting price volatility for mass market customers through hedging supplies acquired to serve these customers; (2) truncating hedging and requiring hourly market pricing for large C&I customers; and (3) allocating the costs of volatility management to the customers who benefit from that management through appropriate commodity charges. The Company also believes that changes to its commodity mechanisms will improve transparency for customers so they will be better able to make educated decisions in the retail electricity marketplace.

In addition, the Company agreed, via stipulation in the 2010 Rate Case, that it would include revisions to its mechanisms for collecting capacity costs from its MHP and non-MHP customers per the proposal set forth by Staff in that case.

II. Summary of Proposed Tariff Modifications

Niagara Mohawk is proposing tariff revisions that would implement the Company's proposal to revise its commodity cost recovery mechanisms. The primary features of that proposal are as follows:

- implement a new Legacy Transition Charge ("LTC") to recover the remaining costs and benefits of the Legacy Contracts through delivery rates;
- revise the methodology for calculating the benefit relating to serving residential customers with NYPA Hydropower, as an adjustment to the LTC;
- eliminate the DCA and CAC mechanisms and replace them with a new mechanism that will reconcile commodity costs and revenues for all commodity customers;
- change the manner in which commodity rates are determined for mass market customers from hourly NYISO Day-Ahead prices to a monthly commodity rate based on a forecast of NYISO prices for each calendar month;
- revise how capacity costs are recovered from customers; and,
- eliminate the Standard Rate Service and Market Rate Service options.

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[3] Development of Retail Competitive Opportunities, Statement of Policy on Further Steps Towards Competition in Retail Energy Markets, Case No. 00-M-0504 (issued August 25, 2004); Order Requiring Development of Utility Specific Guidelines For Electric Commodity Supply Portfolios and Instituting a Phase II to Address Longer-Term Issues, Case No. 06-M-1017 (issued April 19, 2007); Order Establishing Electric Supply Portfolio Standards, Goals, And Reporting Requirements, Case No. 06-M-1017 (issued February 26, 2008); Order Instituting Further Proceedings and Requiring the Filing of Draft Tariffs, Case No. 03-E-0641 (issued September 23, 2005); Order Denying Petitions for Rehearing and Clarification In Part and Adopting Mandatory Hourly Pricing Requirements, Case No. 03-E-0641 (issued April 24, 2006) (collectively referred to herein as the "commodity orders").

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A summary of each of these proposed modifications is set forth below. A more detailed discussion of each of these proposed modifications, including examples of how they will operate in practice, is contained in Chapter 3 of Attachment B to this filing.

Although the Company's proposal changes the manner in which supply rates for certain customers are initially calculated, and shifts the recovery of some costs from the delivery section of the electric bill to commodity section of the bill, the proposed modification to the commodity cost recovery mechanisms will continue to operate as a pure cost pass through.

A. Legacy Transition Charge

Niagara Mohawk is proposing to recover the costs and benefits of its Legacy Contracts through a new mechanism known as the LTC. Under Niagara Mohawk's current tariff, and in accordance with the MJP, the Company collects the net market value of the legacy contracts, or OMVC, from all delivery customers through the CTC, which was reset every two years during the MJP period. The CTC rates charged to customers are a flat, or fixed, price for all months during each two year period, regardless of the underlying market value of the contracts in any specific month.

A new mechanism is necessary because the CTC will be eliminated beginning January 1, 2012, per the January 24, 2011 Commission Order in the Company's 2010 Rate Case. The proposed LTC will be a monthly rate based on the net market value of all Legacy Contracts in each month. The monthly net market value of these contracts is defined as the contract costs less the market value of the generation as determined by NYISO clearing prices. In addition, the Company is proposing to include in the LTC a reconciliation of the sales forecast used to determine the monthly LTC rate, a mechanism that does not currently exist under the CTC. Adopting the LTC will benefit customers in two primary ways. First, using a monthly forecast of electricity market values rather than a two-year forecast will result in a more accurate assessment of the Legacy Contracts' net costs or benefits. Second, incorporating the full reconciliation within the LTC mechanism will ensure that the full benefit and cost of the Legacy Contracts are allocated to the appropriate customers.

The Company proposes to reflect the LTC in the delivery section of customers' bills, which is consistent with the current mechanisms for recovering the net costs of the Legacy Contracts, as well as the Commission's commodity orders which explicitly endorsed the concept that utilities continue to recover the costs of these contracts from all delivery customers.[4]

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[4] *See* Order Requiring Development of Utility Specific Guidelines For Electric Commodity Supply Portfolios and Instituting a Phase II to Address Longer-Term Issues, Case No. 06-M-1017 (issued April 19, 2007) at 22.

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B. NYPA Hydropower

Under Niagara Mohawk's Tariff, the delivery rates for service classes SC-1 and SC-1C are adjusted on a monthly basis to account for any of the relatively low-cost hydropower that Niagara Mohawk procures from NYPA that is allocated to these service classes. The current mechanism for performing this adjustment is contained in Rule 29 in the Tariff using forecasted market prices as established in the most recent CTC reset proceeding. The Company proposes to amend the Tariff so that the benefits of the NYPA hydropower contracts are reconciled using a mechanism that operates in a manner similar to the proposed LTC mechanism: using a monthly forecast of the contracts' values. This will allow the benefits of the NYPA hydropower contracts to continue to flow through to residential customers with the added benefit of reduced monthly bill volatility. This forecast will also be subject to a monthly true-up to reflect actual costs, market prices, and customer loads, and the true-up will be reflected on customers' bills on a two month lag.

C. Electric Supply Reconciliation Mechanism

Niagara Mohawk is proposing to implement a new mechanism, the Electric Supply Reconciliation Mechanism ("ESRM"), to reconcile all commodity costs and revenues not related to Legacy Contracts (including the NYPA Hydropower contracts). Specifically, the ESRM will reconcile: (i) the costs and benefits of the New Hedges as well as costs associated with procuring and maintaining the New Hedges; (ii) timing of actual expenses and revenues; (iii) forecast and actual monthly prices for mass market customers; (iv) capacity costs; (v) ancillary services costs; (vi) prior reconciliations that would have flowed through the CAC prior to January 1, 2012. As part of this reconciliation, the Company will allocate certain costs clearly associated with a particular customer group (such as those relating to the New Hedges) only to that customer group. All other commodity reconciliation amounts are proposed to be allocated among all customer groups purchasing commodity from the Company.

Niagara Mohawk proposes to reflect the ESRM on the commodity portion of its customers' bills. This is consistent with the Commission's directive that commodity costs, including hedging costs, be recovered through commodity charges to commodity service customers, rather than through delivery charges, which the Commission found disguises the cost of both commodity service and delivery service. This presentation is also consistent with the Commission's directive to provide customers with accurate price signals as set forth in its MHP orders.[5]

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[5] *See id.*

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D. Determination of Mass Market Commodity Rates

Niagara Mohawk is proposing to change the basis for calculating the commodity rate for mass market customers. Rather than using the NYISO hourly Day-Ahead market prices, these customers will be charged a rate based on a forecast of NYISO Day-Ahead prices. This forecast will be derived using monthly forward trading market prices, such as NYMEX or other similarly available public prices, approximately four days prior to the forecast month. If forward trading market prices are not available for a particular zone, the Company is proposing to set the forecast prices based on historical data and relationships to zones for which there are forward trading prices.

The Company is proposing this change because it will result in better alignment between monthly hedging costs or benefits and retail commodity rates, while simplifying those rates for customers. Customers will benefit from an easier to understand commodity price so that they can better evaluate their electric supply charges. The change will also allow the Company to continue its obligation to mitigate bill volatility because all contract costs and benefits will be calculated based on these forecast Day-Ahead prices.

E. Capacity Cost Allocation

As with all other load-serving entities in New York, Niagara Mohawk is required by the NYISO to purchase sufficient generation capacity to maintain reliable electric service, based on the peak load demanded by the Company's customers during the NYISO's overall system peak hour. If a load-serving entity has not procured sufficient capacity through bilateral markets or forward auctions to satisfy this obligation, it must purchase the remaining requirements in the NYISO spot market for capacity. Niagara Mohawk's current formula for recovering these costs is set forth in Rule 46 of its Tariff.

In this filing, Niagara Mohawk is proposing three modifications to the manner in which it allocates the costs of procuring capacity to its customers. First, Niagara Mohawk is proposing to modify its formula for determining capacity costs by amending the definition of Locational Based Marginal Capacity Price ("LBMCP"), which is currently defined in the Company's Tariff as "the price of the respective six-month block auction for an entire (capability) obligation period defined by the NYISO as the Capability Period Auction, in $/kW-mo for capacity in each of the respective zones." Niagara Mohawk is proposing to change this definition so that the LBMCP is based on the NYISO Capacity Spot Market price. The Company is proposing this change because the Capacity Spot Market price represents the most accurate price for capacity in New York, due to the fact that it is the price derived from the capacity market where all load-serving entities in New York must ultimately settle their NYISO capacity obligations. By contrast, the NYSIO six-month and monthly auctions are

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forward markets where load-serving entities can choose to participate to acquire capacity on a forward basis, but are under no obligation to do so.

Second, consistent with a stipulation entered into in the 2010 Rate Case, Niagara Mohawk is proposing to modify the Tariff's definition of Class Load Factor, which is used in calculating the hourly price capacity adder that is determined pursuant to the formula set forth in Rule 46. Class Load Factor is currently generally defined as the total kWh used by a class in the previous year, divided by the peak demand of the class in the previous year multiplied by 8,760 (the total number of hours in a year). The Company proposes to replace the reference to peak demand of class in previous year with a reference to the demand of class in previous year at the time of the NYISO peak hour. This results in basing the calculation of capacity costs on the demand of the class during the hour in which the New York system peaks instead of the demand of the class during the hour in which the class itself peaks. The purpose of this modification is to align the Rule 46 capacity allocation formula with how the Company's capacity requirements are determined and assessed to the Company by the NYISO.

Third, the Company proposes to revise the methodology for collecting capacity costs from MHP customers. Rather than charging MHP customers pursuant to the methodology set forth in Rule 46, under which a customer is charged on an hourly basis during on-peak hours, the Company proposes to charge MHP customers for capacity costs by using a kW demand charge based on each customer's individual demand during the NYISO system peak hour, as measured using hourly meter data. This methodology, known as the "capacity tag" methodology, will ensure that MHP customers are allocated their share of the Company's capacity requirement determined at the time of the NYISO peak load. By doing so, it will send customers the appropriate price signal to reduce demand during system peak in order to reduce capacity charges throughout the year. This methodology was proposed by DPS Staff in the 2010 Rate Case. In that case, Niagara Mohawk agreed to propose adopting this methodology for MHP customers in this filing.

F. Standard Rate Service and Market Rate Service Designations

Niagara Mohawk proposes to remove the Standard Rate Service and Market Rate Service classifications under its Tariff. This will have two main impacts. First, customers who purchase their commodity from a supplier other than Niagara Mohawk will no longer receive the benefits or pay the costs associated with any future New Hedges entered into by the Company, although these customers will still be charged costs associated with Legacy Contracts through the LTC. In addition, this change eliminates the option for a Niagara Mohawk mass market customer to choose to receive commodity at a market price. If mass market customers desire market-priced service, they will be required to choose an alternative energy supplier.

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III. Identification of Tariff Amendments

The tariff leaves submitted for filing are as follows:

PSC No. 220 Electricity

Fifth Revised Leaf No. 2
Fourth Revised Leaf No. 3
First Revised Leaf No. 32
First Revised Leaf No. 34
Third Revised Leaf No. 37
Original Leaf No. 37.1
Fourth Revised Leaf No. 148
Second Revised Leaf No. 153
First Revised Leaf No. 172
First Revised Leaf No. 218
First Revised Leaf No. 227
Third Revised Leaf No. 228
Third Revised Leaf No. 229
Original Leaf No. 229.1
Original Leaf No. 229.2
Original Leaf No. 229.3
First Revised Leaf No. 232
First Revised Leaf No. 233
First Revised Leaf No. 234
First Revised Leaf No. 296
First Revised Leaf No. 297
First Revised Leaf No. 300
First Revised Leaf No. 301
First Revised Leaf No. 304
First Revised Leaf No. 309
Sixth Revised Leaf No. 349
Third Revised Leaf No. 350
Sixth Revised Leaf No. 359
Sixth Revised Leaf No. 370
Sixth Revised Leaf No. 371
Sixth Revised Leaf No. 375
Sixth Revised Leaf No. 379
Fourth Revised Leaf No. 381
Fifth Revised Leaf No. 392
First Revised Leaf No. 393
Third Revised Leaf No. 425
First Revised Leaf No. 434
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First Revised Leaf No. 469

PSC No. 214 Outdoor Lighting

Fifth Revised Leaf No. 9.1
Fourth Revised Leaf No. 9.2

IV. Technical Conference

In the 2010 Rate Case, the Company agreed to hold a technical conference with Staff and interested parties to discuss the issues raised herein. To that end, a technical conference is scheduled for March 23, 2011 at 9:30 am in the Company's Albany office, located at 1125 Broadway, Albany NY in room 308A.

Respectfully submitted,

/s/ Keri Sweet Zavaglia

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