

Agenda #4
Management Committee Meeting – August 8, 2002

August 5, 2002

name
company
address
city, state zip

Dear _____ :

The NYISO Board and the market participants of the NYISO are approaching a critical crossroad in the evolution of New York's electric markets. We must decide whether to move ahead to replace much of our aged and outmoded legacy IT infrastructure and implement state-of-the-art real-time market applications (RTS/SMD 2.0) in order to facilitate resolution of most of the remaining seams issues and add additional market efficiencies; or to delay these improvements until after NERTO formation, or until a joint RFP for the ultimate NERTO system can be developed and issued. In this latter case (delaying a decision), we would have to take remedial actions to temporarily maintain our infrastructure until some future point, probably 2-3 years hence.

Earlier this week the Federal Energy Regulatory Commission (FERC) issued the Standard Market Design (SMD) Notice of Proposed Rulemaking (NOPR). Our discussions with FERC prior to issuance and a preliminary review of the NOPR leads us to the belief that New York's markets are very close to what FERC intends, and much closer than any of the existing markets in the other ISO's. In making the decision whether or not to proceed, we have to consider not only the merits of RTS/SMD 2.0 but also the FERC direction that has been received over the last few years and the desire of market participants to resolve the remaining seams issues as soon as possible and move to larger regional markets. Earlier this summer, the NYISO's Board decided to proceed with filing the NERTO proposal with the Commission and that is, of course, a significant factor in the equation.

The RTS/SMD 2.0 development process began as a vehicle to resolve seams issues, and you as market participants have been intimately involved in its development from its inception and have provided valuable direction to the staff. Over these past months the NYISO staff has provided you with detailed and objective information on RTS/SMD 2.0. In fact, this project is really the product of a joint effort with several subcommittees and working groups. What I will attempt to do here is summarize the benefits and risks of proceeding down both of the roads open to us.

These options are:

- **DELAY MAKING THE DECISION** to proceed with major market infrastructure and design improvements until after the formation of NERTO in the 2003-2004 timeframe, or until the completion of an RFP for the NERTO system.

Or

- **PROCEED NOW** with the development of SMD 2.0/RTS on a sole source basis.

The following table lays out the staff’s best judgment of the risks and benefits of these two paths as we see them today.

	<u>Option 1 – Delay/RFP</u>	<u>Option 2 – Proceed</u>
Date Operational	Late 2005 – 2006	Late 2003 to early 2004 (prior to summer 2004)
2-Year Cost 2003-04	\$5 million for essential upgrades to legacy systems	\$30 million (2003 budget impact \$15 million)
Benefits	<ol style="list-style-type: none"> 1. Lower costs over next two years. 2. NERTO structure may be known and a centralized IT management would coordinate IT systems development for both NY and NE by late 2003. 3. Could minimize “throw-away” of some NYISO systems under NERTO. It is more likely that at least some of the applications would be more easily combined for a NERTO single market. 	<ol style="list-style-type: none"> 1. Eliminate most remaining seams issues* - potential benefit of up to \$35 million/year. 2. Enhanced reliability for the market and electric system 2-3 years sooner. 3. Desired stakeholder market improvements earlier (e.g. reduced uplift, ability to reflect scarcity in reserve and energy prices, improved billing, and increased DSM programs).
Risks	<ol style="list-style-type: none"> 1. Money spent on upgrades of legacy systems is a “throwaway”. 2. Less effective elimination of seams issues. Some additional seams improvements might be possible prior to system replacement, but these would be small compared with a new real-time market. 3. Major improvements in market and electric system efficiency and reliability delayed for 2-3 years. 	<ol style="list-style-type: none"> 1. Possibility of some “throwaway” if NERTO implementation requires a different software vendor. 2. Modifications in response to changing regulatory requirements if final FERC SMD order differs markedly from NOPR. 3. More difficulty “conforming” markets if NERTO does not go to a single market and chooses the PJM/MISO approach.

*Except pancaking – elimination of pancaking will be handled separately.

The staff has looked at the risks and benefits of moving ahead with RTS/SMD 2.0 now versus delaying a decision for about a year to allow for either a NY RFP process or for a new NERTO Board to make the decision. It is our conclusion that the benefits of proceeding now are greater than those of delaying a decision, and that the benefits outweigh the risks. Our assessment has had the benefit of extensive discussions with several subcommittees and working groups.

RTS/SMD 2.0 is not a stand-alone program and it requires the associated infrastructure upgrades if it is to be effective. Full implementation will have an initial impact on the budgets for 2003 and 2004, but also has the potential to save up to \$35 million a year. A move to RTS/SMD 2.0 will resolve most of the remaining seams issues, and enhance reliability and market efficiency. We have the potential to lead the industry, and become the first ISO or RTO to be fully compliant with FERC's SMD.

While the ultimate decision will be made by the NYISO Board of Directors this is a landmark decision for the NYISO as a whole, and your opinion and your judgment are needed by the Board to make the best possible decision. Accordingly, we plan to ask for a non-binding vote to approve the current RTS/SMD 2.0 plan at the Management Committee meeting on August 8th. Budget approvals, however, will be accomplished via the normal process.

I look forward to seeing you on August 8th, and expect that we will have a lively and productive discussion on the vital strategic decision before us.

Sincerely,

A handwritten signature in cursive script, appearing to read "W. J. Museler".

William J. Museler
President & CEO