

August 8, 2005

Magalie R. Salas  
Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Washington, D.C. 20426

Fourth Quarterly Report by New York Independent System Operation, Inc. in  
Docket Nos. ER04-230-006, ER01-3155-006, ER01-1385-015, EL01-45-014.

Dear Secretary Salas:

On June 24, 2005, the Commission granted NYISO's Request for Rehearing in this docket, allowing it to introduce a RTS enhancement, improved combined cycle modeling, following the introduction of 15 minute scheduling but requiring the NYISO to continue its quarterly reports on the progress it is making in its combined cycle modeling effort.<sup>1</sup>

Pursuant to the NYISO's commitment in its Request for Rehearing, and the Commission's directive in its Order on Rehearing, the NYISO submits its fourth quarterly report on the progress it is making in pursuing changes to software modeling requirements and market rules that are necessary to adequately recognize combined cycle units within the NYISO markets. NYISO filed its first quarterly report November 8, 2004.

NYISO staff continues to meet individually with staff from most of the existing and planned combined cycle plants in New York to work towards a mutual understanding of the desired, and technically feasible, characteristics and configurations of combined cycle modeling in the NYISO system. Specifically, the NYISO continues to seek individual comment on the White Paper on Combined Cycle Modeling ("White Paper") it issued April 12, 2005. (A copy was attached to the May 6, 2005 Third Quarterly Report.)

As the NYISO reported in its Third Quarterly Report, accommodating the operating characteristics of combined cycle units could require very complicated market and settlement rules and a bidding interface that could look very complicated to its users. Indeed, at least two of the combined cycle owners NYISO staff has spoken with acknowledged that the type of structural changes suggested in the White Paper will require substantial cost and effort and will make bidding substantially more difficult.

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<sup>1</sup> 111 FERC ¶ 61,468 (2005). This Fourth Quarterly Report is being submitted on August 8, the next business day following the proposed filing date of August 6, which was a Saturday.

The NYISO continues to explore the needs and desires of its interested Market Participants to ensure that it does not engage in a project that is more costly and complicated than necessary to make efficient use of the NYISO's combined cycle resources. To that end, and consistent with our agreement with our Market Participants to conduct cost benefit analysis on any substantive investments, we are also initiating a study to determine the expected degree of combined cycle penetration in the New York market and the consequent benefit to the market of specific improvements in operating efficiency associated with certain major enhancements to the market software modeling.<sup>2</sup> The results of this analysis will assist the Market Participants in determining the most desirable, and affordable, future course for this project. This analysis will be discussed with the Market Participants before the next Quarterly report is submitted and will be discussed in greater detail in that filing.

In the meantime, the ISO, working with owners and operators of combined cycle units, has developed two substantive improvements to the modeling and operation of combined cycle units in New York. First, we have filed with the Commission a proposal to exempt steam Generators from persistent undergeneration charges during startup and shutdown sequences and to ensure they get paid for all Energy produced during these periods. Owners of combined cycle units, and other Generators, reported to the NYISO that they could not avoid undergeneration charges during periods of startup and shutdown because their ability to produce energy during these processes depended more on the progress of the startup or shutdown sequence than on the NYISO's basepoints. They felt that being exposed to charges they could not avoid, and facing the lack of compensation for Energy produced to the system during these sequences, were unnecessary burdens that should be eliminated. The NYISO agreed, developed a rules change in cooperation with Market Participants and filed this proposal with the Commission on August 4, 2005.

Second, we have incorporated an alternative to a single unit model for combined cycle configurations that operate with multiple combustion turbines and a single steam turbine. The alternative configuration coupled with other bidding flexibility offered with SMD2 allows these units to better reflect the actual operating capacity constraints of the multi-unit complex and participate in the ancillary service markets while still complying with ICAP bidding obligations. This new model is in place and operating for three plant locations in New York.

While we proceed to evaluate design options, and the costs and benefits associated with the White Paper approach, the NYISO staff and Market Participants will continue to explore additional modeling options and market rules adjustments to the current structure that could, in the near term increase the efficiency of combined cycle plant output in the NYISO Energy Market, short of revising completely the manner in which these plants are modeled, bid and dispatched.

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<sup>2</sup> See, attached, *BS&P Guidelines for NYISO Budget Preparation* which, as a general matter, requires projects estimated to cost more than \$500,000 to be presented for Market Participant approval.

Honorable Magalie R.Salas  
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If our study of costs, benefits, and design options indicates the need for a more sophisticated solution, one that is beyond the capacity of our current Day-Ahead and Real-Time market structure and software, it is likely that we would opt for implementing such a solution in phases because of its complexity and potentially significant costs.

The NYISO's next quarterly report will be filed with the Commission November 7, 2005.

The NYISO has served a copy of this filing on the parties in this docket.

Respectfully submitted,

/s/Mollie Lampi  
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**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the foregoing document upon all parties listed on the official service list maintained by the Secretary of the Commission in docket numbers in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure 18 C.F.R. § 385.2010 (2003).

Dated at Albany, New York this eighth day of August 2005.

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Attachment A

*BS&P Guidelines for NYISO*

# Budget Preparation/ Financing and for Project Monitoring

**Draft**  
07/23/03

## **Executive Summary**

An effective project budgeting and financing process is essential to ensure sound investment decisions that result in reliable, efficient and cost effective operations over the long term. Such processes also aid in assuring that the NYISO remains a viable, cost-effective ISO. This paper sets forth guidelines for the Market Participants and NYISO Staff to use in establishing the NYISO Operating and Capital Budgets and in monitoring project costs.

These guidelines are designed to allow Market Participants and NYISO Staff to continue to carry out their responsibilities in a collaborative way and are not intended to change the respective responsibilities of the NYISO Board and Management Committee as set forth in the NYISO Agreement. Article 7 section 7.02(e) states that the Management Committee shall have the responsibility of “Preparation of the ISO capital and operating budgets for review and approval by the ISO Board.” Article 5 Section 5.08 states that “The ISO Board also shall be responsible for the financial affairs of the corporation, including the ISO’s capital and operating budgets.” These guidelines suggest a process for use in the preparation of a five-year Budget Target and an Annual Operating and Capital Budget recommendation for review and approval by the NYISO Board.<sup>3</sup>

The budget process is comprised of four stages, which are described below:

1. Budget Preparation
2. Identification and Selection of Projects
3. Project Monitoring
4. Evaluation

The budget process is neither intended nor designed to manage staffing, or the ongoing operations or business management of the NYISO or to supplant the Board’s financial responsibility for NYISO operations, nor its autonomy and independence provided for in the NYISO Agreement and elsewhere. Similarly, the budget process is neither intended nor designed to supplant the responsibilities of the Management Committee provided for in the NYISO Agreement and elsewhere.

### **1 Budget Preparation**

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<sup>3</sup> Throughout this document, the term “Budget Target” refers to the five-year (long term) budget. The term “Annual Budget” refers to the first year of the Budget Target.

A necessary step in the budget preparation process is to refer to the NYISO's Strategic Plan. The preparation of the Annual Budget, Budget Target and Strategic Plan will be an iterative process. Using the Strategic Plan as a reference, staff will prepare a preliminary Annual Budget and Budget Target and will provide Market Participants with the information upon which the preliminary budgets are based. This will assist Market Participants in their review and comment on the preliminary budgets and assist them in preparing a budget recommendation concerning the Annual Budget to the ISO Board. Among other things, the Budget Target would clearly identify those funds that would be treated as an expense and those funds that would be available from longer term financing. It is recognized that the budgeting process needs to be flexible with respect to the out years to accommodate new and changing requirements in future years.

## **2 Identification and Selection of Projects**

Project requests will likely originate from a number of different sources for a variety of reasons including: NYISO identified market or operations enhancements or corrections of market flaws; FERC orders; Committee, Subcommittee and Working Group actions; PSC initiatives; resolution of Seams Issues; and, Market Participant requests.

Projects, other than NYISO required “in-year projects” which are fully described below, will generally be presented first to either the Business Issues Committee (BIC) or the Operating Committee (OC) for consideration and approval. In certain cases, project requests may be directly presented to the Management Committee (MC). The NYISO Staff will provide cost estimates and potential budget impacts along with other information associated with proposed projects that come before the Management Committee. Projects estimated to cost \$500,000 or more will require MC approval prior to being forwarded to the Project Priority Team (PPT) for advice on prioritization and scheduling. Projects estimated to cost less than \$500,000 will be considered by the PPT when the appropriate approvals have been received, consistent with existing NYISO practice. The PPT shall take into account, inter alia, the budget impacts when determining prioritization and scheduling.

Some projects may not be anticipated for inclusion in the annual budget, but are developed during the year for implementation within that budget year (“in-year projects.”) Generally such projects will go through the Committee review process outlined above.

- However, a NYISO proposed in-year project that may be completed within the year and within the Annual Budget without significantly impacting the implementation of other approved projects or the Budget Target does not require MC approval.
- MC approval will also not be required in the event that the NYISO determines that an emergency has arisen which affects the reliability of the system and/or competitive and efficient market outcomes<sup>4</sup>.

Such projects, undertaken by the NYISO, will be reported at the next scheduled BS&P meeting and will be included in project monitoring reports.

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<sup>4</sup> The process specified for these NYISO proposed projects is not intended to override the tariff development and approval procedures contained in the NYISO Agreement.



### **3 Project Monitoring**

The NYISO staff shall prepare periodic status reports that provide information on project schedules, milestones and man-hour expenditures for all projects for the PPT and the BS&P Subcommittees. If the NYISO staff determines that a project has exceeded or is expected to exceed its cost estimates by the lesser of 50% of the project's costs or \$500,000 it shall inform the BS&P as soon as practicable, but no later than at its next scheduled meeting. NYISO Staff shall also inform the BS&P when a project is expected to adversely impact the current operating budget or future year budgets in a manner that is not already incorporated into the budget process.

The BS&P or its Chair or Vice Chair shall have an automatic right to add a report and action item to the agenda for the next scheduled MC meeting upon a request placed with the Chair of the Management Committee five business days prior to the date of the Management Committee meeting.

### **4 Evaluation**

If a project can be linked to specific goals or objectives, the NYISO Staff will provide the BS&P with information necessary for the BS&P to evaluate whether a project has achieved those goals and objectives. The overall effectiveness of the budgeting process associated with each project will be reviewed by the NYISO Staff and the BS&P and lessons learned will be used to modify the budgeting process and selection decisions for future projects considered by the MC.

## *Section 1.0 Annual Budget and Budget Targets*

Commencing with the establishment of the 2004 Annual Budget, the annual budget process will produce a Budget Target, developed by NYISO Staff in consultation with the BS&P Subcommittee. Consistent with current practice, the Annual Budget is voted on<sup>5</sup> by the Management Committee for recommendation to the NYISO Board, and reviewed and approved by the NYISO Board. The Budget Target will include NYISO operations and capital projects for a five-year period with the first year being the Annual Budget. The budget process described in this document for the purposes of evaluating Major Projects and capital budgets will not be applied to routine operating expenses. The initial Budget Target (2004-2008) will be developed using the 2003 original approved budget as a base point. The first year included in the Budget Target will be quite detailed and provide, at a minimum, the same level of information as has been provided in recent<sup>6</sup> one year budgeting processes. For the four out-years, the NYISO Staff will provide, at a minimum, an estimate of expenditures for ongoing operations as well as approved and anticipated projects, both expensed and capitalized. Initiatives such as new buildings, back-up control centers, hardware and software upgrades, etc. will be included in the Budget Target as they become known.

Depending upon the nature, scope and resources required, the costs of some projects may be borne as an operating expense in the year incurred whereas the cost of other projects or initiatives may be funded through external capital financing with the related debt service obligations (principal and interest) being recovered over a period of years. The Budget Target will separately identify the portion of the projects' and initiatives' costs that will be expensed and recovered through the Operating Budget and the portion that is to be capitalized.

### **1.1 Project Budget Summary Report**

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<sup>5</sup> "Voted on" as used herein means adoption of the 1<sup>st</sup> year of the Annual Budget.

<sup>6</sup> Recent budgets such as the 2002 and 2003 operating budgets.

For those projects and initiatives, the costs of which are to be expensed, the NYISO will provide the following information, on an aggregated category basis, by year, for the five-year period of the Budget Target:

- The total amount of money estimated to be available for project expense funding.
- Estimated expenditures (costs) for those projects that are already underway.
- Estimated expenditures (costs) for those projects that have been prioritized and scheduled by the PPT but are not yet underway.
- Funding available for project expenses that have not yet been prioritized and scheduled.

For those project and initiatives the costs of which are to be funded through external capital financing, the NYISO will provide the following information, on an aggregated category basis, by year, for the five-year period of the Budget Target:

- The estimated capital budget (financing requirements).
- The total amount of money estimated to be available for the debt service payments of financed projects.
- The debt service payments for completed projects.
- The debt service payments for projects already underway.
- The estimated debt service payments associated with projects that have been prioritized and scheduled by the PPT but are not yet underway.
- The estimated funds (revenue) available for the payment of debt service for projects that have not yet been prioritized and scheduled.

For those projects and initiatives where certain costs may be expensed and the remaining portion of the costs capitalized, the same information as described above shall be included.

## **1.2 Project Budget Report**

The Project Budget Report will be prepared and updated by the NYISO Staff as project prioritization and scheduling are recommended by the PPT. The Project Budget Report will report by project, the information that is aggregated in the project summary report. The report should be prepared monthly to contain the following:

- Project Budget Summary Report described above.
- A listing of completed financed projects grouped by year with the past and remaining future recovery.
- A listing of active projects showing the budgeted amounts, historic expenditures and projected amounts and timing of future expenditures along with a breakdown by expensed and capitalized (i.e. financed) portions of the project. For financed projects, the expected debt service obligation cost recovery by year.

- A listing of scheduled projects showing the budgeted amounts with a breakdown of expensed and financed portions. For financed projects, the expected cost recovery by year.
- A listing of approved but unscheduled projects with budgeted costs by quarter.

## **Section 2.0 Identification and Selection of Projects**

As described in the Executive Summary of this document, projects will have different points of origin and require different levels of review and approval. In general though, a preliminary project proposal should include, at a minimum, the following information:

- Project Name
- Project Description, including perceived need
- Initial description of expected benefits
- Desired/required completion/on-line date

In addition to projects, initiatives such as new buildings, back-up control centers, hardware upgrades, etc. may involve significant expenditures. An initiative that meets the same criteria as a Major Project will also be included and monitored in the budget process. Major Projects are defined to encompass both projects and initiatives the total costs<sup>7</sup> of which exceed \$500,000. While all projects of any size are accounted for in the NYISO budgets, only Major Projects are intended to be subject to these Budget Process guidelines and to Committee review procedures.

The NYISO Staff will develop initial cost estimates to determine whether a project or initiative will exceed the \$500,000 threshold and thus be forwarded to the Management Committee for a vote.<sup>8</sup> NYISO Staff will endeavor to provide this threshold information prior to a BIC or OC vote. NYISO Staff intends to provide resource estimates prior to MC votes on these projects.

As a general practice, most Major Projects will pass the initial screening phase conducted by BIC, or the OC, before entering the Selection Phase of the process. The

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<sup>7</sup> Total costs include both the cost of outside consultants and other direct expenditures plus the cost of internal ISO resources such as labor costs.

<sup>8</sup> All projects remain subject to appropriate review process as described in the NYISO Agreement.

Selection Phase of the process will involve more detailed analysis of the Major Project. Staff's analyses will be presented to the MC for its consideration. In certain cases there may be exceptions to BIC/OC initial screening process. Examples of exceptions include: those proposed projects submitted directly to the MC for consideration, instances where the NYISO Staff has already commenced its detailed analysis and the process noted in Section 2.4 below for NYISO required projects expected to be completed in-year without impacts on existing or future year budgets..

Table 1 sets forth the specific roles and responsibilities of the key participants in the Identification and Selection phase of this process.

**Table 1. Identification and Selection Phase**

<b>Party</b>	<b>Roles &amp; Responsibilities</b>
Project Proponent/s and/or Working Group/Task Force	<ul style="list-style-type: none"> <li>• Develop project proposal.</li> <li>• Submit proposal to BIC or OC.</li> <li>• Provide additional screening information if requested.</li> </ul>
BIC or OC	<ul style="list-style-type: none"> <li>• Review proposal.</li> <li>• Accept, modify or reject.</li> <li>• If adopted, forward project proposal to NYISO Staff for detailed analysis.</li> </ul>
NYISO Staff	<ul style="list-style-type: none"> <li>• Commence detailed analysis and prepare resource and cost estimates.</li> <li>• Prepares budget reports for review by BS&amp;P Subcommittee and MC.</li> <li>• Present results of analysis to MC along with the project proposal.</li> </ul>
Management Committee	<ul style="list-style-type: none"> <li>• Adopt, modify or reject projects following lower committee action (if applicable).</li> <li>• Receive BS&amp;P and PPT reports.</li> </ul>
Project Priority Team	<ul style="list-style-type: none"> <li>• Recommend a Prioritization of the projects adopted by the MC.</li> </ul>
BS&P Subcommittee	<ul style="list-style-type: none"> <li>• Evaluate projects assigned for further analysis by the MC.</li> <li>• Reviews and presents NYISO staff reports to the MC.</li> </ul>

## **2.1 Screening Phase**

The principal objective of the screening phase is to determine whether the proposal is viable and merits further detailed analysis by the NYISO Staff.

The project's proponents will submit the proposal to either BIC or the OC. The Committee conducting the review may use the following as screening criteria to assist in its determination of whether the proposal requires detailed analysis to be conducted by the NYISO Staff.

- Does the project align with the NYISO Strategic Plan?
- Is it needed for the performance of these functions?
- If feasible, can economic benefits be ascribed to the project?
- Does the project support operational, or work, processes that have been simplified or otherwise redesigned?
- Does the project improve service reliability?
- What are the expected benefits of the proposal?
- Is the project required by regulation?
- Are there major risks involved that will reduce the likelihood of the project performing as expected?
- How do the alternatives, if any have been developed, compare with the proposal?

Projects deemed qualified by either BIC or the OC will be submitted to the NYISO Staff for detailed analysis and preparation of further cost estimates.

## **2.2 NYISO Staff Detailed Analysis**

If a Major Project is approved by the BIC or OC, the NYISO Staff in conjunction with the proponents, will conduct a detailed analysis of the proposal. As appropriate, the NYISO Staff's analysis will include:

- Project Name
- Project Description, including need.
- Alternatives, if developed, including potential benefits.
- Preliminary estimated stream of expected benefits (both quantitative and qualitative).



- Preliminary estimated stream of project costs (identify components separately – labor, hardware, software, consultants, etc.).
- Estimated timeline for project completion.
- Whether project can be accommodated within the Budget Target without impacting other already scheduled projects.
- Whether project qualifies for long term financing.
- Whether the project would require deferral of other already scheduled projects.
- Whether the project would require funding beyond that which is contained in the budget target.
- Associated risks of not implementing the proposed project.
- A recommendation as to whether the project should be approved by the MC.

The NYISO Staff will forward the results of its analysis to the MC for its consideration. Major Projects that are approved by the MC will be forwarded to the PPT for further recommendations as to scheduling and prioritization.<sup>9</sup>

### **2.3 In-year projects**

While many projects will be approved for implementation beginning in future budget years, some projects may not have been included in the annual budget, but may be slated for development during the current budget year. Generally such in-year projects will go through the process described above. However, these projects will require additional evaluation by the NYISO Staff to determine whether the project can be fit within the currently approved annual budget without adversely affecting other projects. If in-year projects are adopted when there are insufficient funds budgeted to cover the

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<sup>9</sup> All projects currently being worked on by the NYISO, regardless of origination, are reviewed by the PPT.

costs of implementing the Major Project, several approaches may be used to address the funding shortfall including:

- Deferring implementation of the Major Project through the PPT.
- Adjusting the timing and priority of other projects through the PPT
- Recommending that the NYISO Board approve an increase in Rate Schedule 1 charges to collect the necessary funds for the Major Project
- Recommending that the NYISO Board increase the level of financing available for Major Projects.

To the degree possible, the NYISO Staff, PPT and BS&P shall endeavor to inform the Market Participants of the impacts of such actions prior to the Management Committee action on the issue.

#### **2.4 NYISO required Projects**

Major Projects proposed by the NYISO that can be completed within the current budget year and within the currently approved budget without significantly impacting the implementation of other approved projects or the Budget Target does not require MC approval. MC approval will also not be required in the event that the NYISO determines that an emergency has arisen which affects the reliability of the system and/or competitive and efficient market outcomes<sup>10</sup>.

Such projects, undertaken by the NYISO, will be reported at the next scheduled BS&P meeting and will be included in project monitoring reports.

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<sup>10</sup> The process specified for these NYISO proposed projects is not intended to override the tariff development and approval procedures contained in the NYISO Agreement.

### **3 Section 3.0 Project Monitoring**

The NYISO staff will monitor the status of all projects, regardless of their origin, and prepare periodic reports. Among other things, these monthly reports will identify each project's progress relative to: actual costs incurred versus approved budget, whether the project can be completed within budgeted cost and schedule. At least quarterly the NYISO will present a report on changes in project scope.

#### **3.1 Establish and Maintain Project Cost, Schedule, and Scope**

The NYISO Staff will provide periodic updates to PPT and BS&P on the status of the project's cost, schedule, and scope.

The NYISO staff shall prepare periodic status reports that provide information on project schedules, milestones and man-hour expenditures for all projects, regardless of origin, for the PPT and the BS&P Subcommittees. The NYISO will prepare quarterly reports on project scope. NYISO staff shall affirmatively inform the BS&P when any project exceeds or is expected to exceed its cost estimate by the lesser of 50% of the project's costs or \$500,000. NYISO Staff shall also inform the BS&P when a project is expected to adversely impact the current operating budget or future year budget targets in a manner that is not already incorporated into the budget process.

The BS&P Subcommittee or its Chair or Vice Chair shall have an automatic right to add a report and action item to the agenda for the next scheduled MC meeting upon a request placed with the Chair of the Management Committee five business days prior the Management Committee meeting.

### **3.2 Assess Project Progress**

Throughout a project's life, from pre-operational stages through completion, NYISO staff will assess progress against the project's budgeted cost, schedule, and Scope.

### **3.3 Project Monitoring Status Reports**

The NYISO Staff shall provide Monitoring Status reports periodically for the PPT and BS&P. The contents of this report will be developed collaboratively.

## *Section 4.0*    *Evaluation*

NYISO Staff will conduct an evaluation of Major Projects included in the Budget Preparation and Financing and Project Monitoring Process after the project becomes operational, usually within six months of deployment. The Evaluation Phase “closes the loop” of the budgeting process by comparing actual costs against budget. This will not only allow performance to be assessed, but also helps identify areas where decision-making can be improved. The evaluation should include:

- **An evaluation of whether the project met scope, performance, cost and scheduling objectives; and**

The NYISO Staff shall share these evaluations with the PPT and BS&P to offer a better understanding of project performance and to allow BS&P to recommend to the NYISO Staff adjustments to the project or to the budgeting process, as it deems appropriate.

Such evaluations should take place immediately if a Major Project is cancelled.

The NYISO Staff shall also evaluate, and report to the BS&P, on a Major Project’s investment value or the impact of the project on reliability, economics, customer satisfaction and system capability.

This evaluation should focus on three primary areas described below.

### 1. Impact on Stakeholders

The project’s impact on stakeholders would be measured by the NYISO Staff through use of surveys (formal or informal), interviews, and feedback studies.

### 2. Ability to deliver performance measures (Quantitative and Qualitative)

The project’s impact should be carefully evaluated to determine whether it met its original scope.

### 3. Ability to Meet Performance Goals

- Cost
- Benefit
- Schedule

NYISO staff shall discuss with the BS&P its conclusions, based on these evaluations, of lessons learned, including costs, project management and technical insights and shall work together with the PPT and BS&P to develop, recommend, and modify the budgeting process as appropriate.

## **Section 5.0 Transition**

This guideline document outlines a desired end state. By necessity, the implementation of this business process will take time. It is expected that different aspects of this process will be implemented over a course of twelve months.<sup>11</sup> Staff will evaluate resources necessary to perform these functions and advise the Market Participants if there are concerns about the resources required to implement the guideline or the design of this guideline. Additionally, projects currently scheduled or reviewed by the PPT and those that have already been approved by the Management Committee do not need independent approval under this document. It is anticipated that this guideline may be revised several times as the process is developed and refined over the next few years.

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<sup>11</sup> Some evaluation elements may not be in place until 2005.