

**Comments of New York State Electric & Gas Corporation
and Rochester Gas & Electric Corporation on the NYISO-ISO
New England Proposal**

New York State Electric & Gas Corporation (“NYSEG”) and Rochester Gas & Electric Corporation (“RG&E”) (the “Companies”) offer the following comments in response to the proposal developed by the New York Independent System Operator, Inc. (“NYISO”) and Independent System Operator – New England, Inc. (“ISO-NE”) (the “ISOs”), and presented at the February 2, 2002 Management Committee meeting, to develop common markets between New York and New England (the “NY-NE proposal” or the “Proposal”).¹ The Proposal is memorialized in an agreement (the “Agreement”) executed by the Chairmen of the NYISO and the ISO-NE Boards, effective as of January 28, 2002.

The Companies believe that PJM’s participation is nevertheless critical to the RTO formation process. PJM, as one of the more successful operating ISOs in the Northeast, should have a seat at the table and participate on an equal footing with NYISO, ISO-NE and market participants, at all levels of development, including as voting members on the Oversight Committee, the RTO Development Committee, and the

¹ The Companies’ comments build upon the comments submitted by the Member Systems and Joint Transmission Entities. The Companies’ comments are necessary to emphasize the importance of including PJM in the New England-New York proposal. The Companies support the comments submitted by the Member Systems and the Joint Transmission Entities.

working groups. PJM's participation is crucial at the onset of this process: (a) to ensure that the cost-benefit evaluation described in the Agreement is based on common assumptions and methodology to avoid conflicting evaluations; (b) to avoid wasting time if the evaluation shows that a Northeast RTO should include PJM; (c) to facilitate elimination of existing seams issues and prevention of new seams issues; and (d) to facilitate transition to broader common markets when such common markets advance competition, efficiency and reliability.

PJM's Participation In The Evaluation

The evaluation described in the proposal must be based upon reasonable parameters that can withstand scrutiny and be sufficiently objective to inspire market participant and regulator confidence in the outcome. The criteria, scope, and underlying assumptions must be listed and agreed to by all three ISOs, including PJM. The most persuasive way to evidence the evaluation's objectiveness is to have PJM participate in its performance and review. The evaluation should consider tangible and intangible benefits. Tangible benefits include a comparison of the costs for the following three models: (a) the cost to operate the three ISOs separately; (b) the cost to operate a NY-NE RTO that does not include PJM; and (c) the cost to operate a three-ISO RTO. For the evaluation to be useful, it must be completed with sufficient time for review before any Proposal is put to a vote, a process which must precede any FERC filing. The evaluation must include a comparison of overall economics, including a comparison for each model individually, of: (a) control area operating costs; (b) out-of merit dispatch costs; (c) energy, capacity, ancillary service or other costs that are generalized rather than directed at specific market participant(s) that cause the costs; (d) predicted effect on energy prices

(with all major assumptions listed); and (e) any other criteria needed to aid market participants in evaluating each model.

To the extent practicable, the evaluation must consider intangible benefits, including the benefits derived from having responsive customer service practices, and software that is more easily adaptable to implement market rule changes and evolution. The study should also provide a realistic assessment, based on reasonable assumptions, of benefits, including (a) shared savings resulting from control area consolidation; (b) increased efficiencies; (c) elimination of the transaction risk caused by inconsistent interregional market rules; and (d) decreased transaction costs.

PJM, NYISO, ISO-NE, state regulators, and interested market participants must be given a reasonable opportunity to review, understand, comment and respond to comments on the evaluation. The evaluation process must include a public question and answer period with responses being provided within a reasonable period of time (e.g., one week of receipt of the question). An evaluation without at least these minimum characteristics will lack credibility among market participants.

PJM's Participation In The Proposal

PJM's participation in the RTO development process is crucial to achieve seamless and efficient regional markets. The Proposal and Agreement expressly include NYISO, ISO-NE and Canadian control area operators but make no explicit reference to New York's significant neighboring control area and trading partner – PJM. Instead, the Agreement permits other system operators that negotiate and execute an agreement with NYISO and ISO-NE to participate in development process. The Agreement further states

that any other participating system operators will have to share equally in the cost of the development process, including the cost of hiring consultants selected by NYISO and ISO-NE staff. The agreement presents a Hobson's choice – PJM must either withhold its advice and stay out of the process to develop the NY-NE Proposal or persuade its members to assume an equal share of unspecified costs incurred at the direction of the NYISO and ISO-NE staff and board members. The invitation to any other control area operator to negotiate and execute an agreement with ISO-NE and the NYISO is hollow. NYISO and ISO-NE proceeded with their two-party plan without adequately negotiating with PJM or market participants, including the transmission owners who are necessary co-filing parties in any plan calling for a change in control over their jurisdictional assets. This strategic decision, the motivation behind which is and remains suspect, was in direct contravention of the desire of the over-whelming majority of the market participants in the three control areas to form a three-ISO RTO.

The Companies believe that the benefits of a three-ISO RTO are so compelling that this proposed two-ISO process is premised on a fundamentally flawed foundation. These benefits include: (1) economies of scale and reduced overhead;² (2) increased reliability; (3) increased solution sets; (4) optimized use of inter-control-area interfaces

² NYISO, ISO-NE and PJM aggregate control area management costs are currently in excess of \$400 million and increasing. Permitting NYISO and ISO-NE to develop separate software versions of standard market designs that are different from PJM's software will unnecessarily increase control area development costs.

between NY, PJM and NE; and (5) resolution of seams issues over a broader region.³ Even if PJM, New York, and New England do not form a single RTO, objectives 2, 4 and 5 will be partially served through PJM's participation in the development process.

The Agreement states that the ISOs will conduct an in-depth RTO evaluation. Its evaluation is intended to run concurrent with the development process outlined in the Proposal. Presumably, the ISOs have not prejudged that evaluation by concluding that market participants would not enjoy greater benefits by the inclusion of PJM as a system operator in a Northeast RTO. In fact, the Companies believe that the evaluation would show that a three-ISO RTO consisting of PJM, NY and New England would have significant benefits over a two-ISO RTO. To the extent that the study could show such added benefit, it is only logical that PJM be part of the Proposal at the onset. PJM's participation from the beginning provides a win-win solution. If PJM is excluded from the process and the study shows the benefits that the Companies expect, at the very least, the development process will be delayed and, more significantly, some of the decisions made during the two-ISO process will likely have to be unwound.

In the unlikely event that the evaluation shows that a NY-NE-only Proposal makes sense, market participants will benefit from PJM's participation in the process. If PJM's analysis is inconsistent with the NY-NE evaluation, it will only lead to factual

³ A proposal to a create a common market between only NY-and NE as a means of addressing existing seams issues is irrational. The vast majority of the seams issues identified in the MOU process involved procedural and operational inconsistencies between NY and PJM. Formation of a NE-NY common market design does nothing to address PJM-NY seams issues.

disputes and a lack of confidence. Moreover, all three regions' market participants have a common vested interest in ensuring that seams issues are addressed, particularly with respect to the standard market design ultimately adopted in New England and New York. To proceed in isolation will only ensure perpetuation of existing seams and the creation of new seams with PJM. As a neighboring control area and significant trading partner, PJM must have the same opportunity to participate in RTO development to avoid the perpetuation of existing seams and other trade barriers and, importantly, help ensure that any new software or market processes developed in this process do not create new trade barriers or inefficiencies. Less than two years ago, PJM openly considered terminating the ability of market participants in the PJM control area to engage in certain transactions with New York because of unexplained curtailments and other seams issues. PJM's participation in this effort is crucial if market participants hope to avoid a recurrence of that magnitude. PJM's participation is vital and should not be made contingent upon PJM members' willingness to bear an equal share of all costs.