August 23, 2002

The Honorable Patrick H. Wood, III
The Honorable William L. Massey
The Honorable Linda Breathitt
The Honorable Nora Mead Brownell
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: Joint Petition for Declaratory Order Regarding the Creation of a Northeastern Regional Transmission Organization, Docket No. RT02-

Dear Mr. Chairman and Commissioners:

As indicated in the accompanying filing letter, ISO New England Inc. ("ISO-NE") and the New York Independent System Operator, Inc. ("NYISO") (collectively, the "ISOs") are submitting a joint petition (the "Joint Petition") for a declaratory order regarding the creation of a new Northeastern Regional Transmission Organization (the "NERTO").

The Joint Petition, approved by both Boards of Directors, represents the product of over eight months of work, including an extensive, voluntary stakeholder process. The Joint Petition presents details concerning the market design and operations, transmission services, rate principles and governance that will place the NERTO on a sound organizational and substantive footing to fulfill the goals of the Commission. Further, the implementation schedule reflected in the Joint Petition will facilitate the utilization of the Standard Market Design ("SMD") in the New York and New England regions as quickly as is feasible.

The ISOs appreciate the hard work and thought that has gone into the SMD Notice of Proposed Rulemaking (the "NOPR") and its market standardization principles, because market standardization and enlargement is one of the driving forces behind the formation of NERTO. In addition, the development in June and July by the ISOs, PJM, the Ontario Independent Market Operator and the Commission of a Northeast seams action plan will facilitate easier market and transmission transactions.

The ISOs value the Commission's efforts to propose solutions in the SMD NOPR to many of the difficult independence and governance issues presented in the formation of RTOs. Many of those solutions may well be appropriate for areas of the country in which no independent market and transmission operator currently exists. In the Northeast, however, independent system operators have been formed and have developed considerable expertise in markets, operations and comprehensive regional transmission planning, and their Boards have accumulated and applied extensive experience in these areas. In addition, the transmission-owning utilities in the proposed NERTO region have undergone almost total divestiture of their generating assets.

The most significant characteristics of Board governance -- independence from market participants and accountability to the Commission -- are central in both the SMD NOPR and the Joint Petition. While the Joint Petition's proposals for Board composition and selection procedures differ from the SMD NOPR proposals, they nevertheless fully comply with the Commission's independence requirements. The Joint Petition's proposals maximize independence and take advantage of the experience that Board continuity can provide. The proposals represent a reasonable balance of independence, experience, continuity and efficiency, and will thus increase the probability of achieving an efficient and competitive marketplace in the regions covered. Accordingly, the Commission should accept these proposals as an appropriate variation that is consistent with the SMD NOPR's principles.

That being said, the Joint Petition is consistent with Order No. 2000 and many of the general principles identified in the SMD NOPR. For example, the NERTO would: (i) be governed by a Board of Directors that meets the independence criteria established by the Commission; (ii) include an advisory role for stakeholders and state regulators; (iii) pursue consistency among the market designs of the NERTO and the Canadian system operators within the Northeast Power Coordinating Council ("NPCC"), and other initiatives that can achieve a seamless NPCC Common Market; (iv) operate day-ahead and real-time energy markets which will be committed and dispatched based on locational marginal pricing (in a manner very similar to the market-related contents of the SMD NOPR); (v) end transmission rate pancaking for transactions between New York and New England; (vi) employ a coordinated regionwide transmission planning process reflecting broad input from transmission owners, market participants and state regulators; and (vii) establish a single market and a single tariff for the provision of electricity services across the New England and New York region.

The ISOs appreciate the Commission's cooperation to date in the NERTO efforts, and look forward to the Commission's action concerning the Joint Petition, and to the rapid implementation of the NERTO.

Respectfully submitted,

Gordon van Welie
President and Chief Executive Officer
ISO New England Inc.
One Sullivan Road
Holyoke, MA 01040
(413) 535-4000

William J. Museler
President and Chief Executive Officer
New York Independent System Operator, Inc.
3890 Carman Road
Schenectady, NY 12303
(518) 356-6000

Enclosures

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

ISO New England Inc.	**)**	
New York Independent System Operator, Inc.	**)**	**Docket No. RT02-___-000**
	)	

JOINT PETITION FOR DECLARATORY ORDER REGARDING THE CREATION OF A NORTHEASTERN REGIONAL TRANSMISSION ORGANIZATION

August 23, 2002

TABLE OF CONTENTS

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

ISO New England Inc.	**)**	
New York Independent System Operator, Inc.	**)**	**Docket No. RT02-___-000**
	)	

JOINT PETITION FOR DECLARATORY ORDER REGARDING THE CREATION OF A NORTHEASTERN REGIONAL TRANSMISSION ORGANIZATION

ISO New England Inc. ("ISO-NE") and the New York Independent System Operator, Inc. ("NYISO") (together, the "ISOs" or the "Petitioners") jointly submit this Petition for Declaratory Order.[1]

The Petitioners propose to establish a new Northeastern Regional Transmission Organization (the "NERTO") that will encompass New York and the six New England states. The NERTO will be governed by an independent Board of Directors. In managing the affairs of the NERTO, the Board of Directors will be obligated to make decisions that, in its business judgment, are prudent in light of all facts known at the time decisions are made. Although the current ISO Boards cannot bind the NERTO Board, the plan of the Petitioners, as described in

---

[1] This Petition is submitted pursuant to Rule 207(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 207(a)(2) (2002) and responds to the requirements of Order No. 2000 and the regulations promulgated thereunder. *See Regional Transmission Organizations*, FERC Stats. & Regs.¶ 31,089 (1999) ("Order No. 2000"), *order on reh'g*, FERC Stats. & Regs. ¶ 31,092 (2000) ("Order No. 2000-A"), *aff'd. Public Utility District No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

this proposal and approved by the ISO Boards, is expeditiously to standardize the existing markets, eliminate inter-ISO seams and inter-ISO access charges, and establish a single market including single dispatch. The single NERTO market, as hereinafter described, is referred to in this Petition as the "NERTO Market."

The NERTO will work to harmonize the NERTO Market design with the developing market structures in the Canadian provinces of the Northeast Power Coordinating Council ("NPCC")[2], starting with Ontario and New Brunswick, as a first step towards the establishment of a seamless NPCC-wide common market (the "NPCC Common Market"). The NERTO will also undertake other efforts to integrate and/or conform transmission and operational practices across New England, New York and the Canadian portions of the NPCC.

The Petitioners request a declaratory order stating that the proposed NERTO would qualify as a Regional Transmission Organization ("RTO"). This Petition includes: (i) a "detailed description" of the proposed NERTO, "including a description of the organizational and operational structure and the intended participants" and the NERTO formation process;[3] (ii) a description of the NERTO Market and the NPCC Common Market; (iii) a description of the rate structure that will be filed under Section 205 of the Federal Power Act ("FPA") for the NERTO[4]; and (iv) a discussion of how the NERTO will satisfy each of the characteristics and

---

[2] NPCC includes New York, the six New England states, and the provinces of Ontario, QuJbec, New Brunswick, Nova Scotia, and Prince Edward Island. The total population served is approximately 49 million with approximately 20 million electric customers. The area covered is approximately one million square miles.

[3] 18 C.F.R. § 35.34(d)(3)(i) (2002).

[4] 18 C.F.R. § 35.34(d)(3)(iii) (2002).

functions of an RTO described in Order No. 2000 and the regulations promulgated thereunder.[5] This Petition also describes how Independent Transmission Companies ("ITCs") may be established in the future and how the region's non-jurisdictional transmission owners will participate in the NERTO.

The Petitioners propose that the approval by the Federal Energy Regulatory Commission (the "Commission") of the NERTO's RTO status be subject to: (i) the Commission's acceptance of any necessary filings under Section 203 of the FPA[6]; (ii) timely establishment of the NERTO; and (iii) the Commission's acceptance of complete NERTO tariffs and other documents filed under Section 205 of the FPA.[7] Pursuant to Section 35.34(d)(3)(iv) of the Commission's regulations, these filings will be made as soon as possible following the issuance of a declaratory order. If a favorable declaratory order were issued by January 1, 2003, the ISOs anticipate that the requisite filings could be made by the end of April 2003, and, pending acceptance by the Commission, the NERTO could commence operations by June 30, 2003.

In light of the burdens on the stakeholders in both New England and New York resulting from preparing comments on the Commission's Notice of Proposed Rulemaking ("NOPR") in Docket No. RM01-12-000 and protests and motions to intervene with respect to this Petition, the Petitioners do not object to the Commission's establishing a deadline for protests and interventions on this Petition that is after the current deadline for comments on the NOPR, but no later than November 1, 2002.

---

5 18 C.F.R. § 35.34(d)(3)(ii) (2002).

6 16 U.S.C. § 824b (2001).

7 16 U.S.C. § 824d (2000).

I. EXECUTIVE SUMMARY

The Petitioners' proposal to create the NERTO and to develop the NERTO Market and the NPCC Common Market satisfies all of the requirements of Order No. 2000. The proposal will also further the Commission's goal of standardizing wholesale electricity markets and eliminating or reducing trade barriers, not only in the Northeastern United States, but within the natural NPCC-wide market. In connection with this proposal, the ISOs have sought and received input from market participants and state regulators through an extensive stakeholder process.

The creation of the NERTO and the development of the NERTO Market and the NPCC Common Market will bring significant benefits to the Northeast and adjacent areas and serve the public interest, as summarized below.

A. The NERTO – Its Mission, Structure and Implementation

The NERTO will be a non-profit Delaware entity, responsible for the reliability of the Northeast's bulk power system, the efficiency and competitiveness of the region's wholesale electricity markets and the provision of nondiscriminatory open-access transmission throughout the NERTO region. The NERTO will be governed by an independent Board of Directors. The initial Board of Directors will consist of five directors from each of the existing ISO Boards and two new non-stakeholder directors. The NERTO Board of Directors will be responsible for the NERTO's fulfillment of its responsibilities. The Board of Directors will elect a chief executive officer and other officers who will manage the NERTO.

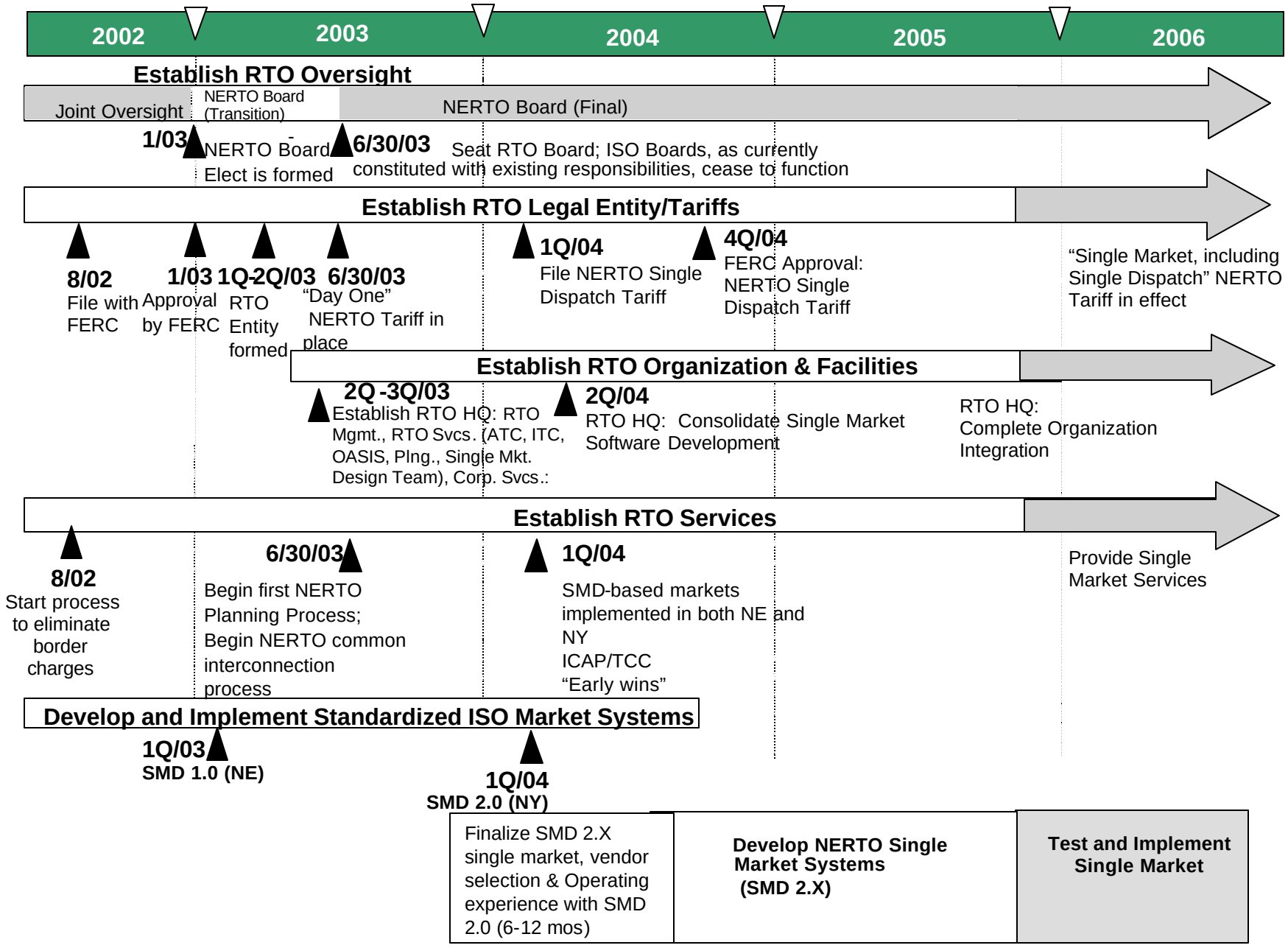
The NERTO will establish a region-wide stakeholder process and an advisory committee of state regulatory officials. The Petitioners expect that NERTO will also enter into a Transmission Operating Agreement (the "TOA") with transmission-owning utilities ("TOs") in the Northeast. Pursuant to the TOA, the NERTO will obtain operational authority over the requisite transmission facilities. As required by Order No. 2000, the NERTO will be the

"transmission provider" under a single, region-wide open-access transmission tariff ("OATT") for the Northeast. The OATT will eliminate rate pancaking in the form of "border charges" on transactions between the New York and New England control areas. The ISOs recommend that the elimination of border charges be conditioned on the consideration by the Commission and the states, on an expedited basis, of mechanisms by which the TOs can recoup lost revenues stemming from the elimination of those border charges.

The NERTO Board will have the unilateral right to file proposed changes to the OATT and other documents on file with the Commission. The NERTO tariff and the TOA will ensure that TOs can recover their revenue requirements and protect their property rights in their transmission facilities. The region-wide stakeholder process and the proposed advisory committee of state regulators will advise the NERTO on proposed tariff and market changes and on other NERTO matters.

The NERTO will be formed by combining the ISOs to establish a single organization under the direction of one independent Board and one chief executive officer. A summary of the proposed NERTO implementation timetable is shown in Figure 1.

Figure 1: Northeast RTO Implementation Timeline



The NERTO will have an "open architecture" that permits future geographic expansions, the possible formation of ITCs, modular software improvements and the implementation of the NPCC Common Market.

B. The NERTO Market and the NPCC Common Market

This Petition includes the ISOs' proposal for the development of the NERTO Market and a broader NPCC Common Market. The NERTO Market will include day-ahead and real-time energy markets co-optimized with regulation and reserves markets, locational marginal pricing ("LMP")-based dispatching and congestion management, a system of financial transmission rights ("FTRs"), security-constrained unit commitment, nodal *ex post* pricing, and a uniform Installed Capacity ("ICAP") market.

Under this design, seams and border charges will be eliminated expeditiously. The NERTO Market will integrate the work ISO-NE has done to develop the "Standard Market Design" for New England with essential NYISO best practices. The proposed NERTO Market implementation plan includes implementation of the "Standard Market Design" ("SMD 1.0")[8] in New England in the first quarter of 2003, followed by the development and implementation of an enhanced market ("SMD 2.0") in New York in the first quarter of 2004.[9] Upon the implementation of SMD 2.0 in New York, all major market seams between New England and New York will be eliminated. The two SMD markets will then be combined to create a single trading market for participants ("SMD 2.X") in the 2005/2006 timeframe.[10] This staged approach allows for interim market improvements, will ensure successful market implementation

---

8 The elements of SMD 1.0 are discussed in Section VI.B below.

9 The elements of SMD 2.0 are discussed in Section VI.B. below.

10 The elements of SMD 2.X are discussed in Section VI.B. below.

while effectively managing risk, and comports with the Petitioners' market implementation philosophy. This philosophy emphasizes appropriate risk management, an objective technology assessment and vendor-neutral technical specifications.

The NERTO Market will be a competitive and efficient market in which all regional resources are used to meet regional load. The NERTO Market will be uniform across the entire NERTO region and will provide one-stop shopping through:

- Single submission of bids;
- Single set of LMPs;
- Single FTR auctions;
- Single energy markets; and
- Single financial settlement.

As many elements of the standardized NERTO market design as possible will be harmonized with the market structures of neighboring NPCC Canadian provinces when those elements are implemented in the NERTO region. In addition, with the approval of the Canadian entities, elements of the standardized NERTO market design will be incorporated into the Canadian market structures. The NERTO will also cooperate with the Canadian system operators to pursue other initiatives with the goal of ensuring that other aspects of the Canadian markets are compatible with the NERTO Market and thus create a seamless NPCC Common Market. For example, as contemplated in the agreements with the Ontario Independent Electricity Market Operator ("IMO") and the New Brunswick Power Corporation ("Énergie NB Power"), results of these efforts could include coordinated congestion management and transaction procedures, and common or compatible energy, ancillary services, transmission rights and resource adequacy markets.

C. Benefits of the NERTO, the NERTO Market and the NPCC Common Market

The formation of the NERTO, encompassing the six New England states and New York, and the creation of the NERTO Market and the NPCC Common Market, will produce significant regional benefits for both consumers and market participants. These benefits include:

- larger and more efficient markets with no trade barriers;
- improved regional operations and reliability;
- the elimination of pancaked rates;
- improved processes for expansion of the region's transmission system and interconnection to the transmission system; and
- the creation of an even more capable and efficient organization to administer the NERTO Market and maintain reliability in the Northeast.

The benefits are expected to result in both regional savings in wholesale power costs and cost savings to market participants through the elimination of multiple, different markets.

The NERTO Market and the NPCC Common Market will substantially further the Commission's market standardization goals. The larger, more efficient NERTO Market will provide one-stop shopping for market participants, and will utilize a uniform system of congestion management that produces appropriate locational prices throughout the Northeast. As the market administrator, the NERTO will effectively manage and expedite market standardization and the elimination of seams in the Northeast. The NERTO will also provide uniform, effective, region-wide market monitoring and market power mitigation in the Northeast. The NPCC Common Market will create a seamless trading area capable of spanning all of the NPCC. In addition to creating the NERTO Market, the proposed market implementation plan will quickly standardize the existing ISO markets and eliminate inter-ISO seams.

The formation of the NERTO – a single entity that will be responsible for operation of the bulk power system and maintaining reliability throughout the Northeast – will improve both operations and reliability. These benefits will be realized through enhanced reserve sharing and improved operation of existing transmission capacity between New England and New York. The NERTO's region-wide transmission and expansion plan will facilitate much needed expansion of the Northeast's transmission system and objective assessment of the merits of transmission, generation and demand-side alternatives. The NERTO will also create a region-wide, long-term generation capacity requirement and market.

Through its single, open-access transmission tariff, the NERTO will eliminate pancaked rates in the Northeast. The NERTO open-access transmission tariff will also provide uniform generation interconnection standards and processes, and the establishment of consistent scheduling, transmission and other business practices throughout the region. The NERTO will also work with adjacent regions to reduce transmission-related trade barriers.

By combining the ISOs into a single organization, the NERTO will have greater resources and capabilities than either ISO. The NERTO will use these capabilities and resources and its greater scope to realize cost savings through organizational synergies and reduced capital expenditures. By retaining essential ISO resources, the NERTO will maintain reliability and continue the operation of existing markets while managing the transition to the NERTO Market and the NPCC Common Market.

As part of their development of this proposal, the ISOs have prepared and are submitting an Economic and Reliability Assessment (the "Assessment") (Attachment X), described further in Section VIII.B.1. The Assessment quantifies the anticipated NERTO-wide benefits of this proposal.

D. Conclusion

The Petitioners believe that the NERTO, the NERTO Market and NPCC Common Market proposals will advance the Commission's electricity market policy goals, will benefit consumers and are in the public interest. The Petitioners therefore respectfully ask the Commission to encourage the implementation of the NERTO and the NERTO Market and, ultimately, the NPCC Common Market, by issuing the requested declaratory order.

II. CORRESPONDENCE

The Petitioners request that all correspondence and service of pleadings and other documents be made upon the following persons.[11]

Kathleen A. Carrigan -- Senior
Vice President, General Counsel
& Secretary
Maria A. Gulluni – Senior Counsel
ISO New England Inc.
One Sullivan Road
Holyoke, Massachusetts 01040
Tel. (413) 535-4000
kcarrigan@iso-ne.com
mgulluni@iso-ne.com

Robert E. Fernandez – General Counsel &
Secretary
Belinda F. Thornton – Director of
Regulatory Affairs
New York Independent System Operator, Inc.
3890 Carman Road
Schenectady, New York 12303
Tel. (518) 356-6000
rfernandez@nyiso.com
bthornton@nyiso.com

Howard H. Shafferman
Ballard Spahr Andrews & Ingersoll, LLP
601 13th Street, N.W.
Suite 1000 South
Washington, DC 20005
Tel. (202) 661-2205
hhs@ballardspahr.com

Arnold H. Quint
Ted J. Murphy
Hunton & Williams
1900 K Street, N.W.
Washington, DC 20006
Tel. (202) 955-1500
aquint@hunton.com
tmurphy@hunton.com

---

[11] Due to the joint nature of this filing, the Petitioners respectfully request a waiver of §385.203 of the Commission's regulations to allow the inclusion of more than two persons on the service list in this proceeding.

Robert C. Gerlach
Ballard Spahr Andrews & Ingersoll, LLP
1735 Market Street
Philadelphia, PA 19103
Tel: (215) 864-8256
gerlach@ballardspahr.com

Ira L. Freilicher
Kathy Robb
Hunton & Williams
200 Park Avenue
New York, NY 10166
Tel: (212) 309-1000
ifreilicher@hunton.com
krobb@hunton.com

III. LIST OF ATTACHMENTS

This Petition consists of an original and fourteen (14) copies of the following documents:

1. The transmittal letter to the Chairman and Commissioners;

2. This Petition;

3. January 28, 2002 Agreement between the Boards of Directors of ISO New England Inc. and the New York Independent System Operator, Inc. (Attachment I);

4. Agreement among the ISOs and the Ontario Independent Electricity Market Operator (Attachment II);

5. Agreement among the ISOs and New Brunswick Power Corporation (Attachment III);

6. Description of the manner in which this Petition satisfies the conditions for extension of the Interim Independent System Operator Agreement between the New England Power Pool and ISO-NE (Attachment IV);

7. Proposed NERTO Code of Conduct (Attachment V);

8. Proposed NERTO interconnection process (Attachment VI);

9. Proposed NERTO system planning and expansion process (Attachment VII);

10. NERTO Implementation Plan Summary (Attachment VIII);

11. Executive summary of NERTO technology assessment (Attachment IX);

12. Economic and Reliability Assessment of the establishment of the proposed NERTO, the proposed NERTO Market, the proposed NPCC Common Market and possible alternative RTO configurations (Attachment X);

13. Affidavit of Dr. David B. Patton addressing the NERTO's Economic and Reliability Assessment and NERTO scope issues (Attachment XI); and

14. Form of *Federal Register* notice (Attachment XII).

IV. THE NERTO PROPOSAL IS BASED ON SOUND PRINCIPLES AND AN EXTENSIVE STAKEHOLDER PROCESS

The NERTO proposal is based on sound principles and was developed with extensive stakeholder input. This section discusses the proposal's genesis, its core principles, and the stakeholder process used to support the Petitioners' development of the NERTO proposal.

A. The Genesis of the NERTO Proposal

The NERTO proposal had its genesis in the cooperative history of the ISOs, and the recognition by the ISO-NE and NYISO Boards that integration of the two organizations to create an RTO could bring significant benefits to the region.

On January 28, 2002, ISO-NE and NYISO entered into an agreement (the "January 28 Agreement") to develop a plan, with stakeholder input, for the creation of an RTO encompassing New England and New York and a common market design, with participation by Canadian control areas. The January 28 Agreement expressly contemplated analysis of the feasibility, including the benefits, of forming the RTO. The January 28 Agreement is Attachment I hereto.

The January 28 Agreement evolved from the long-standing coordination and cooperation between the New England Power Pool ("NEPOOL") and the New York Power Pool ("NYPP") and, consequently, ISO-NE and NYISO. Their membership in the NPCC has facilitated coordination and cooperation for many years and has ensured that the two regions have similar reliability and operational practices. Moreover, the ISOs have undertaken a number of

successful initiatives to address inter-ISO "seams" issues[12] and better harmonize their existing market designs.

The January 28 Agreement also reflected the shared philosophy of the ISO-NE and NYISO Boards with respect to RTO and market development. This philosophy includes rapid movement to an efficient super-regional market that maximizes benefits while minimizing risks, independent assessment of technology and best practices, vendor-neutral technical specifications,[13] implementation of meaningful interim market improvements, and equal representation in RTO governance. The ISOs previously created a market implementation plan, based on this shared philosophy, that was endorsed by the presiding Administrative Law Judge ("ALJ") in his report on the Summer 2001 mediation in Docket No. RT01-99-000.[14]

Through their efforts to standardize market designs in the Northeastern United States, ISO-NE and NYISO have recognized the benefits of integrating neighboring Canadian provinces into an NPCC Common Market, consistent with the existing natural trading area. New England and New York already have close links and substantial trading relationships with Ontario,

---

[12] For example, the ISOs have conformed their market rules to facilitate additional trading between the control areas. In addition, the ISOs have formulated a reserve sharing arrangement which reduced uplift charges in New England by millions of dollars in 2000 and 2001. Details of the Northeast seams action plan developed in June and July, 2002, by the ISOs, PJM, the IMO and the Commission are provided in Appendices A and B to Attachment VIII. These initiatives will greatly facilitate trading in the Northeast.

[13] A "vendor-neutral" approach is one that avoids describing a vendor-specific solution in system procurement specifications.

[14] *Regional Transmission Organizations*, 96 FERC ¶ 63,037 (2001) (endorsing market implementation "Option 1 M," which was put forward by ISO-NE and the NYISO, with a recommendation that emphasis be placed on instituting interim market improvements during the transition to a single RTO and market).

QuJbec, and New Brunswick.[15] A number of proposed merchant transmission projects would permit additional suppliers located in the Canadian portion of the NPCC to sell into the Northeastern United States, thereby bringing the regions even closer together.[16] Many benefits can be achieved by bringing Ontario and New Brunswick, and eventually other NPCC Canadian system operators, into the NPCC Common Market. In addition, reducing transactional impediments through harmonization of transmission tariff and business practices and elimination of rate pancaking will eliminate many existing barriers to trade. As is discussed in detail below in Section VI.E. and Attachments II and III, the Petitioners hope to achieve these objectives through their agreements with the IMO and Énergie NB Power, and through future agreements with other Canadian system operators.

B. The NERTO Proposal Is Based on Sound Economic and Operational Principles

The NERTO proposal is based on sound economic and operational principles. Most importantly, NERTO's formation and structure will be cost-effective and responsive to the needs

---

15 For example, in 2000, transactions among all NPCC Control Areas totaled 37,503,281 MWh, while transactions between PJM and New York totaled 14,730,739 MWh. *See Joint Response of ISO New England Inc. and New York Independent System Operator, Inc.*, Docket No. RTO1-99-000, et al. (March 26, 2002).

16 *See, e.g., Northeast Util. Services Co.*, 98 FERC ¶ 61,310 (2002) (conditionally approving a 330 MW DC undersea cable connecting Connecticut and Long Island); *Neptune Regional Transmission System, LLC*, 96 FERC ¶ 61,147 (2001); *order on reh'g*, 96 FERC ¶ 61,326 (2001); *order on motion for clarification*, 98 FERC ¶ 61,326 (2002) (conditionally approving the undersea "Neptune Project" which will ultimately encompass 3600 MW of transmission capacity linking New York, New England and Canada, as compared to 1200 MW of transmission capacity linking New York and PJM); and *TransÉnergie U.S., Ltd.*, 91 FERC ¶ 61,230 (2000) (conditionally approving the proposed undersea "Cross-Sound Cable Interconnector," a 600 MW line linking Connecticut and Long Island). In addition, Énergie NB Power, the New Brunswick provincial utility, has announced plans to construct an additional transmission line between Maine and New Brunswick. It is scheduled to be completed in 2003.

of the Northeast electricity market. Further, its design, and its market and transmission provisions, will foster competition and preserve reliability.

Pursuant to the January 28 Agreement, in February 2002, the ISOs established a "Joint Oversight Committee" (the "JOC"), composed of three members from each ISO Board and attended by the ISOs' CEOs, to drive the RTO and market development process. The ISOs' Boards established the following principles to guide the NERTO and market development initiatives:

1. Stakeholder advice must be actively solicited and carefully considered in the development of the NERTO and its implementation plan;
2. Existing ISO resources, systems, infrastructure, and intellectual property should be used when adequate for the NERTO's needs to reduce costs and expedite the process;
3. The transition to the NERTO Market must proceed in an orderly manner, with risks managed to avoid transitional disruptions or implementation failures;
4. Integrity of existing ISO markets must be maintained and reliability preserved during the transition to new structures;
5. Existing markets should be harmonized rapidly during the transition; and
6. "Best implementation practices" and overall design principles proposed by the ISOs and endorsed by the ALJ's mediation report should be followed.

Ten joint ISO task forces were established involving more than sixty ISO-NE and NYISO staff members to develop the technical plan to create the NERTO, the NERTO market design and the NPCC Common Market concept, to participate in and receive input from stakeholder working groups, and to address other issues (including the relationship between the NERTO and the TOs).

C. An Extensive Stakeholder Process Has Been Utilized

The ISOs have satisfied Order No. 2000's requirement that RTO applicants establish a voluntary collaborative stakeholder process to help them formulate their plans.[17] Stakeholder advice was important to the development of the NERTO and market proposals, and was received during all facets of the project, starting with the design by the stakeholders of the consultation process itself.

Six working groups were established as part of the stakeholder process:

- Market Design and System Implementation
- Market Monitoring and Mitigation
- Economic and Reliability Evaluation
- Stakeholder Process
- Transmission Planning and Tariffs
- Operations and Facilities

Each working group had a charter to address a series of specific issues.

Stakeholders, including TOs, generators, marketers, load-serving entities, public interest organizations and state regulatory officials from both New England and New York, were active in each of the six working groups. Canadian representatives participated in certain working groups. In addition, PJM Interconnection, L.L.C. ("PJM") provided input into the Assessment and agreed to review the NERTO Market design to ease the identification and elimination of possible impediments to trade between the NERTO and PJM.

---

[17] Order No. 2000 at 30,993.

Eighteen working group meetings were held between March and June, 2002. In addition, four plenary sessions of all of the stakeholders were held, where the stakeholder working groups presented status reports and submitted the results of their work. Board members from NYISO and ISO-NE attended each plenary session. Working groups commented on issue-specific "strawman" papers prepared by the task forces or stakeholders. Stakeholders also communicated through a confidential "Stakeholder Exchange" component of a confidential and secure website (www.nerto.com) that made it easy to share documents and have frank discussions.

Representatives of the IMO and Énergie NB Power also participated in certain working groups. In addition, senior ISO officers traveled to Ontario and New Brunswick to discuss NERTO, policy coordination and market design issues. These meetings were productive and resulted in the agreements that are described in Section VI.E.

State regulatory officials were consulted and encouraged to participate in the stakeholder process. During that process, ISO-NE's JOC members met twice a month with representatives from the New England Conference of Public Utility Commissioners ("NECPUC") to discuss the NERTO effort. ISO-NE staff held several meetings with the NECPUC commissioners and staff. The entire ISO-NE Board also met with NECPUC on several occasions during the NERTO development process. Similarly, NYISO officers, including the Chairman of the NYISO's Board of Directors, met with the Chairman and senior staff of the New York State Public Service Commission ("NYPSC") to obtain their views and keep the NYPSC apprised of the Petitioners' progress.

In addition, ISO-NE's JOC members generally met with the Chairman and Secretary of NEPOOL after every JOC meeting to discuss developments and receive further stakeholder advice. The ISO-NE JOC members also met several times with NEPOOL's Chairman and Vice-

Chairmen, and held two open meetings for all New England market participants to share their thoughts and concerns with the ISO-NE Board. Similarly, the New York JOC members held a meeting with the Management Committee of the NYISO to solicit advice on the formation of NERTO.[18]

The ISOs expect that stakeholders will continue to interact with the JOC and to provide input and collaborate in the development of the FPA Section 205 filings that are to be made if the Commission issues the requested declaratory order on this Petition. Through this continuing process, the stakeholders will provide their advice through all aspects of tariff and market rule development. They will likewise be involved in future modifications to assure responsiveness to regulatory, reliability and market developments.

V. THE NERTO'S MISSION, STRUCTURE, GOVERNANCE, STAKEHOLDER ADVISORY PROCESS, AND TRANSMISSION PROVISIONS WILL TOGETHER ACHIEVE THE GOALS OF ORDER NO. 2000 FOR THE NORTHEAST

Acceptance by the Commission of the NERTO proposal will achieve the goals of Order No. 2000 for the Northeast. This is demonstrated by the discussion below, detailing:

- the NERTO's defined mission;
- the NERTO structure and formation;
- the composition of the NERTO Board of Directors, including the selection and governance procedures that ensure the independence of the NERTO;
- a robust stakeholder advisory process that ensures the NERTO Board and staff have the benefit of full access to the views and expertise of stakeholders; and

---

[18] At meetings in June 2002, the NEPOOL Participants Committee and the NYISO Management Committee considered the Petition and did not support its filing.

- effective transmission arrangements and provisions that facilitate competitive markets and result in construction of needed transmission infrastructure improvements.

A. The NERTO's Mission

The NERTO will be the RTO for the area consisting of the states of Connecticut, Massachusetts, New Hampshire, New York, Rhode Island, Vermont and all of Maine except the non-interconnected portion of Northern Maine. In accordance with its organizational documents, the NERTO will be responsible for maintaining and ensuring the reliability of the NERTO region's bulk power system, for administering and maintaining the efficiency and competitiveness of the wholesale electric markets in the Northeast, and providing non-discriminatory open-access transmission service throughout the Northeast. The NERTO will be the security coordinator for the Northeast and the operator of the control areas in the Northeast. The NERTO will operate both day-ahead and real-time energy markets, regulation and reserve markets and a capacity market in the Northeast. The NERTO will be the transmission provider under a single-region-wide, open-access transmission tariff. The NERTO, under its open-access transmission tariff, will be the provider of ancillary services. Additional responsibilities of the NERTO will include transmission planning and expansion and market monitoring and mitigation.

The seven-state NERTO region will encompass approximately 110,000 square miles with a population of over 33 million. This area includes two of the country's largest metropolitan areas and its financial center. The NERTO will have operational authority for the region's bulk power system, which includes 64,000 megawatts of generating capacity and 18,000 miles of transmission. The NERTO will have a number of interconnections with neighboring control areas (with their approximate nominal transfer capabilities): PJM (2500 MW), Ontario (2400 MW), QuJbec (3425 MW) and New Brunswick (700 MW). The wholesale markets in the

NERTO region, with annual settlements totaling approximately $7 billion, will supply electricity to over 14 million customers, with a 2001 peak load of over 58,000 MW.

The creation of the NERTO will bring to the Northeast the benefits envisaged by the Commission in both Order No. 2000 and the Commission's market standardization initiative. The NERTO will safeguard reliability in the Northeast, eliminate pancaked transmission rates and other barriers to trade, create standard markets to bring the long-term benefits of competition to customers and increase interregional cooperation. The NERTO will also provide a platform for market standardization and the elimination of trade barriers well beyond the NERTO boundaries.

B. The NERTO's Structure and Formation

The NERTO will consolidate all of the duties and responsibilities of ISO-NE[19] and NYISO[20] in a single organization overseen by the NERTO Board of Directors. The NERTO will be a non-profit Delaware limited liability entity. This organizational structure will facilitate the

---

[19] ISO-NE is the Commission-approved independent system operator for the six New England states. ISO-NE is responsible for short-term reliability in New England through its operation of the control area. ISO-NE administers the New England markets and the NEPOOL open-access transmission tariff. It is a Delaware non-profit corporation with an independent Board of Directors. It operates under an Interim Independent System Operator Agreement with NEPOOL (the "ISO Agreement"). The ISO Agreement originally had a term ending June 30, 2002. The term of the ISO Agreement has been extended to March 31, 2003, with a further extension to December 31, 2003 subject to certain conditions discussed in Attachment IV hereto.

[20] The NYISO is a non-profit New York corporation which acts as the independent system operator for New York State's high voltage transmission system. The NYISO is responsible for providing open-access transmission service over New York's high-voltage system and for maintaining short-term reliability. The NYISO's existing market design includes a Locational-Based Marginal Pricing ("LBMP") congestion management system, day-ahead and real-time energy markets (with limited demand bidding), and fully co-optimized markets for ten-minute synchronized reserves, ten-minute non-synchronized reserves, thirty-minute reserves and regulation. The NYISO also administers separate ICAP and Transmission Congestion Contract ("TCC") markets.

one-stop shopping for transmission and market services mandated by Order No. 2000. The structure will allow the centralization of region-wide functions within the NERTO and permit the NERTO to capture the economic efficiencies of a larger organization. The formation of the NERTO, through the combination of the ISOs, will create this new organization while retaining the resources needed to maintain reliability in New England and New York and to administer and make interim improvements in the existing markets.

As set forth more fully in Sections V.E. and F., the NERTO will establish a region-wide stakeholder process which will include all market participants, transmission owners and end users who elect to participate. The NERTO will also propose the establishment of an advisory committee to the Board of Directors consisting of regulators from the seven Northeastern states. The region-wide stakeholder process and the regulatory advisory committee will provide advice and input to the Board of Directors and the management of the NERTO.

Assuming favorable action on the Petition, the ISOs will finalize negotiations with the regional TOs and develop a plan for obtaining all regulatory approvals and taking other legal actions necessary to form the NERTO. Pursuant to the plan, filings will be made expeditiously under FPA Section 205 and, if necessary, Section 203, as well as with the New York Public Service Commission and the New York Supreme Court. Filings may also be required under the Hart-Scott-Rodino Act, and federal and state Worker Adjustment and Retraining Notification statutes. Upon completion of these efforts, the NERTO will be formed as a Delaware non-profit entity.

The Petitioners anticipate that the NERTO will have bylaws or an operating agreement, depending on its form of entity, and an agreement with market participants, all of which will establish certain NERTO and stakeholder governance policies. These issues will include the

NERTO Board selection process, the role of any reliability council, mechanisms for stakeholder access to the Board, and a description of participants' sectors, committees and voting arrangements. The amendment of any of the provisions listed in the preceding sentence will require the approval of the NERTO as well as a decisional vote of market participants in accordance with Section V.F.1. hereof. Otherwise, the NERTO will have the unilateral right to amend its governing documents.

Following the creation of the NERTO and the NERTO Board's assumption of control (i.e., by the end of the second quarter of 2003), the NERTO will consolidate management, certain operations, and market and corporate services. In particular, the ISOs anticipate that Human Resources, Public and Government Affairs, the Project Management Office, Finance, Legal, Available Transmission Capacity ("ATC"), Total Transmission Capacity ("TTC"), Open Access Same-Time Information System ("OASIS"), Planning and Market Design functions will be consolidated in this time frame. Subject to initial Commission approval by January 1, 2003 and timely approval of the NERTO Day 1 Tariff and other documents, it is expected that the NERTO could be formed by June 30, 2003.

C. Board Governance

1. Board of Directors

The NERTO will be governed by an independent, non-stakeholder Board of Directors that will oversee the NERTO's operations. The NERTO Board will select a Chief Executive Officer and other officers responsible for day-to-day operations, all of whom will serve at the pleasure of the Board. The NERTO Board of Directors will have exclusive decision-making authority for the NERTO, including the NERTO tariff and market rules. As a result, the NERTO will not be subject to direction by any entity other than the Commission.

An essential element of the NERTO's independence will be the NERTO Board's exclusive decision-making authority with respect to its budgets and funding.[21] While the NERTO will consult with market participants on its budget (much as the ISOs currently do), the NERTO Board alone will approve the NERTO's budget. The Petitioners expect that the NERTO's operating costs will be recovered from market participants under one or more formula rates that the NERTO will file with the Commission under FPA Section 205. These rates will be based on amounts associated with categories specified in the NERTO's annual budget. The NERTO will also make an annual informational filing, consistent with its internal budgetary process, showing its calculation, under the formulas, of the rates to be collected from market participants in the upcoming year.

The NERTO Board will consist of twelve members plus the Chief Executive Officer, who will be a non-voting member. Initially, the twelve Board members will be composed of five members from the NYISO's Board of Directors, five members from ISO-NE's Board of Directors and two new members. The composition of the initial Board will provide the NERTO, during its crucial start-up phase, with expertise, knowledge and experience from the existing ISO Boards, while the new Board members will bring fresh perspectives. The members from the existing ISO Boards will be chosen by their respective Boards, after consultation with stakeholders on the expertise and experience needed by the NERTO Board.

Directors will serve three-year, staggered terms. Directors will continue to serve until their successors are duly elected and qualified. Terms will be limited to three per director, and,

---

[21] The Petitioners anticipate that funding for the NERTO in 2003 will come from the ISOs' existing funding mechanisms. The NERTO budgetary process described in this paragraph would be instituted in 2004.

after the institution of the initial NERTO Board, no person will be eligible for election or reelection unless he or she is age 70 or younger. The foregoing age limit may be waived by the Board. These age and term limits, and the staggered terms, will ensure regular infusions of new directors with fresh perspectives while maintaining the continuity of the Board.

A nominating committee will nominate all candidates for election and reelection to the NERTO Board, including the two new members of the initial NERTO Board, but not including the initial ten members of the NERTO Board who originate from the two ISO Boards. The initial nominating committee will be composed of two NERTO Board members from the NYISO, two NERTO Board members from ISO-NE, and the Chairs of the NYISO Management Committee and the NEPOOL Participants Committee. After the full initial NERTO Board is seated, the nominating committee will consist of four NERTO directors and two members of market participant leadership.

For each election and reelection of directors, the nomination and election process will proceed in the following manner. First, the nominating committee will solicit input from market participants and regulators on the types of expertise needed on the Board. Next, the nominating committee will engage a search firm if there are vacant seats to fill. In consultation with the search firm, if any, the nominating committee will develop a slate of candidates for presentation to the market participants.

The market participants will then be asked to approve the slate by means of a simple majority of the sector vote of those present or voting by proxy (assuming the adoption of a sector voting process as described in Section V.F.1). If the market participants approve the slate, the nominating committee will present the slate to the NERTO Board for its vote. If the participants do not approve the slate, the nominating committee will consider whether to recommend the

existing slate to the NERTO Board after informing the Board of the participants' vote, or to modify the slate. In the latter case, the nominating committee will repeat the entire process once, and may opt to do so more than once, if necessary.

During the discussions with market participants and state regulators about the governance of the NERTO, the ISOs heard two conflicting messages: the market participants believe that they should be entitled to nominate, elect and reelect directors to the NERTO Board; and New England regulators believe that independence of the Board is crucial and, therefore, market participants should have no role, other than an advisory one, in nominating, electing or reelecting directors to the NERTO Board. The ISOs considered these messages and have made their determinations based upon their estimation of an appropriate balance between independence and responsiveness to stakeholders.

The ISOs' proposal reflects agreement with market participants in a number of areas. For example, market participants and the ISOs agree that the NERTO Board should utilize the existing expertise and experience of the ISOs' Boards while including the fresh perspectives of new directors. Moreover, market participants and the ISOs agree that market participants should have input on the selection of directors.

2. Transition to the NERTO Board

Currently, the JOC, which managed the development of this proposal, is composed of three directors from each ISO. After the Commission approves this Petition, the ISOs will identify the directors from their Boards who will serve on the NERTO Board, and these individuals will become the "NERTO Board-Elect." The NERTO Board-Elect would serve in an advisory capacity to the ISOs' Boards and would not have independent authority. The ISOs' directors, while serving on the NERTO Board-Elect, will remain responsible solely to the appropriate ISO.

Between the Commission's approval of the Petition and the formation of the NERTO (which the ISOs hope will occur by January 1, 2003 and June 30, 2003, respectively), the NERTO Board-Elect will consider transitional issues, including personnel and benefits, initiate the selection of the two new directors and initiate and conduct the search for a Chief Executive Officer and, potentially, other officers. In conjunction with the stakeholders, the NERTO Board-Elect will also begin working on tariffs, budgets and other organic documents.

Once all legal and regulatory approvals are received (currently estimated to occur by June 30, 2003), the NERTO will become operational and the NERTO Board will be instituted. The NERTO Board will select the Chief Executive Officer of the NERTO and will assume full responsibility for all NERTO activities. When the NERTO becomes operational, the existing directors of the ISOs will resign as ISO Board members.

D. The NERTO Code of Conduct

The NERTO will have a Code of Conduct for NERTO directors, officers and employees, to ensure that they will be truly independent from market participants. The NERTO's Code of Conduct will prohibit NERTO directors and staff from holding any financial interests in a market participant, except for a limited transition period after they join the NERTO. The Code of Conduct also precludes directors, officers and employees from engaging in energy-related transactions and obliges them to recuse themselves from certain matters if they seek employment with a market participant. The proposed Code of Conduct is appended to this Petition as Attachment V.

To assure the independence of the NERTO itself, the NERTO will not own any transmission or generation facilities or hold a direct or indirect financial interest in any market participant. While the NERTO will administer bid-based energy and ancillary services markets, it will not take title to any product sold in any of its markets or be a market participant itself.

The NERTO will comply with Order No. 2000's requirement that an RTO which is organized as an ISO submit an audit of the independence of its governance process two years after its approval as an RTO.

E. The NERTO's Unilateral Section 205 Filing Rights

The NERTO will have unilateral FPA Section 205 filing rights to propose tariff and market rule revisions.[22] The NERTO will, however, develop all Section 205 filings in a collaborative manner that allows for stakeholder input and review, except in cases where exigent circumstances make expedited action necessary.

This collaborative process will include meetings between NERTO directors and stakeholder representatives before each regularly scheduled Board meeting to obtain stakeholder input on issues to be considered by the Board at that meeting. Each month, the stakeholders will choose up to three representatives from each sector to serve on this liaison committee. These representatives may either be chosen for some period of time or may be rotated. The Board will choose three or more of its members to meet with this committee each month. Moreover, the full Board will meet with all market participants on a semi-annual basis.

F. Other Intended Participants

1. Stakeholder Process

To address the Commission's desire that RTO Boards consider stakeholder input and not operate in isolation, the ISOs and stakeholders have been working on a stakeholder advisory process. These stakeholder arrangements will supplant the current committee and sector structures within the NYISO and NEPOOL. The market participants and the ISOs agree that

---

[22] Consistent with Order Nos. 2000 and 2000-A, the TOs will retain unilateral Section 205 filing rights with respect to recovery of their revenue requirements and the NERTO will consult with the TOs concerning rate design issues.

market participants should organize principal committees on various subjects, and additionally should form a "committee of the whole." Committees will be chaired by market participants or, where agreed, by NERTO staff.

Market participants and the Petitioners generally agree that market participants should be organized into sectors. The Petitioners believe that there should be at least five principal sectors, to include: Generator Owners; Transmission Owners; Public Power/Environmental Parties; Other Suppliers; and End-Use Consumers. Additionally, entities representing Demand Response Resources should be given a voice in the participant structure, either as a sub-sector or an additional sector. Moreover, the sector structure should include a mechanism for the development and inclusion of new sectors or sub-sectors.

Regarding market participant voting, the Petitioners prefer that market participants' advisory votes not be subject to any threshold (except for votes regarding the election and reelection of directors, as described in Section V.B.1). Rather, advisory votes should be reported to the NERTO Board on individual, sectoral and aggregate bases. The decisional votes of participants on those sections of the NERTO's governing documents described in Section V.B. should be determined by a simple majority of the weighted vote of those present or voting by proxy.

The Petitioners await a proposal from stakeholders on the subject of voting weights. However, the Petitioners expect that any assignment of voting weights should be predicated on the requirements set forth in Order Nos. 888 and 2000 that there be balanced representation between sectors so that no single class of market participants dominates decision-making. The Petitioners' proposals regarding participant voting on governing documents and the election of

directors are based on the assumption that voting weights will be assigned in accordance with the principles set forth in the preceding sentence.

2. State Regulators

In addition to consulting with NERTO participants, the Petitioners propose to establish a formal advisory committee consisting of the seven state regulators. The NERTO Board of Directors will meet with this committee regularly.

3. Transmission Owners

The ISOs contemplate that they will enter into the TOA with the regional TOs, effective on the date that the NERTO commences operations. The TOA will give the NERTO operating authority over the TOs' transmission facilities sufficient for the NERTO to perform the functions required of an RTO, including the provision of transmission service under the NERTO tariff. This operating authority will be limited to operational authority required by the NERTO and will not include any other rights or obligations with respect to the transmission facilities, including any property rights or related obligations or liabilities. The TOA will also provide that the NERTO will offer transmission service under grandfathered agreements, but grandfathered agreements will not be assigned to the NERTO.

The TOA will recognize that the NERTO is the transmission provider under the NERTO OATT and that the NERTO has the right to make unilateral Section 205 filings to change the rate design in the NERTO OATT. Prior to making any changes in rate design, the NERTO will consult with the TOs concerning the impact of the design changes on their revenue requirements, and with the other stakeholders. The TOA will also recognize the right of each TO to make unilateral FPA Section 205 filings to recover its revenue requirements.

This operational authority will provide the NERTO with all operational authority required to be an RTO but will recognize that the transmission facilities will continue to be

physically operated by the TOs and will include specific provisions to protect the tax-exempt financings of the Long Island Power Authority ("LIPA"), the Power Authority of the State of New York ("NYPA") and the Consolidated Edison Company of New York, Inc. ("Con Edison"). The TOA will also include a specific reservation of rights of TOs, including FPA Section 205 rights to file for recovery of revenue requirements and for mergers, acquisitions and restructurings; all rights incident to ownership of the transmission facilities; the right to implement procedures to protect their transmission facilities from physical damage or to prevent injury; and rights necessary for the TOs to fulfill obligations under applicable law, including filings with state and local regulatory authorities.

The provisions of the TOA have not yet been finalized. The ISOs and the TOs have engaged in numerous drafting and negotiating sessions to frame and discuss various issues, including the contract term; insurance, limitations of liability and indemnities; events of default and remedies, including any termination rights of the TOs; payment mechanics for the revenue requirements of the TOs; issues related to current net billing practices; and TO withdrawal provisions. Stakeholders will have the opportunity to provide input on these issues prior to finalization of the TOA.

G. NERTO Transmission Provisions

1. The NERTO Will Utilize a Tariff and Rate Structure That Will Employ an Efficient Transmission Pricing System, and an Interconnection Process That Will Facilitate the Prompt Study and Addition of New Generation and Merchant Transmission Projects Within the NERTO Region

When NERTO operations begin, the NERTO will administer an umbrella tariff that will address the transmission and market arrangements for the New England and New York control areas. This tariff will eliminate "border charges" for transactions between those control areas.

The ISOs recommend that elimination of border charges be conditioned on the consideration by the Commission and the states, on an expedited basis, of mechanisms by which the TOs can recoup lost revenues stemming from the elimination of border charges. Those mechanisms should be designed to avoid distortions in the operation of the wholesale power market.

The NERTO will, with the exceptions described in Section IX below,[23] possess sole authority to receive, evaluate and approve, or deny, all requests for transmission service. The NERTO will likewise have sole responsibility for filing tariff and market rule amendments pursuant to FPA Section 205. The NERTO tariff will employ an LMP congestion management system and support the Commission's standardized market design.[24] The TOs' FPA Section 205 rights to recover their revenue requirements will be protected as well. The NERTO will thus employ a transmission pricing system that will promote efficient use and expansion of transmission and generation facilities.

The ISOs have also worked with regional stakeholders to develop a proposed NERTO process (Attachment VI) for interconnection of generation and merchant transmission projects. The process combines the best features of the Commission-approved ISO-NE and NYISO interconnection rules.

---

[23] In Section IX.A., the Petitioners describe a special NYISO operational protocol that they propose to adopt for the NERTO in order to permit the LIPA to participate in the NERTO without losing its tax-exempt financing status. This protocol would give LIPA limited responsibility for scheduling transactions over non-jurisdictional transmission facilities that were funded with tax-exempt bonds in order to preserve their status.

[24] The Petitioners have not supplied a draft tariff with this filing in recognition of the need for additional stakeholder input, Commission guidance in response to this filing and the pendency of the proposed *pro forma* Network Access Tariff.

a. The "Day One" NERTO Tariff

The ISOs will submit, pursuant to FPA Section 205, a "Day One" Tariff to become effective on the day that the NERTO commences operations. That tariff will consist of New York and New England sub-regional tariff sets, as well as incorporating certain existing ISO tariffs/documents (with limited modifications), under an overarching "umbrella" document.

The umbrella portion of the tariff will explain the overall transmission access and electricity market arrangements that will be in place on "Day One." It will incorporate provisions establishing the NERTO planning and expansion process and the NERTO interconnection process for the two sub-regions. The umbrella tariff will address the cost allocation for new regulated transmission facilities built pursuant to the NERTO System Plan ("NSP")[25] and for interconnection-related upgrades, and provide for the recovery of the NERTO's administrative and start-up costs.

In addition to the umbrella provisions, the Day One tariff will include sub-regional tariff sets for the New York and New England control areas. For New York, the sub-regional tariff set will include the existing NYISO OATT and the Market Administration and Control Area Services Tariff, modified to be NERTO documents. The New York sub-regional tariff sets will provide for the recovery of any NYISO start-up costs that are not recovered by the first day of NERTO operations. For New England, the sub-regional tariff sets will include relevant portions of the Restated NEPOOL Agreement and the NEPOOL OATT (modified to be NERTO

---

[25] The NERTO will consider the value of incentives to encourage expansion of the transmission infrastructure throughout the region, and will work with the states to adjust existing rate approaches to facilitate construction of approved transmission upgrades that will benefit NERTO market and load.

documents rather than NEPOOL documents), recovery of any remaining ISO-NE restructuring costs and ISO-NE's Market Rule 1 reflecting SMD 1.0.[26]

When the NERTO commences operations, the substantive contents of the sub-regional tariff sets will remain largely as they are today, albeit with modifications reflecting the progressive harmonization of the NYISO and ISO-NE systems prior to the NERTO's launch. Accordingly, the sub-regional tariff sets will retain the existing transmission rate designs in New York and New England. In New York, those provisions would include the individual TOs' Transmission Service Charges and the New York Power Authority Transmission Adjustment Charge.

Specialized local provisions will also remain in force. Such provisions include tax-exempt provisions for LIPA, NYPA and Con Edison, which are discussed below in Section IX, and retail rate design provisions currently in effect in New York. The tariff will accommodate retail access programs in New York and New England. The provisions for New England would include the Regional Network Service and Point-to-Point Transmission Service rates under the regional OATT. Therefore, coupled with the elimination of the border charges between the two regions, customers paying regional rates in New York can use transmission in New England without additional charge, and vice versa. On Day One, the New England TOs' local tariffs would remain in place to permit the observance of the existing NEPOOL rate settlement, pending the development of a "Day Two" Tariff as described below. Currently excepted and

---

[26] As described in Section VI, ISO-NE is currently developing SMD 1.0 which will be in place, subject to Commission approval, at the outset of NERTO operations. The existing ISO-NE tariff for administrative cost recovery would cease to exist, supplanted by the NERTO cost-recovery provisions included in the umbrella tariff.

grandfathered transactions and long-term TCCs and TCCs awarded for transmission expansions will remain in force.

When the NERTO commences operations, there will still be several other tariffs or arrangements within its region including, for example, the Maine Electric Power Company tariff, HQ Phase I/Phase II arrangements, and the Cross-Sound Cable tariff. However, the NERTO will coordinate operations and scheduling for those facilities under agreed standardized scheduling and curtailment provisions that are consistent with the NERTO market design. As noted above, the individual New England TOs' local tariffs will remain in place, although planning for facilities covered under the NERTO and local tariffs will be coordinated. Changes to the local tariffs will likewise be coordinated with the NERTO, although the TOs would retain their FPA Section 205 rights as to these local tariffs. NERTO approval, similar to that currently contained in Section 18.4 of the Restated NEPOOL Agreement, would be required for changes in transmission facilities. The ultimate goal is to bring all of these non-NERTO tariffs within the NERTO tariff framework by no later than the time that the "Day Two" Tariff takes effect.[27]

The NERTO will have Section 205 rights regarding the umbrella document and the sub-regional tariff sets, subject to advisory input from stakeholders. Consistent with Order No. 2000, the TOs would retain FPA Section 205 rights with respect to their revenue requirements. In addition, in order to provide for transmission rate certainty during the NERTO and market

---

[27] An Ad Hoc Working Group of the NEPOOL Reliability Committee has prepared a options paper and associated model and materials regarding the future tariff and rate treatment of the HQ Phase I/Phase II facilities. These documents were discussed by the NEPOOL Participants Committee at its August 8, 2002 meeting. See documents related to agenda item 10 in materials posted at http://www.iso-ne.com/committees/NEPOOL_Participants_Committee/Participants_Committee_Agendas/NPC_Agenda_2002-08-08_Supplemental.pdf. NERTO will promptly accommodate the results of this NEPOOL process.

implementation period (and to accommodate existing rate settlements), the ISOs propose that a "transmission rate design moratorium" remain in place from the time that the NERTO commences operations until the effective date of the "Day Two" Tariff which will be at the initiation of SMD 2.X. The moratorium would not: (i) apply to conforming transmission tariff changes necessary to accommodate market rule changes; (ii) preclude the development and implementation of a NERTO rate for new facilities; (iii) cover the rate design for an ITC; (iv) apply to the elimination of seams and changes that may be necessary to recover lost revenue; and (v) apply to changes to transmission owners' revenue requirements or associated rate levels.

b. The "Day Two" NERTO Tariff

The Day One Tariff will evolve to reflect changes in the NERTO's markets. Ultimately, there will be a "Day Two" Tariff uniformly governing the NERTO's provision of open-access transmission service and administration of electricity markets across the entire NERTO region.[28] The NERTO will work with the TOs and with other stakeholders to develop the rate design for the Day Two Tariff. The Day Two Tariff will supersede the Day One Tariff effective with the commencement of SMD 2.X. This should occur in the 2005/2006 timeframe.

The regional TOs have not yet proposed an incentive or performance-based transmission rate proposal. Such arrangements are currently under discussion, will be discussed with stakeholders, and may be the subject of future filings by the TOs.

c. Elimination of Existing Border Charges

The Day One Tariff will eliminate border charges for transactions between the New England and New York control areas. As noted above, the ISOs recommend that the elimination

---

[28] TOs will retain the option, where it currently exists, to directly bill and collect their transmission revenues directly from end-use customers.

of border charges be conditioned on the consideration by the Commission and the states, on an expedited basis, of mechanisms by which the TOs can recoup lost revenues stemming from the elimination of border charges. Those mechanisms should be designed to avoid distortions in the operation of the wholesale power market.

In the near-term, starting on the first day of NERTO operations, through-and-out charges will continue to be assessed on transactions between the NERTO and its Canadian neighbors or PJM, or through NERTO. These charges will be eliminated as soon as arrangements can be negotiated with the Canadian system operators and with PJM. The NERTO will accomplish these arrangements as rapidly as reasonably possible.

The ISOs also anticipate that an agreement will be reached with the New England TOs to allow for the elimination or phase out of existing "non-PTF" generator out charges beginning on the first day of NERTO operations.

d. The NERTO Will Provide One-Stop Shopping for New Interconnections

The ISOs have worked with regional stakeholders to develop a proposed NERTO interconnection process that combines the best features of the Commission-approved ISO-NE and NYISO interconnection rules. This process would be effective on the first day of NERTO operations for all new projects with appropriate grandfathering provisions in order to accommodate projects already in the existing New England or New York queues. A description of the proposed NERTO interconnection process is appended hereto as Attachment VI, and is summarized in Section VIII.E.2. It would govern the interconnection of new generating projects, merchant transmission facilities and other system upgrade facilities in compliance with a "Minimum Interconnection Standard," as described in Section VIII.E.2.b., below.

When the ISOs make the requisite FPA Section 205 filings to implement the proposed process, they will take account of the Commission's final interconnection rule.[29]

2. The NERTO Proposal Reflects a Comprehensive and Fair System Planning and Expansion Process that Will Result in the Construction of Needed Infrastructure Improvements

The NERTO proposal includes a comprehensive system planning and expansion process (Attachment VII) developed with input from U.S. and Canadian stakeholders and state regulatory personnel. This fair and balanced process complies with the requirements of Order No. 2000 and subsequent Commission orders, and will result in the construction of needed infrastructure improvements.

The NERTO system planning and expansion process (summarized in Section VIII.K below, described in Attachment VII and depicted in the process diagram included therein) builds upon the regional transmission expansion planning process approved by the Commission and successfully implemented in New England, while incorporating best practices from the NYISO and input from stakeholders.[30] This process will produce an annual NSP (including transmission upgrades) that is based on market responses and regulated transmission responses to a region-wide "needs assessment" prepared by the NERTO and ultimately approved by the NERTO Board. The NSP will be developed with input from the Planning Advisory Committee ("PAC"). Membership in the PAC is open to any entity, including state regulatory officials. The PAC's procedures will conform to those of the NERTO's other stakeholder advisory committees to provide meaningful input.

---

29 *See Standardization of Generator Interconnection Agreements and Procedures*, Notice of Proposed Rulemaking, FERC Stats. & Regs. ¶ 32,560, 67 Fed. Reg. 22249 (2002).

30 *See New England Power Pool*, 83 FERC ¶ 61,045 (1998), *on reh'g*, 95 FERC ¶ 61,384 (2001), *order on compliance*, 98 FERC ¶ 61,173 (2002).

The NSP will provide an annual assessment of the system needs of the NERTO Control Areas in a consolidated manner. It has been designed to maintain the reliability of the NERTO Control Areas while accounting for economic and environmental considerations.

The NSP will be developed in coordination with the similar plans of the surrounding RTOs and Control Areas. Interregional planning studies will be conducted over as broad a region as feasible, including adjacent Canadian systems who are members of the NPCC, the Mid-Atlantic Area Council ("MAAC") and the East Central Area Reliability Coordination Agreement. Coordinated planning has already begun among the NPCC control areas under the auspices of the NPCC's CP-10 Working Group, which is being expanded to MAAC. The CP-10 Working Group has published the first phase of an ongoing multi-phase study of how transmission bottlenecks are adversely affecting electricity markets and potentially affecting reliability in the NPCC and other regions. The intended result of this study is a plan for transmission expansion across the participating regions necessary to foster electricity transactions. The NSP will account for and fully reflect the work product of the CP-10 Working Group.

VI. THE NERTO MARKET DESIGN WILL PROMOTE COMPETITION, ITS BENEFITS WILL BE IMPLEMENTED IN PHASES ON A PROMPT AND EFFECTIVE BASIS, THE NERTO MARKET MONITORING AND MITIGATION PROVISIONS ARE APPROPRIATE, AND THE NPCC COMMON MARKET WILL SIGNIFICANTLY INCREASE THE BENEFITS OF THE NERTO PROPOSAL

As this section demonstrates, the NERTO Market design and its implementation plan will bring early benefits and increase them on a phased basis. Implementation of SMD 1.0 in New England is expected to be completed in the first quarter of 2003 and SMD 2.0 in New York by the first quarter of 2004. The NERTO Market is expected to be operational in the 2005/2006 time frame.

The NERTO Market design will significantly further the Commission's market standardization initiative. The NERTO market monitoring and mitigation provisions will meet the Commission's objectives and ensure that market conduct is appropriate. Moreover, the increased trading area facilitated by the NERTO agreements with Canadian system operators within the NPCC will bring significant benefits to the Northeast and to the NPCC region as a whole.

A. The NERTO Market Design Will Advance the Commission's Goals and Meet the Needs of the Marketplace

When its market evolution is completed, the NERTO will operate a seamless energy market that spans the entire Northeastern region of the United States. Furthermore, the NERTO will be closely integrated, through the NPCC Common Market, with the Canadian energy markets to the north. The NERTO Market will also be fully consistent with the Commission's standardized market design requirements. In short, the NERTO will implement the Commission's vision for standardized markets in both design and operation through its market implementation plan.

The NERTO Market will serve approximately 33 million people, with expected NERTO-administered settlements of $7 billion annually. The implementation of markets for an RTO of this size and scope will require a significant effort over several years. The initial phase of the NPCC Common Market (which will include Ontario and New Brunswick) will have a total of 86,000 MW of load and 98,000 MW of generation, and will serve 45 million people. Expansion of the NPCC Common Market to include other NPCC provinces would further increase these figures.

The following discussion provides a description of the NERTO Market. It also summarizes the elements of the NERTO Implementation Plan (the "Implementation Plan"), and

describes the efforts that will be undertaken to form the NPCC Common Market. The Petitioners anticipate that one of the early actions of the NERTO Board will be to cause management to draft a more detailed and improved system migration and implementation plan that draws on the expertise of both ISO development teams. The NERTO will work with stakeholders through the NERTO stakeholder process on continued development of the NERTO Market design and the Implementation Plan.

SMD 2.X will be based on SMD 1.0, which ISO-NE is currently developing, and SMD 2.0, which will be developed for New York, including modifications to incorporate identified best practices. When fully implemented, the NERTO Market will include day-ahead and real-time energy markets co-optimized with regulation and reserves markets, LMP-based dispatching and congestion management, a system of FTRs, security-constrained unit commitment, nodal *ex post* pricing, and a uniform ICAP market. Both physical and "virtual" bids and offers will be permitted in the NERTO-administered day-ahead energy market. All market participants will have the option to hedge the risk of congestion within the NERTO by purchasing financial transmission rights in flexible multi-period auctions and in a liquid secondary market. Participants will be able to engage in bilateral or self-supply transactions instead of participating in the NERTO Market. The NERTO Market design will be consistent with the Commission's standardized market design principles that are being developed in the rulemaking in Docket No. RM01-12-000.

The NERTO will promote robust demand-side response mechanisms, including a day-ahead demand response program based on the current New York model, to be expanded through the Northeast. These demand-side mechanisms will ultimately include the ability for qualified demand resources to participate in the ancillary services markets. The NERTO will also

administer an ICAP market based on the unforced capacity design currently used in New York and PJM, at least until such time as reserve markets and demand-side response mechanisms are proven to obviate the need for an ICAP market in the Northeast. Under SMD 2.X, the NERTO will establish locational requirements for reserves. It will also employ prospective mitigation measures that will be incorporated into its software to remedy market power abuses in the day-ahead market and in real-time in New York City.

The NERTO real-time market will use a real-time scheduling and dispatch process consistent with its day-ahead security constrained unit commitment ("SCUC") model. This model includes a real-time, security-constrained scheduling process that looks ahead three hours and executes at 15-minute intervals and a dispatch process that looks ahead one hour and executes on five-minute intervals. The SCUC will replace the separate Balancing Market Evaluation and Security Constrained Dispatch mechanisms currently used in New York.

B. The NERTO Implementation Plan Ensures That the Benefits of NERTO, the NERTO Market and the NPCC Common Market Will Be Delivered Promptly and Reliably

The Petitioners have developed a preliminary, three-stage Implementation Plan (Attachment VIII) to deliver the benefits of NERTO, the NERTO Market and the NPCC Common Market to the Northeast promptly and reliably. The Implementation Plan is aggressive but achievable.

The proposed SMD 2.X includes a number of sophisticated features that are consistent with, but not yet included in, either SMD 1.0 or the current NYISO market design. The ISOs estimate that the system-build, testing, and implementation of SMD 2.X can be completed in the 2005/2006 timeframe, i.e., once the markets are standardized and have been in operation across the region. During development of SMD 2.X, the NERTO will progressively improve and integrate the New England and New York markets in stages, as described below.

Stage 1 will be reached during the first quarter of 2003. At this time ISO-NE will transition to SMD 1.0 market rules while the NYISO continues to operate under its current market rules. SMD 1.0 will include LMP pricing, nodal pricing, losses, a day-ahead market, spinning reserve[31] and regulation markets. In addition, the SMD 1.0 market design will include the following features:

- Nodal pricing at load buses;
- *Ex post* real-time pricing;
- Ability to accommodate transaction changes at 15-minute intervals;
- "E-schedules" for internal transactions permitting changes up to the start of daily settlement;
- Self-commitment by generation;
- Self-scheduling by generation; and
- Ability to accept Short Notice External Transactions.

The NYISO will work with its software vendors during this period to enhance its market design. The result of these enhancements – SMD 2.0 – will incorporate key market design features of SMD 1.0 plus certain other enhancements and leading practices to its real-time balancing market. The features of SMD 2.0 include:

- Simultaneous co-optimization of ancillary services and energy in day-ahead and real-time market commitment decisions;
- 10-minute spinning and non-spinning day-ahead and real-time reserve markets;
- 30-minute day-ahead and real-time operating reserve markets;

---

[31] Spinning reserves markets will be initiated after initial SMD 1.0 implementation.

- Accommodation of demand-side participation in reserve markets;
- Automated *ex ante* mitigation procedures in day-ahead markets and in real-time in New York City;
- Price-responsive day-ahead demand reduction program;
- Ability to bid negative prices;
- Locational reserves;
- Generator bids that may vary by hour; and
- Generator bids that may change up to one hour in advance of real-time.

The NERTO is expected to be formed by the end of the second quarter of 2003. After the NERTO is formed, an organizational integration team will be responsible for the rationalization, integration and migration of the two current ISO business entities to the new administrative and operational structure of the NERTO.

Stage 2 will be reached in the first quarter of 2004, with New York's transition to operation under SMD 2.0, and is expected to last until delivery and testing of the SMD 2.X systems and software. After Stage 2 is reached, the team will determine the remaining steps necessary to move to SMD 2.X. The features of SMD 1.0 and SMD 2.0 to be included in SMD 2.X will be based on an assessment of the performance of SMD 1.0 and SMD 2.0 as well as the Commission's standardized market design. Additionally, the team will prepare for the transition to SMD 2.X by developing detailed testing processes, regional operating procedures, and training programs for both staff and customers.

Preparatory activities leading to Stage 3 will include delivery and installation of the systems and software necessary to support the NERTO's major SMD 2.X components. To

provide necessary backup systems for secure market and system operations, the ISOs currently expect to create appropriate redundancy through the use of both existing control centers.

Finally, the NERTO will test all of the system components, train NERTO personnel and market participants, and conduct complete market trials. The Petitioners expect the NERTO to reach SMD 2.X, i.e., Stage 3, in the 2005/2006 timeframe.

The Implementation Plan is phased to allow the NERTO to realize regional market benefits from the elimination of export fees and seams and standardized New York and New England markets, prior to any implementation of a single dispatch and common settlement. The early phases of the plan also include the activities and tasks required to meet the minimum functional requirements of an RTO (i.e., centralized TTC, ATC, OASIS, open-scheduling system and Planning). These early phases are followed by integration of administrative functions seeking synergies and the design, building, testing and implementation activities.

C. The First Phase of the Technology Assessment Supports the Feasibility of the Proposed NERTO Market Planning, Procurement and Implementation Processes

The ISOs contracted with KEMA Consulting and Rational Software to study the technical feasibility of creating the NERTO Market. The purposes of the study included: providing the ISOs with a high-level assessment of the readiness of existing and near-future technology to support this endeavor; identifying the critical architecture components that are required for successful implementation; and developing a short-term plan to optimize the use of existing applications, software infrastructure and required technology in the period leading up to day one of NERTO operations. An executive summary of the first phase of the technology assessment is Attachment IX hereto.

The study concluded that the state of the technology is generally such that a twelve-month planning and procurement phase, followed by a twenty-four month implementation phase,

is feasible. The study also outlined critical success factors, like early identification of NERTO leadership and dedicated resources, and made architecture, applications and platform recommendations.

D. The NERTO Market Monitoring and Mitigation Structure and Plan Are Appropriate, and Will Assist the Commission in Assuring a Competitive Northeastern Marketplace

To monitor the NERTO Market, the NERTO will utilize both an internal and an external independent market monitoring unit. This is desirable because the two monitors will have complementary advantages. The internal unit's strength will be its close physical proximity to NERTO operators and to real-time operational and market data. The external unit, on the other hand, will bring special outside expertise, an independent perspective and substantial credibility with stakeholders. Having two complementary units will enhance the NERTO's market monitoring program and make each unit more effective than it would be on its own.

The internal unit will be part of the NERTO, and will be appointed by and report directly to the NERTO's chief executive officer. The internal unit will also have a regular reporting relationship with the Board, which is expected to include periodic meetings, with executive sessions as needed. The internal unit will (i) perform real-time market monitoring for efficiency, competitiveness, anomalies, etc., (ii) when necessary, implement Commission-approved market mitigation measures, (iii) directly provide the Commission with unfettered access to data and records necessary to perform its regulatory oversight function, and (iv) consult with the external market monitoring unit to ensure that the markets are operating and evolving appropriately and, where required, to develop rule changes and other modifications to ensure appropriate market outcomes.

The external independent market monitoring unit (the "IMMU") will be a person or persons external to the NERTO staff. The IMMU will regularly report directly to the NERTO

Board and will provide defined regular reports simultaneously to the Commission, the Board and state regulators. The IMMU will be appointed by the NERTO Board, with notification to the Commission. Any termination (voluntary or involuntary) of the IMMU must also be reported and explained to the Commission by the NERTO Board and the IMMU. The IMMU's functions and responsibilities will include, at least: (i) monitoring the markets for efficiency, competitiveness, anomalies, etc., including identifying flaws in the design and application of the market rules and procedures, (ii) monitoring the NERTO's administration of the market rules and procedures to ensure that NERTO practices do not result in improper market outcomes, (iii) consulting and advising the internal market monitoring unit on market efficiency and market power issues, (iv) notifying the Commission if the NERTO's administration of the markets is improper or incorrect, and (v) providing regular reports to the Commission, the NERTO Board, state regulators and market participants on the state of the market and its evolution. Finally, market participants will have direct access to the IMMU, as they do today with the ISOs' independent market advisor, and stakeholders may submit complaints or requests for investigations to the IMMU. This will help ensure the integrity of the market and facilitate the rapid identification of issues that compromise its efficiency.

Many stakeholders have suggested that it would be appropriate for the IMMU, once named, to participate in the development of a detailed description of the functions of the internal unit and the IMMU. The ISOs agree, and plan to include such a detailed breakdown in the NERTO Tariff filing.

In addition to these internal and external market monitoring functions, the NERTO Board will, with stakeholder input, hire an external auditor with appropriate qualifications for the purpose of ensuring that NERTO operation complies with the market rules. The NERTO will

manage all operational audits and receive the reports resulting from those audits directly.[32] Given the specific skills set necessary for the performance of these operational audits, these operational audits will not come within the purview of the market monitoring units.

The ISOs believe that the NERTO, as directed by the NERTO Board, must be fully responsible for the operation of the markets. The requirements outlined above, namely that: (i) the Commission will be consulted on the voluntary or involuntary termination of the IMMU, (ii) the IMMU will have the right to notify the Commission directly in certain circumstances, and (iii) the IMMU will submit its reports simultaneously to the Commission and the Board, ensure that the actions of the NERTO Board will be subject to checks and balances. Many of the market participants have proposed that the IMMU be subject to an Independent Oversight Committee ("IOC") of three members. For the foregoing reasons, the ISOs believe that an IOC is unnecessary.

1. The NERTO Market Monitoring Plan

The NERTO will monitor the energy and ancillary services markets that it administers for evidence of potentially abusive behavior associated with market design flaws or residual market power. Vigilant monitoring will be necessary because opportunities for the exercise of market power will continue to exist in the portions of New England and New York with slim reserve margins, highly concentrated generation ownership and severe transmission congestion, regardless of what market design is implemented by the NERTO. The NERTO will also monitor the effects of bilateral transactions on its markets and, to the extent practicable, evaluate the conditions or events outside of the NERTO region that affect the supply and demand for, or the

---

[32] The NERTO will continue to perform all of the other types of audits the ISOs perform today, including without limitation physical audits.

quantity and price of, products and services sold in any of the NERTO-administered markets. Finally, the IMMU will prepare annual reports on the competitive structure and performance of the NERTO markets, other conditions in or affecting competition in those markets and their economic efficiency.

The NERTO will initially utilize the existing market monitoring plans of the ISOs. These plans will be very similar on the first day of NERTO operations, as the ISOs' existing plans already are today, and they will progressively converge as the ISO markets come together pursuant to the single market implementation plan.

2. NERTO Market Power Mitigation Measures

The NERTO's market power mitigation plan will be modeled on the NYISO's recently accepted comprehensive market power mitigation measures,[33] which have recently been adopted for use by the California ISO[34]. ISO-NE contributed to the formulation of the NYISO's comprehensive measures and is currently working to adopt a similar system for use in New England concurrent with the implementation of SMD 1.0. Until such time as the NERTO Market is in place, however, the NERTO will administer the mitigation plans for New England and New York. As with the NERTO's monitoring plans, the regional mitigation plans will be very similar and will progressively converge over time as the ISO markets move together. The final versions will reflect an allocation of responsibilities between monitoring entities.

Mitigation measures are necessary in the NERTO region because high levels of congestion, low reserve margins and insufficient demand-side responsiveness increase the likelihood of the exercise of market power. This is particularly true in frequently constrained

---

33 *See New York Independent System Operator, Inc. et al*., 99 FERC ¶ 61,246 (2002).

34 *See California Independent System Operator Corporation,* 100 FERC ¶ 61,060 (2002).

sub-regions like New York City, Long Island, Boston and Southwestern Connecticut. At the same time, the NERTO's mitigation measures will be consistent with the Commission's goals that mitigation be prospective in nature and as non-intrusive as possible.

The mitigation measures focus on mitigating economic and physical withholding. They are designed to distinguish between scarcity and market power conditions and are narrowly tailored to avoid artificially depressing prices or interfering with legitimate bidding behavior. The measures also ensure that suppliers will not be required to sell energy at a price below their production costs (including legitimate opportunity cost). Finally, the measures will automatically cease to operate when the conditions responsible for market power issues in the Northeast subside, e.g., due to the construction of new transmission infrastructure or the implementation of more robust demand response mechanisms, because the mitigation thresholds will no longer be triggered.

The NERTO's mitigation plan will be constructed around a two-part "conduct" and "impact" test. To screen bidders' conduct for potential economic withholding, the NERTO will use past accepted offers over a reasonable period of time as its preferred method for establishing bidder "reference levels." Once reference levels are established, economic withholding can be identified by detecting bids at specified dollar or percentage thresholds above a particular unit's reference level for the output corresponding to the bid. If this conduct test is met, the NERTO will impose prospective mitigation only if the conduct has a significant effect on prices, as determined by the impact thresholds prescribed in the plan. The NERTO will consult with affected market participants to the greatest extent possible before mitigating to afford them an opportunity to justify bids that are legitimate but trigger the conduct and impact screens. In

mitigation, a suspect bid will be replaced with a bid set at the appropriate reference level. Mitigated suppliers will still be eligible to receive the market-clearing LMP if they are selected.

Mitigation thresholds will be set at levels that are likely to be reached only if structural problems, for example, transmission congestion, enable the exercise of market power. Lower thresholds will be used for sub-regions, like New York City, that are known to be more vulnerable to market power abuses. The two-part test will be incorporated into the NERTO's day-ahead market software and, with respect to New York City, to its real-time software so that it will operate automatically and without any implementation delays. This is essential because the Commission's insistence that mitigation measures be exclusively prospective means that entities that exercise market power can reap unjust windfalls during any mitigation delays.

In addition, as a temporary demand response proxy, the NERTO tariff and market rules will retain the existing $1,000 cap on offers to sell energy. The bid cap may be eliminated as soon as demand response measures become sufficiently robust to obviate the need for it.

3. Monitoring of ITC Activities

In the event that one or more ITCs are eventually established in the Northeast, they will not share in the NERTO's market monitoring responsibilities. ITC activities will be monitored to determine if the division of responsibilities between the NERTO and the ITC creates a competitive or reliability problem that affects the NERTO's ability to provide efficient, reliable and non-discriminatory services and market administration and whether the ITC's administration of its responsibilities adversely affects system reliability or the competitiveness of any NERTO market.

E. The NPCC Common Market Will Significantly Increase the Benefits to the Northeastern United States and the Neighboring Portions of Canada

Because the NERTO region is so closely interconnected, and conducts so much electricity trade with neighboring NPCC Canadian system operators,[35] the NERTO will endeavor to promote the NPCC Common Market, that is, a seamless NPCC trading area. The Petitioners have taken a variety of steps, particularly with Ontario, to eliminate seams, to the extent possible considering international jurisdictional and sovereignty concerns.

1. Ontario

Ontario has gone further than any other Canadian NPCC jurisdiction to restructure its wholesale and retail electricity sectors. It has already established an RTO-like entity, the IMO, which currently administers a bid-based, security-constrained single settlement market that is jointly optimized with an operating reserves market. Furthermore, the IMO is committed to evolving its marketplace and maintaining Ontario as an effective part of the broader North American marketplace. Including Ontario in the NERTO market is a very high priority. The Petitioners hope to achieve a high degree of convergence of the NERTO and IMO market designs by the time they implement the NERTO Market.

The IMO region has a peak load of approximately 25,300 MW and 29,500 MW of generating capability. Its territory encompasses 1.1 million square miles, has a population of 12 million, 6.6 million electricity customers and 17,918 miles of transmission lines. In addition to its interconnections with other provinces, the IMO region has a maximum export capability to New York of 2,500 MW, constituting almost half of the overall maximum Canadian export capability of 5,050 MW to the NERTO region.

---

[35] See footnote 15.

The NYISO and the IMO have already developed improved scheduling procedures to minimize the seams problems associated with the differences between their current market designs and to facilitate transactions.

In early June 2002, the ISOs and the IMO entered into a System Operations, Planning and Market Development Agreement ("IMO Agreement"). The IMO Agreement commits the parties to continue their existing efforts to coordinate transaction procedures, ensure that the transfer capabilities of shared interfaces are calculated consistently, develop reserve sharing mechanisms and institute cooperative system expansion and planning procedures. The IMO Agreement also specifies that the parties will establish a "Coordinating Committee" to develop recommendations on market design, market surveillance, business practices, system planning protocols and other coordination activities to reduce barriers to trade and improve reliability. The Coordinating Committee has had an initial, productive meeting and will meet on a regular basis. Nothing in the IMO Agreement precludes future expansions of the Coordinating Committee to include other systems.

In addition, the IMO Agreement establishes a staged plan for increasing the integration of the IMO and NERTO markets. In the first phase, the Coordinating Committee will present recommendations and implementation milestones to the ISO and IMO Boards regarding short-term objectives, such as:

- possible enhancements to better harmonize the existing markets;
- the IMO's possible adoption of components of the Commission's standardized market design that are suitable for Ontario; and
- possible modifications to the NERTO's market design to accommodate the IMO's needs and ensure seamless trading with Ontario.

In the second phase, the Coordinating Committee will present recommendations and implementation milestones to the Boards regarding intermediate-term objectives, such as:

- eliminating export charges;
- coordinating system planning;
- adopting standardized market monitoring and mitigation rules; and
- standardizing transaction scheduling procedures to permit one-stop shopping.

Finally, in the third phase, the Coordinating Committee will submit recommendations and implementation milestones to the Boards regarding long-term objectives such as the introduction of seamlessly compatible and, where possible, standardized market rules, business practices, information standards and market structures.

2. New Brunswick

Énergie NB Power serves a market with a peak load of approximately 2,800 MW and 4,100 MW of generating capability. Its territory encompasses 27,566 square miles, with a population of 760,000, approximately 340,000 electricity customers and 4,092 miles of transmission lines. New Brunswick is in the process of implementing wholesale and retail competition programs. The province is currently considering a market design focused on bilateral trading arrangements and Order No. 888 type open-access provisions that would not reflect the Commission's SMD principles. However, the Petitioners have had productive discussions with representatives of the vertically-integrated provincial utility, Énergie NB Power, and the ISOs and Énergie NB Power have entered into an "Agreement on Enhancing Coordination of System Operation, Planning, and Market Development" (the "Énergie NB Power Agreement"), which is summarized below and included as Attachment III hereto. The

Petitioners are optimistic that New Brunswick will ultimately institute a market design that is compatible with the NERTO's.

The Énergie NB Power Agreement states general principles reflecting the joint goals of the ISOs and Énergie NB Power, provides for formation of a liaison committee, and establishes near-term, intermediate-term and long-term objectives. The joint goals include increased integration of services and compatibility of market designs. The liaison committee will meet regularly to advance the objectives of the Énergie NB Power Agreement, including the development and tracking of schedules for attaining these objectives.

Near-term objectives include:

- streamlining of transaction scheduling;
- expansion of transfer capability;
- consolidation of security coordinator function;
- coordinating calculation of available transfer capability and total transfer capability;
- integration of Area Control Error; and
- coordination of maintenance.

Intermediate-term objectives include:

- reserve sharing; and
- joint system planning.

Long-term objectives will involve identification of other goals conducive to achieving an end state of seamless markets across all NPCC control areas, including exploration of the following (recognizing the pendency of Énergie NB Power's market redesign and industry restructuring process):

- achievement of common market design and common energy products;
- single day-ahead commitment and real-time dispatch across the entire region;
- elimination of barriers to trade; and
- coordinated or consolidated market monitoring.

VII. THE NERTO PROPOSAL FULLY ACCOMMODATES OPEN ARCHITECTURE PRINCIPLES

The Commission's RTO regulations specify that "[a]ny proposal to participate in a [RTO] must not contain any provision that would limit the capability of the [RTO] to evolve in ways that would improve its efficiency . . . ."[36] Order No. 2000 likewise states that RTOs must have "the flexibility to improve their organizations in the future in terms of structure, geographic scope, market support and operations to meet market needs."[37]

A. The NERTO Proposal Reflects an Open Architecture

The ISOs' January 28 Agreement contemplates that any other system operator may join the NERTO or the market development process. The detailed filings necessary to establish the NERTO will not contain any conditions that would interfere with the NERTO's ability to evolve over time. Similarly, the NERTO's organic documents and its tariff will not contain any provision that would interfere with the NERTO's ability to evolve. The NERTO will remain open to the possibility of further expansion within or beyond the NPCC. The Commission's initiative to standardize market rules, commercial practices and software standards should further enhance the NERTO's ability to expand in the future. The NERTO will also be open to

---

[36] 18 C.F.R. § 35.34(l) (2002).

[37] Order No. 2000 at 31,170.

structural changes, including the formation of ITCs, to the extent authorized by Commission policy.

Finally, the NERTO's software systems will have an open architecture that will make it easier to modify them quickly either to institute a new market enhancement or to prevent them from acting as a barrier to trade. The software will also be structured in a modular way that will make it easy to implement upgrades and to prevent a problem in one software system from having unintended adverse effects on others.

B. The NERTO Proposal Accommodates the Development of ITCs, and Includes a Clear and Appropriate Allocation of the Roles and Responsibilities of ITCs and the NERTO

A number of Northeastern TOs favor establishing one or more ITCs in the NERTO region. These ITCs[38] would operate within the NERTO framework and could share or assume certain RTO functions, provided that the Commission's requirements are met. [39]

The ISOs are open to continuing the discussion of ITC issues with the TOs, in order to arrive at an overall allocation of ITC responsibilities that is supportive of efficient markets and system reliability. For now, the ISOs have developed a general framework that, in their view, delineates an appropriate allocation of certain RTO responsibilities to ITCs.[40]

The ISOs believe that properly constituted and equipped ITCs may take on certain RTO responsibilities in the following areas in their own systems, as explained in greater detail below:

- reliability coordination;

---

38 It appears unlikely that a single ITC would be coterminous with the NERTO region.

39 *See Alliance Companies, et al.*, 99 FERC ¶ 61,105, at 61,432-40 (2002) (establishing policies governing the allocation of RTO functions to ITCs); *TRANSlink Transmission Company, L.L.C., et al.*, 99 FERC ¶ 61,106, at 61,461-73 (2002) (same).

40 These concepts have been discussed with the TOs, and input has been received from stakeholders at a Transmission Planning and Tariff Working Group meeting.

- transmission rates and tariff administration;
- congestion reduction;
- curtailments;
- operations;
- planning; and
- operating guides, manuals, procedures and protocols.

The ISOs' proposals in each of these areas will be summarized briefly below.

1. Reliability Coordination

Under the framework, the NERTO will be the regional Reliability Authority,[41] with the responsibility for system reliability and operation of the markets in the region. As the Reliability Authority, the NERTO will have operational authority over the bulk power system (transmission, generation, and associated infrastructure), and will have hierarchical control over the performance of certain RTO functions by an ITC.

For example, an ITC may perform security analysis and real-time monitoring of its system, much as the NERTO performs real-time monitoring and security assessment of the entire NERTO bulk power system (including the ITC footprint). An ITC may also take actions to preserve the security of the ITC system, including but not limited to voltage management, the determination of active and passive transmission device settings, changes in topology, outage management, and other operating actions affecting the ITC system, in accordance with operating

---

[41] The term "Reliability Authority," as used herein, has the meaning ascribed to it in "The NERC Functional Model" (June 12, 2001). The NERC Functional Model is posted on the web at ftp://www.nerc.com/pub/sys/all_updl/oc/cactf/CACTF-Final-Report-Functional-Model.pdf.

guides, manuals, and procedures developed pursuant to the provisions described below. An ITC is to inform the NERTO of any such actions and coordinate such actions with the NERTO.

To ensure that any disputes do not threaten reliability, the NERTO may intercede and direct appropriate actions in its role as the regional Reliability Authority. If these actions are disputed, the NERTO's position shall control, pending resolution of the dispute.

2. Transmission Rates and Tariff Administration

Under the framework, an ITC will possess the unilateral right, without receiving any NERTO approval, to make filings at the Commission proposing changes to rates and/or rate design applicable to the ITC's system.[42] The ITC must consult with the NERTO at least thirty days prior to submitting any such filing to the Commission and any such filing must be consistent with the congestion pricing methodology for the NERTO region approved by the Commission.

Such ITC rate or rate structure changes would be included in discrete rate schedules of the NERTO tariff. In its filing of the ITC rate schedule or changes with the Commission, an ITC must (consistent with recent ITC orders) justify any differences from the NERTO tariff and explain how regional uniformity is not harmed. In no event will an ITC implement rates or a rate structure that results in pancaked transmission charges for any one transaction within the NERTO region.

---

[42] ITCs are likely to propose incentive rate structures.

Service to load outside the ITC and for "wheeling through" or "wheeling out" service with respect to the NERTO region will be provided under NERTO (rather than ITC) rates, but the ITC has the right to propose changes in the level of ITC costs reflected in those NERTO rates, and NERTO will consult with the ITC at least thirty days prior to proposing rates or changed rates so that the ITC may, if necessary, propose complementary changes for rates for those services covered by the ITC's rate schedules.

3. ITC Actions to Reduce Congestion

Under the framework, the NERTO will have the authority to determine the congestion pricing methodology for the NERTO region and will have the authority to calculate congestion prices for the region in accordance with that methodology. So long as its actions are consistent with this methodology, an ITC may take actions to reduce congestion on the ITC system in accordance with operating guides, manuals, and procedures developed pursuant to the framework. Such actions could include, but are not limited to, voltage management, the determination of active and passive transmission device settings, changes in topology, outage management, and other operating actions affecting the ITC transmission system. An ITC will coordinate such actions with the NERTO so that overall congestion in the NERTO is not thereby increased.

4. Curtailments

An ITC may develop protocols for the coordination of transmission service curtailments on the ITC system, subject to coordination with the NERTO and in accordance with operating guides, manuals, and procedures developed pursuant to the framework. The NERTO will be responsible for curtailment of transmission service in accordance with those same documents.

5. Operations

An ITC, like existing TOs, will exercise physical control of its transmission facilities. An ITC will be responsible for establishing ratings and rating procedures for its facilities within the ITC system in accordance with good utility practice, taking into account applicable industry standards, including those of the Institute of Electrical and Electronics Engineers, Inc., the North American Electricity Reliability Council (the "NERC"), the NPCC, other reliability agencies, local reliability rules, and guidelines established by the NERTO in consultation with transmission owners.

An ITC will be responsible for developing transmission maintenance and outage schedules for the ITC system and will coordinate transmission maintenance outage schedules with the NERTO. The NERTO will have the authority to disapprove transmission maintenance outages on the ITC system in the circumstances specified in operating guides, manuals, and procedures. The ISOs anticipate that the NERTO would initially utilize the New England operating guides, manuals and procedures related to transmission maintenance for the entire NERTO system. The NERTO will also have the authority to revoke transmission maintenance outages if forced transmission outages or emergency circumstances compromise the integrity or reliability of the NERTO transmission system. In a similar vein, an ITC may coordinate generator maintenance schedules for generators within the ITC system with ITC transmission outage schedules. An ITC may modify its planned transmission outage schedules in coordination with generator outage schedules to maximize throughput and minimize exposure to congestion while maintaining safe and reliable operation of the ITC system. The ITC is required to submit any modifications to its planned transmission outage schedules to the NERTO, and the NERTO may disapprove those modifications in the circumstances specified in operating guides, manuals, and procedures. The NERTO may also revoke approval of generation maintenance outages in accordance with NERTO procedures. Compensation for TO, ITC or generator direct costs incurred in response to NERTO revocations of approval for maintenance outages shall be provided in accordance with the Commission's directives.

In addition, an ITC may manage the configuration and topology of transmission facilities on the ITC system, including the performance of transmission operations actions in accordance with the operating guides. These actions would be designed to address reliability and/or to

improve market or operational efficiency, subject to the NERTO's ultimate authority to intercede and direct appropriate actions in its role as the regional Reliability Authority.

6. Planning

An ITC may perform a number of roles during the various phases of the NERTO system planning process described in section VIII.K of this Petition. For example, as part of the NERTO planning process, an ITC may participate in the development of the regional needs assessment and develop a system needs assessment for the ITC system. The ITC will be responsible for providing the technical and analytical studies for the ITC system. The NERTO will be responsible for developing the planning criteria for the NERTO system. The ITC, in consultation with the NERTO, will develop the transmission planning criteria for the ITC system that are consistent with the NERTO planning criteria, the applicable criteria of NERC and area reliability councils and the applicable local TO criteria. The NERTO will review the ITC's needs assessment and will publish the completed needs assessment for the entire NERTO region, including the ITC system.

In the "request for solutions" stage of the system planning process, an ITC may develop, with respect to the ITC system, options for new transmission projects, the use of innovative technology, and improved utilization of existing transmission facilities in response to the needs assessment. During this same phase, market participants will have the opportunity to propose other projects – such as generation, merchant transmission and demand response programs – that may eliminate the need for new transmission within the ITC system. The ITC may propose merchant transmission projects to address needs identified in the assessment, provided that any such project shall be treated comparably with any other merchant transmission proposal, and that the ITC has implemented a code of conduct preventing disclosure to its merchant transmission developers of confidential and proprietary information of market participants.

In the phase in which the NERTO plan is approved by the NERTO Board of Directors, the proposals of the ITC, TOs (that are not ITC members) and market participants will be assessed to arrive at the final NSP.

7. Operating Guides, Manuals, Procedures and Protocols

Under the ITC framework, an ITC and the NERTO will be responsible for jointly developing and establishing (subject to stakeholder input) operating guides, manuals and procedures relating to the start-up and operation of the ITC system. In the event that the ITC and the NERTO disagree about the guides, manuals and procedures relating to the start-up and operation of ITC facilities under the NERTO's operational authority, the ITC will have the opportunity to submit its proposed operating guides, manuals, or procedures to the Commission for resolution of the dispute. Pending such resolution, the NERTO will, as the system operator with ultimate authority for the real-time operation of all NERTO transmission systems under the NERTO's operational control, implement its proposed version(s) of the disputed operating guides, manuals, or procedures.

In rare instances in which a disagreement concerning real-time operational decisions (not otherwise specified in the operating guides, manuals or procedures) with respect to ITC facilities arises between an ITC and the NERTO, those parties will attempt to reach consensus where time limitations do not make it impracticable to do so. In the absence of such consensus, or if time limitations do not permit reaching consensus, the NERTO will implement its operational decision.

8. Data Sharing

In order to operate the NERTO bulk power system and markets, the NERTO will have access to certain confidential and proprietary information of market participants. The NERTO will share with the ITC information within the possession of the NERTO that the parties agree is

necessary for the ITC to fulfill those rights, responsibilities and functions that the Commission authorizes the ITC to undertake. In no event, however, will the NERTO agree to share information that will compromise the competitive nature of the market or that runs counter to Commission guidance.[43]

VIII. THE NERTO WILL POSSESS ALL OF THE REQUIRED RTO CHARACTERISTICS AND WILL PERFORM ALL OF THE REQUIRED RTO FUNCTIONS PRESCRIBED BY ORDER NO. 2000

A. Characteristic No. 1 --- Independence

The Commission's RTO regulations specify that an "[RTO] must be independent of any market participant."[44] An "[RTO], its employees, and any non-stakeholder directors must not have financial interests in any market participant,"[45] and "must have a decision-making process that is independent of control by any market participant or class of market participants" with "exclusive and independent authority under [FPA Section 205] to propose rates, terms and conditions of transmission service provided over the facilities it operates."[46] The Commission has clarified that stakeholders may only play an advisory role in an RTO.[47] Order No. 2000 does,

---

43 Any sharing of such information will be conditioned on the ITC's agreement to protect the confidentiality of the information. The NERTO will have no liability for any failure of the ITC to adhere to such agreement.

44 18 C.F.R. § 35.34(j)(1) (2002).

45 18 C.F.R. § 35.34(j)(1)(i) (2002).

46 18 C.F.R. §§ 35.34(j) (ii) and (iii) (2002).

47 *See, e.g., Bangor Hydro-Electric Company, et. al.*, 96 FERC ¶ 61,063 at 61,259 (2001) ("In order for ISO-NE to be truly independent of market participants, it must have sole authority to make changes to Market Rules and any other changes it deems necessary without being required to seek approval from NEPOOL. Under a restructured RTO environment, market participant committees such as NEPOOL should serve a purely advisory role.") *See also New York Indep. Sys. Operator, Inc.*, 96 FERC ¶ 61,059 at

(continued...)

however, permit transmission-owning utilities that join RTOs to make Section 205 filings regarding the payments the RTO will make for use of their transmission facilities.[48]

With its independent Board, its Code of Conduct, unilateral 205 rights and budget control, as described in Section V above, the NERTO will fully satisfy the independence requirements of Order No. 2000.

B. Characteristic No. 2 — Scope and Configuration

The Commission's RTO regulations prescribe that an RTO must "serve an appropriate region" that is "of sufficient scope and configuration to permit the [RTO] to maintain reliability, effectively perform its required functions, and support efficient and non-discriminatory power markets."[49] Order No. 2000 articulated a number of "boundary evaluation" and "regional configuration" factors that the Commission would consider when reviewing RTO scope proposals.[50] In practice, the Commission has focused predominantly on the question of whether a proposed RTO serves a "natural market"[51] although it has not yet developed a rigorous definition of "natural market." A detailed discussion of natural market issues is contained in Section B.2.

(...continued)

61,187 (2001); *Midwest Indep. Transmission Sys. Operator, Inc.*, 97 FERC ¶ 61,326 at 62,505-06 (2001).

48 *See, e.g., Midwest Indep. Transmission Sys. Operator, Inc.*, 97 FERC ¶ 61,326 at 62,505 (2001).

49 18 C.F.R. § 35.34(j)(2) (2002).

50 Order No. 2000 at 31,081-85.

51 *New York Indep. Sys. Operator, Inc., et al.*, 96 FERC ¶ 61,059, 61,189 (2001); *Bangor Hydro-Elec. Co., et al.*, 96 FERC ¶ 61,063, 61,254 (2001); *Southwest Power Pool, Inc.*, 96 FERC ¶ 61,062, 61,251 (2001); *PJM Interconnection, LLC*, 96 FERC ¶ 61,060, 61,211 (2001).

The NERTO will fully meet the scope and configuration requirements. The NERTO region will have a peak load of approximately 56,150 MW, 63,300 MW of generating capacity, 18,800 miles of transmission lines, 14 million electric customers and a population of 33 million people. The NERTO will be substantially larger than the GridSouth RTO,[52] which was previously conditionally approved by the Commission. The NERTO would also be comparable in size to the proposed SETrans RTO.[53]

Moreover, as is demonstrated below, a review of the factors that the Commission has stated it would consider when evaluating scope and configuration illustrates the NERTO's compliance with Order No. 2000's requirements.[54] Specifically:

- ***"Perform essential RTO functions and achieving RTO goals"***

> The NERTO will perform all of the required RTO functions and will administer markets that reflect the Commission's principles. As Order No. 2000 requires, the NERTO's configuration will permit it to "ensure non-discrimination and enhance efficiency in the provision of transmission and ancillary services, maintain and enhance reliability, encourage competitive energy markets,

---

52 The proposed GridSouth RTO would cover an area of roughly 65,000 square miles with approximately 34,000 MW of connected peak load and 22,000 miles of transmission lines. *See RTO Compliance Filing of Carolina Power & Light Company, et. al.*, Docket No. RT01-74-000 at 39 (October 16, 2000).

53 SETrans, excluding the regions currently encompassed by the proposed GridSouth and GridFlorida RTOs, would encompass 74,453 MW of generation, 54,006 miles of transmission facilities rated at 44 kv or higher and 309,065 square miles of territory. *See* <http://www.setransgrid.com/fact.htm>.

54 While the Commission's more recent orders appear to focus almost exclusively on a single boundary evaluation factor, *i.e., "recognize trading patterns,"* Order No. 2000 unequivocally states that "it would not be appropriate to identify any one factor as the single most important," Order No. 2000 at 31,085, and that "assessing the appropriateness of a region's configuration will require balancing factors and a flexible approach." *Id.* at 31,083.

promote overall operating efficiency and facilitate efficient expansion of the transmission grid."[55]

- ***"Encompass a contiguous geographic area"***

  The NERTO will encompass a single, contiguous area. It will include all of the transmission-owning utilities in the region, including owners that are not subject to the Commission's jurisdiction.

- ***"Encompass a highly interconnected portion of the grid"***

  The NERTO will encompass the control areas currently operated by ISO-NE and the NYISO. The ISOs currently operate highly integrated and interdependent grids that have a long history of successful coordination and cooperation. Both ISO grids are also operated under the same NPCC reliability standards.

- ***"Deter the exercise of market power"***

  The NERTO Market will not be dominated by a small group of suppliers or manipulated by entities exercising control over a critical transmission corridor. In addition, the NERTO will make efficient use of its market power monitoring and mitigation tools, and will ensure that the SMD 2.X market design has effective mitigation features.

- ***"Recognize trading patterns"***

  The characteristics of, and interconnections between, the ISO-NE and NYISO, based on many years of interregional cooperation through the NPCC, provide a strong foundation for a successful market. First, the New England and New York systems have been restructured in a similar manner (*e.g.*, utilities in both regions have divested a major portion of their generating units, and retail access is widespread in both regions). Second, a diverse balance of peaking, intermediate, and baseload generating units in New England and New York will be available to the NERTO. For example, New York has a surplus of quick-start peaking units which are in short supply in New England, while New England is adding substantial new baseload and intermediate capacity. This complementary generating capacity makes New England and New York natural trading partners and increases the market and

---

[55] Order No. 2000 at 31,083-84.

reliability benefits associated with creating an RTO for the combined region. This will provide opportunities for more efficient system operations, better market balance, and cost savings to customers. Third, a comprehensive regional system planning process will identify efficient transmission expansion projects based on a broad Northeast-wide outlook that includes the effects of Canadian imports. Finally, there is already substantial trade between New England and New York, and among the NPCC regions, and this trade is expected to grow substantially in the future.

- ***"Take into account existing regional boundaries (e.g., NERC regions)"***

  The NERTO will not "disrupt existing useful institutions." In particular, both ISO-NE and the NYISO are NPCC members and the NERTO will likewise become a NPCC member. Moreover, the NERTO will encompass two regions with a long history of successful tight power pool operations.

- ***"Encompass existing regional transmission entities and control areas"***

  The NERTO will encompass the existing ISOs as well as the existing New England and New York control areas.

- ***"Take into account international boundaries"***

  The NERTO proposal recognizes that the natural market in the Northeast does not stop where the Commission's jurisdiction ends. Beyond market efficiency, reliability in New England and New York is heavily dependent on Canadian supplies. The Petitioners are therefore making, and the NERTO will continue to make, every effort to bring the Canadian provinces into a seamless NPCC Common Market with New England and New York.

- ***"Accurate and reliable ATC determinations"***

  The NERTO will permit accurate regional ATC and TTC calculations. The adoption of NPCC Common Market and a standardized market design across the Eastern Interconnection will help the NERTO by eliminating operational and market discrepancies that lead to the calculation of inconsistent ATCs and TTCs. Moreover, the accuracy of the NERTO's calculations will be enhanced by the NERTO's participation in an NPCC and MAAC-wide ATC/TTC posting initiative.

- ***"Resolve loop flow issues"***

The NERTO's congestion management system will address loop flows within its region, and the NERTO's participation in various inter-regional bodies, such as the Lake Erie Security Process Working Group, will enable it to effectively address inter-regional flows.[56]

- ***"Manage transmission congestion"***

  The NERTO will effectively manage congestion through the use of LMP systems.

- ***"Offer transmission service at non-pancaked rates"***

  Subject to approval by the Commission, existing inter-ISO "border" transmission charges for transactions between New England and New York will be eliminated. These changes will have a significant positive impact on the market efficiency of the entire super-region.

- ***"Improve operations"***

  The mix of New England and New York generating resources (peaking, intermediate, and base load) that will be available to the NERTO will offer the opportunity for efficiencies in the unit commitment and dispatch process, permit greater reserve sharing and result in more reliable operations. In addition, establishing the NERTO will reduce the number of OASIS sites in the Northeast, consolidate expertise, better allocate scarce transmission capacity across the region, enhance cooperation with Canadian system operators and facilitate the operation of a larger, more efficient market.

- ***"Transmission planning"***

  The NERTO will have an efficient, integrated system expansion planning process and a comprehensive interconnection process. The NERTO processes will be coordinated with those in neighboring NPCC Canadian provinces, as well as in PJM.

As demonstrated above, the NERTO's scope and configuration are appropriate and fully compliant with Order No. 2000's standards.

---

[56] The recently signed New York/PJM agreement provides an additional interim vehicle for resolving "loop flow" and other seams issues.

Moreover, Order No. 2000 invited RTO applicants to propose "flexible and innovative ways" to achieve sufficient scope. The Commission has stated that "an RTO may be able to achieve sufficient 'effective scope' by coordination and agreements with neighboring entities ..." that result in the creation of a "seamless trading area."[57] Consequently, the Commission required an RTO applicant that proposes to rely on "effective scope" mechanisms to "demonstrate that the arrangement it proposes to eliminate the effect of seams is the practical equivalent of eliminating the seams by forming a larger RTO."[58]

The NERTO's coordination arrangements with neighboring Canadian system operators and PJM and the implementation of a standardized market design will expand its "effective scope" and make the NERTO the "practical equivalent" of a larger RTO. A common market consisting of the NERTO, Ontario and New Brunswick, which is likely to be achieved first, would encompass a total of 98,000 MW of generation, a peak load of 86,000 MW, and a population of approximately 45 million people. Ultimately, a NPCC Common Market spanning the NERTO, Ontario and the remainder of the NPCC would further increase these figures. Having a common market, common commercial practices and highly similar tariffs will permit the NERTO and neighboring Canadian system operators to establish a "seamless trading area."

Finally, the Commission's national RTO cost-benefit study[59] confirmed that the size of RTOs had much less to do with creating consumer benefits than market design, market

---

57 Order No. 2000 at 31,083.

58 Id.

59 Economic Assessment of RTO Policy, Prepared for the Federal Energy Regulatory Commission by ICF Consulting (February 26, 2002) ("FERC Assessment"); see also Additional Information Regarding the Economic Assessment of RTO Policy Report released February 27, 2002. Prepared for the Federal Energy Regulatory Commission by ICF Consulting (March 21, 2002).

performance and scheduling improvements. The study suggested that this was particularly true in the Northeast since the economic benefits associated with combining ISO-NE, the NYISO, PJM and the Virginia Electric and Power Company in a single RTO were not significantly greater than the benefits that would be expected if the three existing ISOs were left in place.[60]

1. NERTO Economic and Reliability Assessment

The ISOs conducted a comprehensive Economic and Reliability Assessment which demonstrates that forming the NERTO and the NERTO Market would bring net economic benefits to the region. The complete analysis is appended to this Petition as Attachment X.

The Assessment was conducted using the General Electric Multi-Area Production Simulation ("GE-MAPS") model, which simulated the market scheduling and dispatch system actually used in New England and New York, and the GE Multi-Area Reliability Simulation ("MARS") model. The GE-MAPS model was also used by PJM and the RTO West sponsoring utilities to conduct their own RTO cost-benefit analyses. The Assessment considered the potential benefits associated with: (i) eliminating inter-ISO seams and establishing a NERTO Market design, based on the Commission's standardized market design, with common scheduling rules and procedures; (ii) eliminating inter-ISO access charges; (iii) implementing a single regional unit commitment and dispatch; and (iv) increasing resource diversity and reserve sharing.

The Assessment focused on two base years, 2005 and 2010. The year 2005 was chosen because this would be the earliest year in which a single dispatch could be implemented. The year 2010 was chosen so that the Assessment would reflect changes in the expected benefits over

---

60 *See* FERC Assessment at 74, 76.

time. As is described in greater detail in Attachment X, the Assessment used a "hurdle rate" approach similar to the one adopted by ICF Consulting in the national RTO cost/benefit analysis that it conducted for the Commission. The principal assumptions used for the computer modeling analysis and the various scenarios and sensitivity cases considered were developed through a collaborative stakeholder process which was initiated by the ISOs in February 2002. All of the assumptions, scenarios and sensitivity cases are discussed in detail in Attachment X.

The Assessment indicates that the region as a whole would experience economic benefits by combining New York and New England. In the earlier year (2005), the Assessment predicts that New York would experience savings, while New England would experience relatively small increases in wholesale power costs. This is expected to occur, in part, because, under NERTO, New York would have a greater ability to import less-expensive power from New England. In the later year (2010), the relatively small cost increases to New England are expected to become small savings, principally because the development of new generation in New York should cause prices to equalize between the areas. In turn, the savings to New York as a result of forming NERTO would decrease over time. The Assessment also shows that, if the region experiences significant fuel price increases, New England's initial cost increases would be mitigated slightly, and its positive benefits would increase slightly in the later years.

The Assessment also analyzed an alternative RTO configuration that included ISO-NE, the NYISO and PJM. The Assessment concludes that, with this alternative configuration, New York, New England and PJM collectively would realize slightly lower regional savings in 2005 compared with the savings realized by New York and New England in the New York – New England configuration, and substantially lower corresponding regional savings in 2010. New York would experience higher savings if PJM were included in the RTO. New England would

also experience a smaller wholesale market cost increase in 2005, and greater savings in 2010. PJM, however, would experience larger wholesale power cost increases if it were part of the same RTO as ISO-NE and the NYISO than it would under the NERTO scenario. These cost increases and savings are relatively modest when compared to the dollar volume of transactions in the Northeastern energy markets.

The Assessment also examines the administrative savings and organizational synergies that could be expected as a result of the NERTO's formation as well as the likely implementation costs. Administrative and capital cost savings are likely to be small in the near term because they will be essentially offset by transitional costs associated with the consolidation of operations and investments in new technology. In the longer term (starting in 2007), administrative and capital cost savings in the range of $35 – 65 million per year are anticipated.

The Assessment also evaluates the effect of the NERTO's creation on SO_2 and NOx emissions, finding that it would be small. In addition, the Assessment addresses a variety of qualitative benefits that the establishment of the NERTO is expected to bring, such as enhanced reliability.

The Assessment forecasts a regional benefit arising from the creation of the NERTO.[61] It also forecasts that New York will initially receive a benefit and New England will initially incur a cost. The study is based on estimates of future events and economic conditions. Actual results may differ from those presently forecast. The NERTO Board will periodically review actual

---

[61] Moreover, the Assessment is consistent with PJM's own cost-benefit analysis which concluded that the best scenario for all three ISO regions would be for ISO-NE and the NYISO to combine while PJM focuses on closer integration with systems to its west.

results and, subject to applicable regulatory approvals, adopt measures to avoid significant economic disadvantage to either part of the NERTO region.

The independent market adviser to the ISOs, Dr. David B. Patton, has reviewed the validity of the assumptions and methods underlying the Assessment. His review, provided in the affidavit in Attachment XI to this Petition, concludes that the assumptions and methods utilized in the Assessment are reasonable and appropriate for estimating the benefits of forming the NERTO, although some classes of qualitative benefits could not be captured by the Assessment. Dr. Patton discusses the qualitative benefits in the remaining portion of his affidavit, addressing the scope of NERTO.[62]

2. The NERTO Proposal Encompasses a Natural Market

The NERTO proposal encompasses a "natural market" which may be linked to RTO scope determinations.

By way of background, New England and New York are tightly interconnected and trade extensively with each other.[63] The bulk power transmission systems in New England and New York possess similar and complementary attributes. Both areas are densely populated. Each has a tradition of successful tight power pool operation and a major load center that faces severe locational congestion problems. Both regions have required transmission-owning utilities to divest most or all of their generating facilities and have adopted retail competition programs. The two regions also have complementary generation portfolios. In addition, because prices in

---

62 *See* Section VIII.B.2 below.

63 For example, there were 6,089,866 MWh of transactions between New York and New England in 2000.

New England and New York are generally similar, transactions between them play an important price arbitraging role and improve efficiency.

New England and New York are also closely integrated with the NPCC portion of Canada. There is extensive trade between them, and Canadian supply is essential to reliability and market efficiency in the Northeastern United States. New England, New York and the NPCC portions of Canada have also worked together to develop regional reliability standards and operating procedures to improve reliability.

Dr. Patton's affidavit (Attachment XI) assesses whether the combination of the New York and New England regions constitutes a natural market, and finds that it does. In his affidavit, Dr. Patton suggests that natural markets should be defined by identifying geographic areas where having a single RTO operation, rather than multiple RTOs, would generate significant efficiency benefits while minimizing diseconomies of scale.

Dr. Patton identifies three attributes of a natural market in the context of RTO formation. First, a natural market is present when RTO formation in the region can improve the efficiency of flows – i.e., the dispatch of energy and reserves – through single market operation. In adjacent areas where one area enjoys a cost advantage over the other due to differences in the costs of supplies, relatively large transactions will be scheduled when transmission is available, even in the absence of a single RTO spanning those two areas. By contrast, New York and New England rely on similar portfolios of generation and capacity margins. In these circumstances, arbitrage of price differences would be materially aided by the NERTO's facilitation of transactions through a single market. While these transactions may well be smaller individually, and less predictable in flow direction, they can have a significant cumulative value.

Second, Dr. Patton finds that a natural market is present where a single RTO market improves commitment efficiencies and the management of operating reserves. Dr. Patton finds that NERTO's formation would allow for a reduction in the total operating reserves for the two ISO areas. Consolidated procurement of operating reserves for the combined New York – New England region would also produce savings because the designation of operating reserves can be optimized through the region (subject to locational requirements). This could result in one of the subregions carrying a much larger share of the region's operating reserves than is possible today. New York would likely hold additional reserves for the region since peaking resources (of which New York has more than New England) are generally relied on to provide a significant share of 10-minute operating reserves. Improved reserve optimization will have energy market benefits as well, because resources are made available to the energy market that would otherwise have been designated to provide operating reserves under the regimes of the existing ISOs.

Third, Dr. Patton finds that NERTO formation should improve management of the Northeast's significant imports from Canada. As a preliminary matter, Dr. Patton notes that the ISOs have signed agreements with the market operators in Ontario and New Brunswick to work together to coordinate the development of the respective markets and facilitate trading throughout the NPCC. He finds that these agreements promise benefits to the entire region as the wholesale power markets develop throughout the NPCC. In particular, QuJbec is interconnected with both New York and New England in a variety of locations. Currently, each ISO individually limits the imports from QuJbec below the physical capability of the interfaces to ensure system reliability. A substantial share of the imports into New York is actually wheeled to New England. NERTO formation will allow the RTO to coordinate and maximize

the imports across each of these interfaces, with attendant economic and reliability benefits for both New England and New York.

Dr. Patton also notes that extremely large RTO regions may result in diseconomies that would be inconsistent with natural market characteristics. Such diseconomies can arise as operators are compelled to use increasingly conservative assumptions in operating the transmission system and thereby reducing the utilization of the transmission capability. However, Dr. Patton finds that the NERTO region is not likely to exhibit these diseconomies, given its size.

In summary, Dr. Patton concludes that the NERTO region encompasses a natural market.

C. Characteristic No. 3 — Operational Authority

The Commission's RTO regulations specify that an RTO "must have operational authority for all transmission facilities under its control"[64] and must be the security coordinator for the facilities that it controls."[65] In addition, the regulations require that "if any operational functions are delegated to, or shared with, entities other than the [RTO], the [RTO] must ensure that this sharing of operational authority will not adversely affect reliability or provide any market participant with an unfair competitive advantage."[66] If an RTO delegates or shares operational authority with another entity, it "must prepare a public report that assesses whether any division of operational authority hinders the [RTO] in providing reliable, non-discriminatory and efficiently-priced transmission service."[67]

---

64 18 C.F.R. § 35.34(j)(3) (2002).

65 18 C.F.R. § 35.34(j)(3)(ii) (2002).

66 18 C.F.R. § 35.34(j)(3)(i) (2002).

67 *Id*.

The proposed NERTO will comply with these requirements.

1. The NERTO's Operational Authority Will Satisfy Order No. 2000's Requirements

The NERTO will exercise day-to-day operational authority over all of the bulk power transmission facilities that are currently controlled by the ISOs. The NERTO will therefore have "operational authority for all transmission facilities under its control" and will satisfy Order No. 2000's operational authority requirement. For purposes of NERC's new functional model, the NERTO will be the "Reliability Authority" for all bulk power system facilities in its region. The NERTO will also be responsible for all operating procedures and operating guides that affect grid reliability and market efficiency in the region it will serve.

NERTO's operational authority over the bulk power systems in New England and New York will be through the dispatch of all interconnected generation and indirect hierarchical control over the region's high voltage transmission facilities. Order No. 2000 clearly establishes that the hierarchical, master-satellite local control center arrangements that both ISOs currently use, and the NERTO will employ,[68] are acceptable, provided that the RTO has "clear authority to direct all actions that affect the facilities under its control."[69] The NERTO will have this authority and will thus comply with Order No. 2000.

2. The NERTO Will Be the Security Coordinator for All Transmission Facilities Under Its Control

The NERTO will be the security coordinator for the entire NERTO region. It will assume these responsibilities from the ISOs, which are currently the security coordinators for

---

[68] Hierarchical control in New England is conducted through master-satellite arrangements. In New York, it is accomplished through local control centers operated by TOs subject to NYISO direction.

[69] Order No. 2000 at 31,091.

their respective control areas.[70] The NERTO's security coordination responsibilities will be clearly stated in the NERTO's OATT. Like the existing ISOs, the NERTO will satisfy the NERC Security Coordinator Standards of Conduct, including the independence requirement.[71] In addition, although Order No. 2000 does not require RTOs to perform control area functions, the proposed NERTO will assume all of the control area functions that are currently performed by ISO-NE and the NYISO.

D. Characteristic No. 4 — Short-Term Reliability

The Commission's RTO regulations specify that an RTO "must have exclusive authority for maintaining the short-term reliability of the grid that it operates."[72] Order No. 2000 defines "short-term reliability" responsibilities as encompassing "all transmission reliability responsibilities short of grid capacity enhancement," and ranging from real time to the planning horizon.[73] To satisfy this requirement, an RTO must: (i) have exclusive authority for receiving, confirming and implementing all interchange schedules; (ii) have the right to order redispatch of any generator connected to transmission facilities over which it has operational authority, if necessary, for reliable operations; (iii) to the extent that it operates transmission facilities owned by other entities, have authority to approve or disapprove all requests for scheduled outages of transmission facilities to ensure that the outages can be accommodated within existing reliability

---

70 With respect to ISO-NE's security coordinator status, *see* ISO Agreement § 6.01. With respect to the NYISO's security coordinator status, *see Central Hudson Gas & Electric Corp., et. al.,* 83 FERC ¶ 61,352 at 62,414 (1998); *Bangor Hydro-Elec. Co., et al.,* 96 FERC ¶ 61,063 at 61,259 (2001).

71 The NERC Security Coordinator Standards of Conduct are posted at http://ftp.nerc.com/pub/sys/all_updl/oc/opman/scstandardsofconduct.pdf.

72 18 C.F.R. § 35.34(j)(4) (2002).

73 Order No. 2000 at 31,103.

standards; and (iv) to the extent that it operates under reliability standards established by another entity, for example, a regional reliability council, report to the Commission if those standards hinder it from providing reliable, non-discriminatory and efficiently-priced transmission service.[74]

The NERTO will comply with these requirements, and will be responsible for maintaining the short-term system reliability of the New England and New York control areas. The NERTO OATT will expressly empower the NERTO to receive, confirm and implement all interchange schedules and to coordinate interchange schedules with neighboring RTOs and control areas. As the operator of the two Northeastern control areas, the NERTO will balance generation and load and re-dispatch all generation that bids into its energy markets or that participates in bilateral transactions involving a NERTO control area. The NERTO will also have authority to coordinate maintenance schedules and approve outage schedules for bulk power transmission and generation facilities that are under its operational control.[75] Finally, because the NERTO will operate under reliability standards established by NERC, the NPCC and other reliability organizations with jurisdiction, if any, it will monitor the effects of these standards and will inform the Commission if it concludes that they are hindering its ability to provide efficient, reliable transmission service.

As a member of the NPCC, the NERTO will participate in the NPCC's Reliability Compliance and Enforcement Program and on the Compliance Monitoring and Assessment Subcommittee. These activities will help to ensure that the NERTO fulfills its short-term

---

74 18 C.F.R. § 35.34(j) (i) – (iv) (2002).

75 NERTO transmission owners will be permitted to schedule outages on any transmission facilities that are not subject to the NERTO's control but must notify the NERTO when they do so.

reliability responsibilities and that NPCC reliability policies evolve in a way that is compatible with the creation of the NPCC Common Market.

E. Function No. 1 — Tariff Administration and Design

The Commission's RTO regulations require that an RTO "must administer its own transmission tariff and employ a transaction pricing system that will promote efficient use and expansion of transmission and generation facilities."[76] An RTO "must be the sole administrator of its own Commission-approved open access transmission tariff," and have "sole authority to receive, evaluate and approve or deny all requests for transmission service."[77] The Commission has subsequently clarified that, if an RTO shares Section 205 filing rights, the RTO does not satisfy the independence requirement.[78] In addition, RTOs "must have the authority to review and approve all requests for new interconnections."[79] Order No. 2000-A clarified that, among other things, this requirement means that RTOs must provide "one-stop shopping" for merchant generators that seek to connect to the grid without separately obtaining transmission service."[80] Finally, "[c]ustomers under the [RTO] tariff must not be charged multiple access fees for the recovery of capital costs of transmission service over facilities that the [RTO] controls."[81]

The NERTO will comply with all of these requirements.

---

76 18 C.F.R. § 35.34(k)(1) (2002).

77 18 C.F.R. § 35.34(k)(1)(i) (2002).

78 *New York Indep. Sys. Operator, Inc., et al.*, 96 FERC ¶ 61,059, 61,193 (2001); *Bangor Hydro-Elec. Co., et al.*, 96 FERC 61,063, 61,257-59 (2001).

79 18 C.F.R. § 35.34(k)(1)(i) (2002).

80 Order No. 2000-A at 31,376 ("We also agree with Dynegy that new generators should not have to negotiate separately with the RTO and individual transmission owners. We expect one-stop shopping under any RTO.")

81 18 C.F.R. § 35.34(k)(1)(ii) (2002).

1. The NERTO Will Be the Sole Administrator of its Own Open Access Transmission Tariff, Will Have the Exclusive Right to Amend it Under FPA Section 205 and Will Employ an Efficient Transaction Pricing System

The NERTO will be the sole administrator of a single open-access transmission tariff for New England and New York and shall, with the one exception described in Section IX below,[82] possess sole authority to receive, evaluate and approve, or deny, all requests for transmission service. The NERTO will likewise have sole responsibility for filing tariff and market rule amendments, pursuant to FPA Section 205. The NERTO tariff will provide "Network Access" transmission service, employ an LMP congestion management system and support the Commission's standardized market design.[83] The NERTO will thus employ a transaction pricing system that will promote efficient use and expansion of transmission and generation facilities.

To the extent required by Commission policy, the NERTO tariff will govern all wholesale and retail transmission service within the NERTO region.

2. The NERTO Will Provide One-Stop Shopping for New Interconnections

The ISOs have worked with regional stakeholders to develop a proposed NERTO interconnection process that combines the best features of the Commission-approved ISO-NE and NYISO interconnection rules. This process would govern the interconnection of new generating projects, merchant transmission facilities and other system upgrade facilities in

---

[82] The Petitioners describe a special NYISO operational protocol that they propose to adopt for the NERTO in order to permit LIPA to participate in the NERTO without losing its tax-exempt financing status. This protocol would give LIPA limited responsibility for scheduling transactions over non-jurisdictional transmission facilities funded with tax-exempt bonds in order to preserve their status.

[83] The Petitioners have not supplied a draft tariff with this filing in recognition of the need for additional stakeholder input, Commission guidance in response to this filing and the pendency of the proposed *pro forma* Network Access Tariff.

compliance with a "Minimum Interconnection Standard," as described in Section VIII.E.2.b., below. It would be effective on the first day of NERTO operations for all new projects and would include appropriate grandfathering provisions, described below, in order to accommodate projects already in the existing New England or New York queues. A full description of this process is appended hereto as Attachment VI and a summary is provided below.

a. Proposed System Impact Study Procedures

For purposes of determining priority for conducting or reviewing a System Impact Study ("SIS") for an Interconnecting Project ("IP"),[84] the NERTO will give priority to each interconnection proposal based on the date its application was submitted to the NERTO. During the initial transition period following the start of NERTO operations, the ISOs' existing study queues will be merged according to the original date of submittal to the respective ISO.

The SIS will be performed to evaluate the impact of the requested service on the reliability and operating characteristics of the bulk power system, consistent with:

- Good utility practice;
- NERC standards, guides, and procedures;
- NPCC criteria and guidelines;
- New England criteria, rules, procedures, and reliability standards for New England interconnections;
- New York criteria, rules, procedures, and reliability standards for New York interconnections;
- Applicable requirements of the NERTO Tariff;
- Any additional applicable guides, standards, and criteria of the impacted TO(s), as accepted by the NERTO; and

---

[84] An IP is a generating unit, merchant transmission project, or any system upgrade facility.

- Other applicable guidelines and standards that may need to be incorporated by the NERTO from time to time.

As such, the study will examine the impact on the NERTO regional power system, its component systems and on neighboring and external systems. The SIS will identify if the requested interconnection service can be provided without adverse impact on the reliability and operating characteristics of the system. The study will also identify whether modification of the system is necessary to provide the requested service.

b. The Proposed Minimum Interconnection Standard

Following a brief transition period, the SIS will apply the existing ISO-NE "Minimum Interconnection Standard." That is, the IP will be required to interconnect in a manner that avoids any significant adverse effect on system reliability, stability, or operability, including protecting against the degradation of transfer capability affected by the IP that remains after re-dispatch under system conditions, as currently specified in the NEPOOL OATT.

c. Proposed Cost Allocation Rules

IPs will be responsible for the cost of their direct attachment facilities. An IP's share of System Upgrade Facilities ("SUF"), or "but for," cost will be determined in a "class year study" of the type currently used by the NYISO. The class year study will be conducted annually in conjunction with the development of the NSP. To be included in the class year study or to be reflected in the NSP baseline, an IP must have its SIS completed and approved by the NERTO and must have met the appropriate state or local regulatory milestones, or the equivalent, as established by the NERTO in consultation with the Planning Advisory Committee (*e.g.*, an accepted milestone in a State's siting process) by March 1 of each year. In the class year process, the cost of SUF will first be allocated between IPs and TOs, and then the IPs' share of

the cost will be allocated between each individual IP on the basis of an Annual Transmission Baseline Assessment.

d. Facilities Studies and Interconnection Agreements

Upon acceptance of the cost responsibilities determined through the cost allocation process described above, the IP will enter into a facilities study ("FS") agreement which will provide the detailed design, engineering and final cost estimates for the direct attachment facilities and any system upgrade facilities. Simultaneously with the conduct or completion of the FS, the IP will enter into the appropriate interconnection agreements ("IA") with the interconnecting TO(s). The purpose of the IA is to establish and provide the security, credit assurances and/or deposits that the NERTO and the TO(s) determine are necessary to ensure payment for direct attachment facilities and SUFs.

e. Transition Rules

Transition rules are proposed to preserve existing expectations of IPs already in the ISOs' interconnection queues. If the start-up date of the NERTO occurs on or before March 1 in any given year, applicants with pending interconnection applications in New England and New York will have until the second March 1 following commencement of NERTO operations to complete the interconnection process under the criteria and rules in effect in New England and New York, respectively, immediately before commencement of NERTO operations.

If the effective date of the NERTO occurs after March 1 of any given year, applicants with pending interconnection applications in New England and New York will have twelve months from the date of commencement of NERTO operations to complete the interconnection process under the criteria and rules in effect in New England and New York, respectively, immediately before commencement of NERTO operations.

After the transition period, all units will be subject to the NERTO's criteria and rules.

3. Elimination of Existing Inter-ISO Transmission Access Charges

As described in Section V.G.1.c above, the NERTO's Tariff will address the elimination of border charges for transactions across the NERTO region.

F. Function No. 2 — Congestion Management

Pursuant to the Commission's regulations, an RTO "must ensure the development and operation of market mechanisms to manage transmission congestion."[85] These market mechanisms "must accommodate broad participation by all market participants, and must provide all transmission customers with efficient price signals that show the consequences of their transmission usage decisions."[86] RTOs must either operate these markets themselves or ensure that the task is performed by another independent entity.[87] RTOs must have market-based congestion management mechanisms in place within one year of their commencement of operations. If an RTO will not have market mechanisms on its start-up date it must have "an effective protocol for managing congestion" in place during the interim.[88]

Order No. 2000 emphasized that "congestion pricing proposals should seek to ensure that: (1) the generators that are dispatched in the presence of transmission constraints are those that can serve load at least-cost; and (ii) limited transmission capacity is used by market participants that value that use most highly."[89] Order No. 2000 identified LMP-based congestion management systems, coupled with financial rights for firm transmission service, as a "sound

---

85 18 C.F.R. § 35.34(k)(2) (2002).

86 *Id* at (k)(2)(i).

87 *Id*.

88 18 C.F.R. § 35.34(k)(2)(ii) (2002).

89 Order No. 2000 at 31,126; *See also* Order No. 2000-A at 31,376.

framework for efficient congestion management"[90] but did not mandate its use. Subsequent to Order No. 2000, the Commission has proposed the use of LMP-based congestion management systems.

Upon the completion of a transition period, the NERTO will implement a single LMP system with financial transmission rights to manage congestion in New England and New York. It will therefore comply with the Commission's RTO requirements. The NERTO's LMP system will be based on the "SMD 1.0" version of LMP that is currently being developed by ISO-NE and on the NYISO's LMP system. ISO-NE expects to implement SMD 1.0 in New England by the first quarter of 2003, assuming Commission approval. The NERTO's LMP system will supplant the NYISO's existing LBMP congestion management system.

Consistent with Order No. 2000, the NERTO will operate the LMP system itself, independent of market participants. The NERTO's LMP will be consistent with the Commission's standardized market design. It will thus be essentially identical to the LMP systems that will be used in the rest of the Eastern Interconnection. In addition, the ISOs and, ultimately, the NERTO will work with neighboring NPCC Canadian system operators to make their congestion management systems as much like the NERTO's as possible in order to help create an NPCC Common Market.

The ISOs' market implementation proposal provides that the NERTO will initially operate separate New England and New York markets. During that transitional period, the

---

[90] Order No. 2000 at 31,127.

NERTO markets will have separate, though very similar, congestion management systems.[91] By the first quarter of 2003, a LMP-based "SMD 1.0" congestion management system will be in place in New England while New York will still be operating the NYISO's current LMP-based system. Likewise, starting in approximately the first quarter of 2004, New York will have implemented a "SMD 2.0" congestion management system that is even more similar to, but still slightly different than, the SMD 1.0 version that will be in place in New England. Nevertheless, because the systems used in New England and New York will be so similar, and because the two regions are in the process of transitioning to an identical market design, this arrangement will not impede inter-regional trade. Moreover, because both regions will be using LMP-based congestion management systems, the NERTO as a whole will be in compliance with Order No. 2000's requirements during the transition period.

Alternatively, the ISOs ask that the Commission consider the NERTO's interim administration of separate but similar LMP systems to be "an effective protocol for managing congestion" during the transition. The Commission has previously indicated that it might allow an RTO to use a non-LMP based congestion management tool on an interim basis while the RTO moved to adopt an SMD-based market design.[92] It is therefore appropriate to allow the NERTO

---

91 *See* Section VI and Attachment VIII for a description of the market design implementation timetable, including the length of the NERTO's transition from two congestion management systems to one.

92 *See, e.g., Midwest Indep. Transmission Sys. Operator, Inc*., 97 FERC ¶ 61,326 at 62,513 (2001) (stating that the Commission would consider relaxing the deadline for the Midwest Independent System Operator (the "MISO") to implement market-based congestion management mechanisms given the amount of time that would be required to implement the Commission's standardized market design).

to retain two separate, but very similar, LMP-based congestion management systems during the transition to the NERTO Market.[93]

G. Function No. 3 — Parallel Path Flows

The Commission's RTO regulations require that an RTO "must develop and implement procedures to address parallel path flow issues within its region and with other regions."[94] RTOs must have procedures to deal with internal parallel path flows at the time that they commence operations and must have procedures in place to address parallel path flows involving other regions within three years of commencing operations.[95]

1. Parallel Path Flows Inside the NERTO

The NERTO will address parallel path flows in its own region through its administration of a regional LMP congestion management regime.[96] The NERTO's greater scope will give it a greater capability than either ISO-NE or the NYISO currently has to make scheduling and

---

93 The Commission has previously expressed concern that the NYISO's current LBMP congestion management system is excessively "inward-focused" and did not "address the need for more interregional coordination in the solution to congestion management." Several of the factors that caused the Commission concern in the past have already been addressed by the NYISO. *See New York Independent System Operator, Inc.*, 100 FERC ¶ 61,122 (2002) (accepting tariff changes to allow for the deliverability of energy from the New York Control Area by generators providing ICAP to external control areas); *New York Independent System Operator, Inc.*, 98 FERC 61,189 (2002) (approving "pre-scheduling" of inter-control area energy transactions involving New York). They will therefore not pose problems even during the NERTO transition. Furthermore, the NERTO will ultimately administer a LMP congestion management system that will reflect the Commission's SMD principles and will thus be compatible with the congestion management systems that will be implemented in neighboring regions.

94 18 C.F.R. § 35.34(k)(3) (2002).

95 *Id*.

96 As noted above, prior to the implementation of a single regional congestion management system, the NERTO will address parallel path flows in New York and New England by operating separate LMP systems in each region.

redispatching decisions that minimize parallel path flow effects in New England or New York. The creation of a NPCC Common Market with neighboring Canadian provinces, and close coordination between the NERTO and PJM, will enhance the effectiveness of the NERTO's internal parallel path flow management procedures.

2. Parallel Path Flows Outside of the NERTO

Outside of the NERTO's own region, the most significant parallel path flow in the northern portion of the Eastern Interconnection is the Lake Erie loop flow, which has a substantial effect in New York.[97] The NERTO will succeed the NYISO as a signatory to the latest version of the Lake Erie System Redispatch Agreement ("Lake Erie Agreement")[98] along with the other control area operators surrounding Lake Erie, *i.e.*, American Electric Power Co., FirstEnergy, Michigan Electric Coordinating Systems, the IMO, the International Transmission Company, and PJM. The Lake Erie Agreement establishes a market-based interregional operational process to facilitate transmission congestion management among the Lake Erie control areas and avoid transmission loading relief ("TLR") curtailments and load shedding. Under the agreement, signatories will assist each other by engaging in intra- or inter-Control Area redispatching, reconfigurations of the transmission systems and/or phase angle regulator

---

97 New England is not substantially affected by the Lake Erie circulation or any other parallel path flow external to New England. Most of New England's interconnections with Canada are DC ties, which prevent parallel path flow problems. Moreover, New England's AC interconnections with New York expose New England to relatively limited parallel path flows.

98 Filed on August 12, 2002 in Docket No. ER02-2459-000. *See also Northeast Power Coordinating Council*, 92 FERC ¶ 61,209 (2000) (accepting revisions to existing Lake Erie Emergency Redispatch ("LEER") procedures for Summer 2000); *North American Electric Reliability Council*, 87 FERC ¶ 61,160 (1999) (accepting LEER procedures); *North American Elec. Reliability Council*, 85 FERC ¶ 61,353 (1998) (accepting previous Lake Erie procedures).

("PAR") adjustments in order to maintain transactions when possible. In addition, the new Ontario-Michigan PARs will greatly reduce loop flows around Lake Erie, so that the NERTO will essentially become radial to the rest of the Eastern Interconnection.

Furthermore, the NERTO will succeed the NYISO as a participant in the Lake Erie Security Process Working Group ("LESPWG"). The LESPWG is working to improve Lake Erie flow management by identifying the responsibilities of affected control areas and by offering guidance regarding flow conditions. The LESPWG's eventual goal is to establish non-emergency inter-regional parallel path flow management. The NERTO will continue to work with the LESPWG and will strive to achieve this goal before Order No. 2000's three-year deadline expires.

The NERTO will also step into the NYISO's place in the existing NYISO – PJM Unscheduled Transmission Services Agreement ("UTS").[99] The UTS governs the provision of transmission service in connection with transactions that were not previously scheduled by the ISOs. This agreement will permit the NERTO and PJM to account for the inter-regional cost implications of unexpected inter-regional parallel path flows.

Accordingly, the NERTO will already have a number of tools to help it manage inter-regional parallel path flows when it commences operations. Still more tools will be available in the next few years. Thus, the NERTO will satisfy Order No. 2000's requirements.

---

[99] *See Letter Order*, Docket Nos. ER01-1115-000, ER01-1115-001, ER01-1115-002 (March 6, 2002) (approving the latest version of the Unscheduled Transmission Services Agreement).

H. Function No. 4 — Ancillary Services

The Commission's RTO regulations require that an RTO "serve as the provider of last resort of all ancillary services required by Order No. 888."[100] The regulations also specify that: (i) the RTO must have the authority to decide the minimum required amounts and location of each ancillary service, must have direct or indirect operational control over all ancillary services providers and must promote the development of competitive markets for ancillary services whenever feasible; (ii) the RTO must ensure that its transmission customers have access to a real-time balancing market administered by the RTO or another independent entity; and (iii) "all market participants must have the option of self-supplying or acquiring ancillary services from third parties," subject to any restrictions imposed by Order No. 888 or subsequent orders.[101]

The Commission has proposed to build on Order No. 2000's requirements by mandating that all RTOs operate bid-based, multi-settlement operating reserves and regulation markets that are co-optimized with RTO administered energy markets. Load-Serving entities would meet their operating reserves and regulation obligations through these markets, bilateral transactions or self-supply arrangements. RTOs would have the option of establishing special locational ancillary services requirements where appropriate. Ancillary services other than regulation and operating reserves would be procured through traditional, cost-based administrative means.

The NERTO will satisfy the Commission's ancillary services requirements.[102] The NYISO already satisfies most of the Commission's ancillary services requirements, as will ISO-NE once it implements "SMD 1.0." The NERTO will assume all of the ancillary services related

---

100 18 C.F.R. § 35.34(k)(4) (2002).

101 18 C.F.R. § 35.34(k)(4) (i) – (iii) (2002).

102 *See New York Sys. Operator, Inc.*, 96 FERC ¶ 61,059 at 61,196 (2001); *Bangor Hydro-Elec. Co.*, 96 FERC ¶ 61,063 at 61,268 (2001).

functions that the Petitioners currently perform and will administer even more robust ancillary services markets.

1. Provider of Last Resort

The NERTO will be the provider of last resort for all of the ancillary services required by Order No. 888, or their functional equivalents. The NERTO will not own generation facilities and will therefore not be a traditional "supplier" of generation-related ancillary services. Order No. 2000, however, allows RTOs to satisfy this requirement "through a variety of mechanisms, including contractual arrangements, indirect or direct control of certain specified generation facilities or market mechanisms."[103] Once the NERTO's "Stage Three" market design is in place it will comply with this requirement by administering bid-based day-ahead and real-time markets for Ten-Minute Synchronized Reserves, Ten-Minute Non-Synchronized Reserves, Thirty Minute Reserves and Regulation service.[104] In addition, the NERTO will allocate cost-based charges and payments for Voltage Support (*i.e.*, reactive power) service and will provide cost-based Black Start (*i.e.*, system restoration) service in the event of a system-wide blackout. All of these ancillary services will be provided under the NERTO tariff so that "transmission customers will have access to one-stop shopping."[105]

---

103 Order No. 2000 at 31,141.

104 Prior to NERTO's implementation of "SMD 2.X," the NERTO will administer all of these markets in New York but will only administer regulation and spinning reserves markets in New England.

105 Order No. 2000 at 31,141.

2. Establishing Required Minimum Amounts of Ancillary Services and Locational Ancillary Services Requirements and Supporting Competitive Ancillary Services Markets

The NERTO tariff will include provisions and formulae specifying the minimum amount of each ancillary service that each transmission customer will procure. The NERTO tariff will also reflect transmission reliability criteria from which special locational requirements for New York City and Long Island are derived. The NERTO tariff will empower the NERTO to exercise the requisite level of operational control over all ancillary services providers. Finally, once the NERTO's "Stage Three" market design is in place, the NERTO will administer bid-based markets for all ancillary services that can be efficiently procured through markets. The NERTO will therefore be in full compliance with the Commission's ancillary services requirements.

3. Real-Time Balancing Market

The NERTO will satisfy this requirement by administering a bid-based real-time energy market, which will be co-optimized with its competitive ancillary services markets. If a transmission customer is short of energy or ancillary services needed to fulfill its obligations, it will automatically purchase the required quantities from the appropriate market. Conversely, if a transmission customer is long it will automatically sell its excess. Such purchases and sales will be priced at the appropriate NERTO-determined LMP level.

4. Self-Supply

The NERTO will support self-supply of regulation and operating reserves to the extent that it is feasible to do so within a market framework that co-optimizes energy and ancillary services. Consistent with Order No. 888, NERTO customers will not be permitted to self-supply Voltage Support or Black Start service. As Order No. 888 recognizes, self-supply of these services is not technically feasible.

I. Function No. 5 — OASIS, Total Transfer Capability and Available Transfer Capability

The Commission's RTO regulations prescribe that an RTO "must be single OASIS site administrator for all transmission facilities under its control and independently calculate TTC and ATC."[106] Order No. 2000 requires that an RTO calculate ATC values based on data developed partially or totally by that RTO in order to ensure that ATC values are based on accurate information and to minimize opportunities for manipulation.[107] Order No. 2000 also requires RTOs to coordinate their ATC calculations with neighboring areas and to develop procedures to validate their own ATC values. The NERTO will fully comply with these requirements.

The NERTO will administer a single OASIS node for its region[108] and will base its ATC calculations on data that it develops itself. The NERTO will review the existing ISOs' procedures for validating ATC calculations and will adopt them to the extent appropriate while developing new procedures to the extent necessary. Insofar as TOs continue to administer certain local transmission facilities, *e.g.*, non-PTF facilities in New England, they will administer separate OASIS nodes for these "sub-RTO" facilities.

The NERTO OASIS will be enhanced by NERTO's participation in the NPCC ATC/TTC Working Group's single NPCC-wide ATC/TTC website. The TTC and ATC values for all NPCC control areas are posted to this site. Several other non-NPCC control areas (Manitoba-

---

106 18 C.F.R. § 35.34(k)(5) (2002).

107 Order No. 2000 at 31,143, 31,145.

108 ISO-NE currently does not calculate TTC for the Northern Maine Independent System Administrator Interfaces, which are radial to New Brunswick, or the Citizens/Southern Canada Load, which is radial to TransÉnergie. Although the Petitioners hope that these areas will eventually come under the NERTO's OASIS (and operational) umbrella this is not likely to be the case by the time that the NERTO commences operations.

Hydro, Michigan Electric, Minnesota Power and PJM) participate. If different control area operators post different TTC/ATC values for the same inter-control area tie, the NPCC site will post a comparison for each path and each relevant time frame. This will make it easier for market participants to understand when and where transmission capacity is available. It will also help the NERTO, and other participating control areas, ensure that their ATC/TTC calculations are consistent. The future consistency of neighboring RTOs' TTC/ATC calculations should also improve over time because all RTOs will be administering standardized LMP-based markets.

J. Function No. 6 — Market Monitoring

Order No. 2000 requires an RTO to ensure that it provides "reliable, efficient and not unduly discriminatory transmission service" by instituting "objective monitoring of markets it operates or administers to identify market design flaws, market power abuses and opportunities for efficiency improvements."[109] The RTO's monitoring activities must include: (i) monitoring the activities of market participants in its region, including TOs; (ii) periodically assessing how activities in markets that it does not administer, *e.g.*, bilateral power sales markets and markets operated by independent power exchanges, affect the efficiency of RTO-administered markets and operations (and vice versa); and (iii) filing reports with the Commission and other affected regulatory authorities concerning opportunities for efficiency improvements, market power abuses and market design flaws.[110]

The NERTO Market Monitoring and Mitigation Plan described in Section VI will meet all of the requirements of Order No. 2000 and subsequent guidance provided by the Commission. The combined capabilities of the NERTO's internal unit and the IMMU will identify both market

---

[109] 18 C.F.R. § 35.34(k)(6) (2002).

[110] 18 C.F.R. § 35.34(k)(6) (i) – (iii) (2002).

design flaws and market power abuses. The IMMU will provide independent advice directly to the NERTO Board on, among other things, correcting market design flaws and improving efficiencies. The NERTO's mitigation plan includes clear and concise thresholds for mitigation and addresses locational market power which will occur in the NERTO regions. Mitigation will be *ex ante* and designed to prevent the disruption of the markets.

K. Function No. 7 — Transmission Planning and Expansion

The Commission's RTO regulations specify that RTOs "must be responsible for planning, and for directing or arranging, necessary transmission expansions, additions and upgrades" and "working to coordinate such efforts with appropriate state authorities."[111] In addition, the RTO planning process: (i) "must encourage market-driven operating and investment actions for preventing and relieving congestion;" and (ii) "accommodate efforts by state regulatory commissions to create multi-state agreements to review and approve new transmission facilities."[112]

Subsequent Commission orders clarified that RTO transmission plans "must be more than a collection of traditional expansion plans developed by the TOs and assembled by the RTO . . . ."[113] The Commission requires RTO planning protocols to: (1) explain how an RTO "will pursue infrastructure investment that will make generation markets more competitive;" and (2) focus on identifying projects that expand trading opportunities, better integrate the grid, and

---

111 18 C.F.R. § 35.34(k)(7) (2002).

112 18 C.F.R. § 35.34(k)(7) (i) and (ii) (2002).

113 *PJM Interconnection, L.L.C.*, 96 FERC ¶ 61,061 at 61,240 (2001).

alleviate congestion.[114] The planning process should allow for third-party participation as well as permit merchant projects.

The proposed NERTO system planning and expansion process (Attachment VII), which was developed with input from U.S. and Canadian stakeholders and state regulatory personnel, complies with all of these requirements. A summary of the proposed process follows.

1. Planning Cycle and Baseline

At least every three years, the NSP will reflect the results of a new comprehensive system enhancement and expansion study. In intervening years, the NSP may only be updated from the previously approved NSP. To ensure responsiveness to changing conditions, the NSP may be adjusted during a year, and transmission upgrades may be added or removed. If a transmission upgrade is removed by the NERTO (for example, if a market project negates the need for a transmission upgrade), the project sponsor is reimbursed for the prudent costs expended to date.

The baseline for the NSP includes:

- all projects that have met milestones (such as the determination of the absence of "significant adverse impact" under the New England Section 18.4 process or siting approval) determined by the NERTO in collaboration with the PAC, including but not limited to proposed generation and transmission projects and merchant transmission facilities;
- demand-side projects planned within the NERTO Control Areas and identified to the NERTO; and
- the requirements for system restoration services.

---

[114] *Midwest Independent Transmission System Operator, Inc.*, 97 FERC ¶ 61,326 at 62,320 (2001), citing *GridFlorida, LLC*, 94 FERC ¶ 61,363 at 62,367 (2001).

The NSP will have a ten-year planning horizon, reflecting a ten-year capacity and load forecast. The NSP will produce a list, determined by the NERTO to be appropriate, of proposed Reliability Transmission Upgrades[115] and Market Efficiency Transmission Upgrades[116] (collectively, "Transmission Upgrades") to the NERTO Transmission System for the next five years.[117]

2. Needs Assessment

The NSP development procedure begins with an initial solicitation by the NERTO of the PAC's perception of regional needs. Thereafter, the PAC receives drafts of the NSP and provides input at each stage. Necessary data is supplied, subject to appropriate confidentiality protections, by TOs, transmission customers, and market project proponents. The comprehensive system enhancement and expansion study ("SEES") – conducted at least once every three years – includes a needs assessment by the NERTO, and NERTO analyses of the market and transmission solutions offered in response thereto.

---

115 Reliability Transmission Upgrades are those additions and upgrades not required by the interconnection of a generator that are nonetheless necessary to ensure the continued reliability of the NERTO system, taking into account load growth and known resource changes, and include those upgrades necessary to provide acceptable stability response, short circuit capability and system voltage levels, and those facilities required to provide adequate thermal capability and local voltage levels that cannot otherwise be achieved with reasonable assumptions for certain amounts of generation being unavailable (due to maintenance or forced outages) for purposes of long-term planning studies. In evaluating proposed Reliability Transmission Upgrades, NERC, NPCC, NERTO, other reliability agency, and Transmission Owner criteria, rules, standards, guides, and policies will be used to define the system facilities required to maintain reliability.

116 Market Efficiency Transmission Upgrades are those additions and upgrades that do not qualify as Reliability Transmission Upgrades, are not related to the interconnection of a generator, and are designed to improve the efficiency of the markets by, for example, reducing congestion in load pockets and relieving "bottled generation."

117 These Transmission Upgrades do not include Merchant Transmission Facilities, although Merchant Transmission Facilities are reflected in the NSP "baseline."

The needs assessment, which receives PAC input, assesses resource adequacy, transmission adequacy, and includes reliability needs as well as projected congestion levels under various conditions. The PAC also provides input on the SEES's scope, assumptions and procedures. The needs assessment will consider the views, if any, of state regulators, the NERTO's independent market monitoring unit (as described in Section VI.D.), and the NERTO Board. A subcommittee of the NERTO Board will convene a public meeting to review the proposed needs assessment. Fundamentally, the SEES will identify situations that either do not meet the reliability criteria or significantly affect the efficient operation of the NERTO bulk power system. The criteria for determining which market-efficiency needs shall be included in the completed needs assessment, and for assessing the cost-effectiveness of solutions proposed in response thereto, will be developed by the NERTO with input from the PAC.

3. Request for Solutions; Evaluation of Solutions

The next phase of the NSP process involves the NERTO's issuance of a "Request for Solutions" to solicit projects that can meet the needs described in the needs assessment. Solutions may include new transmission facilities (either regulated or merchant), generation (conventional, distributed or renewables), demand response and conservation programs. It is expected that, whatever the market response, the affected TO(s) will provide a regulated transmission proposal(s) in response to the NERTO's needs assessment for all identified needs. The NERTO will evaluate (under the criteria developed in the manner described above) whether the market response (including merchant transmission) is sufficient to alleviate the need for a particular Transmission Upgrade, and achievable within the required time period. If so, the NERTO will reflect this finding (without selecting a particular market proposal) in its recommended draft NSP, and that particular additional Transmission Upgrade will be listed in the NSP, subject to NERTO having the flexibility to indicate that the project should proceed at a

later date. If the market response is not sufficient, and if the particular Transmission Upgrade is needed and is viable from a financial and timeliness standpoint, it will be listed in the draft NSP with an indication to begin development. The SEES results will be public and included in the draft NSP recommended by the NERTO staff.

4. NSP Approval

The final phase involves the approval of the NSP. The process specifies that a subcommittee of the NERTO Board will hold a public meeting to obtain input on the draft NSP. Thereafter, the Board will consider the views of the subcommittee (based on those public meetings) and will approve, modify or remand the draft NSP. In considering whether to include a particular Market Efficiency Transmission Upgrade in the NSP, the Board will consider the relative severity of the congestion addressed, and the funding mechanism for Reliability Transmission Upgrades in Exhibit 1 of Attachment VII as well as any other funding mechanisms recommended by NERTO staff, with input from the PAC. Ultimately, the Commission and/or state regulators will be asked to accept the funding mechanism approved by the NERTO Board.

In considering whether to approve the recommended NSP, the Board may, if it finds that a proposed Market Efficiency Transmission Upgrade or Reliability Transmission Upgrade is not viable from a timeliness or financial standpoint, or if no Transmission Upgrade has been proposed, direct the NERTO staff to issue a Request for Alternative Proposals ("RFAP"), and withhold approval of the NSP pending the results of that RFAP. The RFAP will solicit generation, demand-side and merchant transmission alternatives to the proposed Transmission Upgrade, and normally will focus on interim ("gap") solutions. The NERTO staff will analyze the alternatives offered in response to the RFAP and provide a recommendation to the Board, along with a recommended funding mechanism reflecting input from the PAC. The Board may choose to include one of the alternatives in the approved NSP.

5. RFP for Construction of Transmission Upgrades

For a Transmission Upgrade (other than merchant transmission) included in the NSP, and for which siting approvals have been obtained by the TO project sponsor, a Request for Proposals ("RFP") will be issued by the NERTO inviting any entity (including the TO) to construct the upgrade. Upgrades costing under $20 million, replacements of existing equipment, upgrades with a construction period of less than nine months, and interconnection-related transmission facilities will initially be exempted from the RFP process, and these exemptions may be expanded or supplemented by the NERTO Board and posted on the NERTO website. The RFP will include NERTO-approved technical specifications provided by the TO; a proposed construction contract; required technical/financial qualifications; and acceptable engineering practices, governmental, technical and financial requirements. Selection criteria will be developed by the NERTO in consultation with the PAC and will be posted on the NERTO website.

The NERTO will oversee the RFP process. Where a TO project sponsor is not bidding, the successful bidder will be selected by the project sponsor. The sponsor and bidder will execute the construction contract, the sponsor will manage the construction and the NERTO will approve major change orders. Where the sponsor plans to bid, the NERTO will select the successful bidder and, if it is the project sponsor, may arrange for third-party review of construction performance.[118] To ensure cost control and reasonableness of the resulting rates,

---

[118] If the successful bidder is not the project sponsor, the project sponsor will execute the construction contract with the successful bidder and manage the construction process, as in the case where the project sponsor was not a bidder.

entities whose proposals are accepted in response to the RFP will be compensated in accordance with the terms of the accepted proposal.[119]

6. Obligation to Build

In addition to any other obligations imposed on the TOs, the Petitioners anticipate that the TOA will commit TOs that are designated to build Transmission Upgrades in the NSP to construct and own or finance such facilities or enter into appropriate contracts to fulfill such obligations, subject to:

- the requirements of applicable law;
- government regulations and approvals including, without limitation, siting requirements, construction and operating permits;
- the availability of required financing;
- the ability to acquire necessary rights-of-way; and
- the right to recover, pursuant to appropriate financial arrangements and tariffs or contracts approved or accepted by those regulatory agencies with jurisdiction, all reasonably incurred costs, plus reasonable return on investment.

7. Merchant Transmission Facilities

Merchant transmission facilities will be accommodated within the NERTO framework and accounted for in the NSP, subject to approved interconnection agreements and to agreements for operational control by the NERTO.

---

[119] *See New England Power Pool*, 95 FERC ¶ 61,384 (2001).

8. Allocation of Transmission Upgrade Costs

The costs of Reliability Transmission Upgrades included in the final NSP will be allocated by the agreement of NERTO participants. If no agreement is reached among the participants, the costs of facilities with a voltage of 345 kv and above that contribute to the parallel carrying capability of the NERTO Transmission System will be rolled into a NERTO-wide rate charged to NERTO load, and costs of facilities with a voltage below 345 kv will be charged to the load in the sub-region (i.e., either New York or New England) in which the facilities are built, in accordance with existing practices in each sub-region.[120] Transformer costs are split according to voltage levels. The default allocation method will be reevaluated in light of final rules issued subsequently by the Commission. For Market Efficiency Transmission Upgrades, the NERTO Board will consider the foregoing allocation methods and any allocation recommended by the NERTO staff (with input from the PAC).

L. Function No. 8 — Inter-Regional Coordination

The Commission's current RTO regulations require an RTO to "ensure the integration of reliability practices within an interconnection and market interface practices among regions."[121] Pursuant to Order No. 2000, the integration of reliability practices "involves procedures for the coordination of reliability practices and sharing of reliability data among regions in an interconnection, including procedures that address parallel path flows, ancillary service standards, transmission loading relief procedures among other reliability-related coordination

---

[120] The allocation of the costs for other technologies, such as High Voltage Direct Current ("HVDC") and Flexible AC Transmission Systems ("FACTS"), shall be developed on a case-by-case basis.

[121] 18 C.F.R. § 35.34(k)(8) (2002).

requirements . . . ."[122] Similarly, Order No. 2000 states that the integration of market practices involves "developing some level of standardization of inter-regional market standards and practices, including the coordination and data necessary for calculation of TTC and ATC, transmission reservation practices, scheduling practices, and congestion management procedures, as well as other market coordination requirements . . . ."[123] To the extent that it "is not possible to set forth the coordination arrangements at the time an RTO application is filed," an RTO applicant "must propose reporting requirements, including a schedule for itself to provide follow-up details as to how it is meeting the coordination requirements . . . ."[124]

Order No. 2000 emphasized that the inter-regional coordination requirement did not mean that "all RTOs necessarily must have a uniform practice, but that RTO reliability and market interface practices must be compatible with each other, especially at the 'seams.'"[125] Subsequent to the issuance of Order No. 2000, however, the Commission appears to have concluded that merely having compatible market designs in neighboring RTOs is insufficient and that all RTOs must adopt a standardized market design. Similarly, the Commission has pressed for the formation of a single standard-setting organization for the wholesale electric industry that will develop business practices and electronic communications standards to complement the Commission's standardized market design principles.[126]

---

122 Order No. 2000 at 31,168.

123 *Id.*

124 *Id.* at 31,167.

125 *Id.*

126 *See Electricity Market Design and Structure*, 97 FERC ¶ 61,289 (2001).

1. Elimination of Seams

The formation of the proposed NERTO will ultimately eliminate all market and reliability seams between New England and New York, leaving the NERTO with a single set of market interface and reliability practices. All market interface and reliability practices would be identical. Moreover, because New York and most of the New England states have initiated retail competition programs, and because most of the generation in all seven states has been divested, there are no "structural" seams between the two regions.

During the transition to the NERTO Market, the ISOs will work to more closely harmonize their existing markets, and thus will progressively eliminate market interface seams. Major milestones will include: (i) implementation of a region wide "open-scheduling system" ("OSS") to permit "one-stop shopping"; (ii) adoption of fifteen-minute scheduling; (iii) eliminating the NYISO's BME and incorporating alternative functional solutions into enhanced real-time software; (iv) eliminating inter-ISO access charges; and (v) instituting a common ICAP market design. Additional information regarding this harmonization is provided above in Section VI.B. and in Attachment VIII. Consistent with Order No. 2000, the Petitioners will submit updates to the Commission reporting on the progress of these efforts.

The NERTO will continue current efforts to identify and address "seams" and other potential barriers to trade with PJM. The NYISO and PJM have made great progress recently in addressing seams issues through enhanced control area checkout and transaction management processes, the implementation of an interregional congestion management pilot, and significant steps toward harmonizing the ICAP rules to allow suppliers in New York to sell ICAP to load serving entities in PJM. On March 15, 2002, the NYISO and PJM executed an Interregional Coordination and Issue Resolution Agreement with the specific goal of resolving any remaining seams between the two control areas on an expedited basis. This Agreement includes the

development of a prioritized workplan, a formal dispute resolution process and quarterly reporting of progress to both the Commission and state public utilities commissions. The NERTO will continue in these efforts after its formation. Moreover, to insure that new barriers are not created in the process of implementing the NERTO, the ISOs will continue to review key elements of the NERTO market design with PJM staff and seek their input to ensure that SMD 2.X supports and enhances regional trade.

2. Integration of Market Interface Practices

The Commission's pending initiative to establish standardized network access tariffs and standardized wholesale electric market designs will ensure that the NERTO has few or no significant "market" seams with other Commission-jurisdictional RTOs in the Eastern Interconnection. The final rule in that proceeding should more than ensure that there is "some level of standardization of inter-regional market standards and practices, including the coordination and data necessary for calculation of TTC and ATC, transmission reservation practices, scheduling practices and congestion management procedures, as well as other market coordination requirements . . . ." between the NERTO and other jurisdictional RTOs.

The NERTO's use of commercial standards developed through the auspices of a wholesale electric industry standards-setting organization will further strengthen the integration of RTO market practices. The standardization of scheduling and transmission reservation practices will bring significant benefits. The NERTO's adoption of the OSS will facilitate "one-stop shopping" across a region even broader than the NPCC by making a single set of scheduling tools available to market participants.

The ISOs therefore expect that there will be no significant market-related seams between the market rules and practices of the NERTO and other Commission-jurisdictional RTOs. If a

significant seam were to arise between the NERTO and PJM, the only other Commission-jurisdictional RTO directly interconnected[127] to the NERTO, it would be resolved swiftly.

Finally, the establishment of a NPCC Common Market will help eliminate seams between the NERTO and its Canadian neighbors. The ISOs are focusing first on eliminating seams between the NERTO region and Ontario and New Brunswick. Later efforts will focus on the other Canadian provinces' system operators.

3. Integration of Reliability Practices

Because the NERTO and the Canadian participants in the NPCC Common Market will all be members of the NPCC, their reliability practices will be very similar. In the unlikely event that a "reliability seam" arises because different reliability practices are required by the NPCC and the MAAC, they will be addressed expeditiously pursuant to the aforementioned Interregional Coordination and Issue Resolution Agreement. Moreover, because the NERTO will be a member of the NERC it will implement any mandatory national reliability standards the NERC eventually obtains authority to promulgate. Finally, as noted in Section VIII.G.2, the NERTO will assume the ISOs' current rights and obligations under the Lake Erie Agreement and participate in the LESPWG, thereby assuring that there will be no parallel path flow management seams. In short, there should be few, if any, reliability-related seams between the NERTO and its neighbors.

---

[127] The NERTO would be indirectly interconnected with the MISO through the IMO, which is interconnected with both New York and the MISO.

IX. ACCOMMODATION OF PARTICIPATION OF NON-JURISDICTIONAL TRANSMISSION OWNERS AND BY OTHER TRANSMISSION OWNERS WITH TAX-EXEMPT FINANCING

A. The Long Island Power Authority and the New York Power Authority

LIPA and NYPA are significant non-jurisdictional transmission-owning utilities in New York. As the Commission is aware, LIPA's and NYPA's participation in the NYISO was contingent upon special provisions ensuring that such participation would not result in a violation of the private use restrictions applicable to publicly-financed tax-exempt debt and would not affect LIPA's or NYPA's non-jurisdictional status under FPA Section 201(f).[128] In order to facilitate LIPA's and NYPA's future participation in the NERTO, the Petitioners propose to carry these provisions forward under the NERTO tariff and the TOA. These provisions will not affect the NERTO's ability to fulfill its responsibilities. To the contrary, the Petitioners believe that LIPA's and NYPA's participation will enhance the NERTO's performance.

The scope of the special provisions needed to accommodate LIPA's and NYPA's participation in the NERTO are limited to: (1) procedures to allow for compliance with the private use restrictions applicable to tax-exempt debt issued by the Boards of Trustees for the Long Island Power Authority ("Authority") and NYPA;[129] and (2) clarifications necessary to reflect LIPA's and NYPA's non-jurisdictional status.

---

[128] *See Central Hudson Gas & Electric Corp.*, 88 FERC ¶ 61,138 at 61,403 (1999) (approving arrangements necessary to accommodate LIPA's participation in the NYISO).

[129] LIPA is the Authority's subsidiary.

1. LIPA's and NYPA's Compliance with the Private Use Restrictions

The use or control of LIPA's and NYPA's transmission facilities by a non-governmental entity, as defined under the Internal Revenue Code, could violate the private use rules applicable to their bonds. The NERTO will be such a non-governmental entity. Similarly, certain types of transmission service contracts for specific end-use customers may constitute prohibited private use. In order to permit LIPA and NYPA to participate in the NERTO without adversely affecting the Authority's tax-exempt debt, the Petitioners propose to include language in the NERTO tariff providing that LIPA and NYPA will not be required to provide transmission service where the provision of such service would result in the loss of tax-exempt status for either entity's existing tax-exempt bonds or impair their ability to issue tax-exempt bonds in the future.

Moreover, if it is determined that LIPA's or NYPA's tax-exempt status is jeopardized, the Petitioners will include language in the TOA specifying that LIPA or NYPA, as the case may be, will be permitted to withdraw from the NERTO with thirty (30) days' prior notice. LIPA and NYPA will be required to provide longer notice when possible and will in all cases be required to provide a written explanation regarding the need for their withdrawal.

A particular concern connected with LIPA's participation in the NERTO is the scheduling of transactions over LIPA's transmission facilities. Scheduling certain transactions over these facilities would constitute an impermissible private use of publicly financed transmission facilities under the Internal Revenue Code. To avoid this problem, and to avoid situations that might force LIPA to withdraw from the NERTO, the Petitioners will support the adoption of a scheduling protocol which will give LIPA the right to review and pre-approve all transactions to be scheduled over its facilities. Furthermore, because of the high degree of risk for private use complications with respect to the Northport-Norwalk Intertie, LIPA will be the

only party authorized to submit schedules to the NERTO for transmission over that intertie. This scheduling protocol is limited to a review by LIPA to ensure its compliance with the private use restrictions. The actual scheduling of such transactions, outside of the Northport – Norwalk Intertie will remain the responsibility of the NERTO, upon LIPA's certification that the private use rules will not be violated.

The LIPA scheduling protocol will not require review of grandfathered transactions. It will be non-discriminatory. The Petitioners will work with LIPA to ensure that the LIPA scheduling protocol that is currently employed by the NYISO is updated for the NERTO's use. In particular, LIPA will develop an updated list of pre-approved transactions that the NERTO may schedule over its transmission facilities and a list of eligible customers that may withdraw power from and inject it into Long Island. Every effort will be made to ensure that the list of "pre-approvals" is as extensive as possible in order to minimize inconvenience to other market participants. Except for pre-approved and grandfathered transactions, LIPA will establish a process to review transactions involving its facilities prior to the NERTO's scheduling of specific transactions. In general, the review and approval process should not be lengthy except in instances where LIPA requires advice from its bond counsel or the IRS.

Finally, because LIPA must track transactions on Long Island to ensure compliance with the private use rules, the NERTO proposes to provide LIPA with information on net transmission flows in and out of Long Island.

2. Clarification of LIPA's and NYPA's Non-Jurisdictional Status

As was noted above, pursuant to FPA Section 201(f), LIPA and NYPA, as statutorily created agencies under the laws of New York State, are not subject to the Commission's jurisdiction under part II of the FPA, including with respect to the Commission's exercise of its

general FPA ratemaking authority. The NERTO tariff will clearly recognize LIPA's and NYPA's non-jurisdictional status.

B. Other Transmission Owners with Tax-Exempt Financing

The ISOs intend to include language in the NERTO tariff specifying, with respect to transmission facilities that were financed with local furnishing bonds, as described in Section 142(f) of the Internal Revenue Code, that neither the NERTO, nor the relevant TO, will be required to provide transmission service that would jeopardize the tax-exempt status of any such local furnishing bonds. The Commission has previously approved an identical provision in the NYISO OATT.[130]

X. SUBMISSION OF FUTURE FILINGS

Once the Commission issues the requested declaratory order, the plan for submitting any required FPA Section 203 filings, NERTO's Day One Tariff, the TOA and other organic documents will be implemented so that these filings can be submitted by April 30, 2003.

In addition, ISO-NE will continue to implement SMD 1.0 in accordance with its previously announced plans which call for implementation no later than the first quarter of 2003, while the NYISO will continue to move toward SMD 2.0. The NERTO will make future Section 205 filings as specified in the timetable set forth in its NERTO Implementation Plan[131] and will submit a final tariff filing in time to permit the expeditious implementation of the NERTO market design.

---

130 *See* NYISO OATT at §§ 5.1 – 5.2.

131 *See* Figure 1 and Attachment VIII.

XI. ENVIRONMENTAL POLICY

The ISOs anticipate that the NERTO will adopt an environmental policy which provides that the NERTO will consider the environmental consequences of its policies and operations and will balance, as reasonably as possible, the potential risks of harm to the environment against the benefits to be derived from proposed actions.

The NYISO currently has an environmental policy which includes the preceding commitment as well as commitments to (i) include an environmental audit in its annual audit plan; (ii) incorporate environmental considerations when making major operational and planning decisions; (iii) assess the environmental consequences of overall NYISO and market operations at least once a year; and (iv) prepare an annual report on matters related to environmental policy, including an assessment of the environmental impact of the NYISO's activities.

XII. CONCLUSION

WHEREFORE, for the foregoing reasons, ISO New England Inc. and the New York Independent System Operator, Inc. respectfully request that the Commission expeditiously issue a declaratory order stating that the proposed Northeastern Regional Transmission Organization would qualify as a Regional Transmission Organization pending its timely establishment, and the Commission's acceptance of complete tariffs and related documentation to be submitted in the future.

Respectfully submitted,

ISO NEW ENGLAND INC.

By:_____
Howard H. Shafferman
Ballard Spahr Andrews & Ingersoll, LLP
601 13th Street, N.W., Suite 1000 South
Washington, DC 20005
Tel. (202) 661-2205
hhs@ballardspahr.com

NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

By:_____
Arnold H. Quint
Hunton & Williams
1900 K Street, N.W
Washington, DC 20006
Tel. (202) 955-1500
aquint@hunton.com

August 23, 2002

ATTACHMENT I

Agreement

This agreement, effective as of January 28, 2002, will confirm the intentions of the Boards of Directors of ISO NEW ENGLAND INC. ("ISO-NE") and the NEW YORK INDEPENDENT SYSTEM OPERATOR ("NYISO," and, together with ISO-NE, the "ISOs"), which are the independent system operators for New England and New York, respectively (New England and New York, together, the "Northeast"), for the development of a plan to establish a common market design. The ISOs believe that significant benefits can be derived from combining the NYISO and ISO-NE in forming a regional transmission organization. The ISOs agree, however, to conduct an in-depth evaluation of the feasibility, including the benefits, of the formation of a regional transmission organization, including the development of a plan for a regional transmission organization that may include one or more independent transmission companies (the "Northeast RTO" or "NERTO").

The development of the common market design shall include provision for participation by the Independent Electricity Market Operator of the Province of Ontario; TransÉnergie, responsible for operation of Québec's transmission system; the New Brunswick Power Corporation, responsible for operation of New Brunswick's transmission system; and Nova Scotia Power Inc., responsible for operation of Nova Scotia's transmission system (these four together, the "Canadian Control Areas"), to the extent they elect to participate. Any other operator of a system executing an agreement with the ISOs may also participate in the development of the common market design. The ISOs agree that the common market design shall conform as closely as is reasonably possible to any uniform market design adopted by the Federal Energy Regulatory Commission ("FERC") for all RTOs and ISOs.

The ISOs agree that the evaluation of the feasibility of forming a Northeast RTO should be conducted while the development of the common market design is taking place. The ISOs

agree that the objectives of the Northeast RTO include, without limitation, evaluation of the costs and benefits of RTO formation, ensuring the reliability of the bulk power systems, standardizing wholesale electricity markets, creating a single market for the Northeast, defining the components of the single market, managing parallel path flows, coordinating planning and scheduling to most efficiently develop and utilize any needed transmission additions, promoting development of efficient demand response mechanisms, streamlining and facilitating needed and approved interconnections, minimizing barriers to wholesale electricity trading between the Northeast RTO, adjacent U.S. control areas, and Canadian Control Areas, alleviating transmission congestion, maximizing the efficient use of the transmission system for both internal NERTO and external transactions, minimizing to the extent practicable the environmental impact in achieving the objectives of the Northeast RTO, and fostering innovation in both processes and technology.

In pursuing these objectives, the parties would accommodate the formation of Independent Transmission Companies ("ITCs"). The ISOs will work cooperatively with transmission owners ("TO"s), other stakeholders and regulators in pursuing these objectives and, to be responsive to their concerns, will provide ample opportunity for those concerns to be expressed. The ISOs recognize the importance of the participation of TOs in the Northeast RTO, as well as the need to obtain necessary approvals from FERC.

The ISOs agree that the evaluation of the feasibility of the potential Northeast RTO shall include the development of a plan (the "Northeast RTO Plan") to address, without limitation: (i) the objectives of the Northeast RTO; (ii) market standardization, evolution, and consolidation; (iii) governance of the Northeast RTO; (iv) transition issues; (v) transmission tariff; (vi) services tariff; (vii) transmission planning; (viii) consideration of issues related to ITCs; (ix) accommodations for tax-exempt entities; (x) security plans for cyber, physical, and market integrity; (xi) considerations for protection of the natural environment; and (xii) coordination with neighboring control areas. The plan will be developed and evaluated in a collaborative manner with stakeholders, regulators, and TOs of both regions.

The ISOs shall create an "Oversight Committee" consisting of an equal number of members from each of their Boards of Directors. Each of the ISOs' Chief Executive Officers, in

their capacity as co-chairs of the RTO Development Committee referred to below, shall use their best efforts to attend all meetings of the Oversight Committee. The Oversight Committee may expand its membership to include representation from any other operator of a system executing an agreement with the ISOs to participate in the development of a Northeast RTO Plan. The Oversight Committee shall have the overall responsibility for development of a Northeast RTO Plan for evaluation, including the resolution of issues that are not resolved by the RTO Development Committee referenced below, and shall be responsible for presenting a Northeast RTO Plan to the ISOs' full Boards of Directors. The Oversight Committee shall satisfy itself that the Northeast RTO Plan development takes place in a collaborative manner with stakeholders, regulators, and TOs. The Oversight Committee shall meet as frequently as its members deem necessary.

The ISOs shall each assign a representative to act as its project manager for the development of the Northeast RTO Plan. The two project managers shall serve on an "RTO Development Committee." The ISOs' Chief Executive Officers shall co-chair the RTO Development Committee. The RTO Development Committee shall report to the Oversight Committee and shall meet as frequently as its members deem necessary, but no less often than the Oversight Committee requires. The RTO Development Committee shall make provision for participation in the process by the Canadian Control Areas, and any other operator of a system that executes an agreement with the ISOs.

The RTO Development Committee may create a task force on any issue to be incorporated into the Northeast RTO Plan, including without limitation: (A) transition issues; (B) technology assessment; (C) stakeholder role in the Northeast RTO; (D) tariff development; (E) transmission planning; (F) market standardization and coordination; (G) participation in the common market design by the Canadian Control Areas; and (H) security. Each task force shall be comprised of equal numbers of representatives from the ISOs and, as appropriate, the Canadian Control Areas, and any other operator of a system that executes an agreement with the ISOs, which representatives shall be appointed by the CEO or designee for the relevant party. Task forces shall report to the RTO Development Committee and shall meet as frequently as the RTO Development Committee deems necessary. Task forces shall obtain stakeholder and

regulator input on the issues addressed by the task forces. The RTO Development Committee may also hire consultant(s) with Oversight Committee approval.

The ISOs agree to use best efforts (i) to provide a copy of this agreement to the FERC and state commissioners on or before January 31, 2002; (ii) if it is determined to proceed with a Northeast RTO, to file the Northeast RTO Plan including detailed timetables, supporting documentation, and an RTO application, with the FERC on or before June 30, 2002; and (iii) to secure an order from the FERC addressing the June 30, 2002 filing as soon as practicable thereafter.

Each of the parties to this agreement shall bear its costs incurred in the fulfillment of its obligations set forth herein. The ISOs, and any other operator of a system executing an agreement with the ISOs, as appropriate, shall share equally the expense of any consultant hired with Oversight Committee approval.

Either party may terminate its participation under this agreement at its sole discretion with thirty (30) days' written notice to the other party. Such termination of a party's participation under this agreement shall be accomplished without any liability of such party (except for any liability for a breach of a provision hereof by such party occurring prior to the date on which such party's termination becomes effective). Upon termination, the parties shall have no further obligation under this agreement except to pay expenses already incurred.

The ISOs shall execute a separate Confidentiality Agreement applicable to the activities contemplated hereunder, acceptable in form and substance to their respective general counsels.

This agreement, and any disputes arising out of this agreement, shall be governed by and construed in accordance with the laws of the State of New York, without regard to its conflicts of laws principles.

The foregoing is accepted and approved as of the effective date of this agreement.

NEW YORK INDEPENDENT SYSTEM OPERATOR

By: _____
Name: Richard J. Grossi
Title: Chairman of the Board

ISO NEW ENGLAND INC.

By: _____
Name: William W. Berry
Title: Chairman of the Board

ATTACHMENT II

NORTHEAST INDEPENDENT MARKET OPERATORS

SYSTEM OPERATION, PLANNING AND MARKET DEVELOPMENT

AGREEMENT

This Agreement, between the Independent Electricity Market Operator ("IMO") for Ontario, ISO New England, Inc. ("ISO-NE") and the New York Independent System Operator, Inc. ("NYISO"), establishes the Northeast Independent Market Operators Coordinating Committee and outlines a plan of coordinated system operations, system planning and market development to be undertaken by the parties.

BACKGROUND

A. Each of the parties now has an open competitive electricity market for the wholesale and retail supply of electricity.

B. NYISO and ISO-NE are cooperatively developing a proposal for a Northeast Regional Transmission Organization ("NERTO").

C. The IMO desires that the Ontario market evolve to maintain its effectiveness as part of the broader North American marketplace with which it is interconnected at Manitoba, Minnesota, Michigan, Quebec and New York.

D. The NYISO and ISO-NE agree that augmenting existing coordination agreements and practices with the IMO in the manner described here will lead to a coherent electric marketplace within this natural trading area.

E. The parties acknowledge that the broader North American marketplace is evolving toward a standard market design, including associated business practices and reliability standards.

F. The parties agree that increasing the compatibility of the markets to enable seamless transaction of products across their borders is a key consideration and objective in future market evolution.

G. The parties agree that coordinating transmission priorities, such as system planning, connection assessment, and system tariffs, is in the best interest of customers.

H. The parties wish to work together to accomplish these objectives and towards that end have held a formative, first meeting of the Coordinating Committee in Toronto, Canada, May 16, 2002.

AGREEMENTS

In consideration of the foregoing, the parties agree as follows:

1. Establishment of Coordinating Committee

The parties agree to establish the Northeastern Independent Market Operators Coordinating Committee ("Coordinating Committee"). The membership of the Coordinating Committee will consist of executive staff from each party. The Coordination Committee will develop recommendations on complementary market design, business practices, system planning protocols, and other coordination activities that, if adopted by the parties, will reduce barriers to electricity trading in the region, improve reliability, and fulfill the objectives set forth below.

1.1 Procedures

The Coordinating Committee will hold its second meeting July 30, 2002, in Holyoke, Massachusetts. The parties agree to establish business processes and a regular schedule of meetings for the Coordinating Committee.

1.2 Cooperation with Other Regions

a. The parties anticipate that other independent market operators may wish to join the Coordinating Committee as they are formed in other control areas within NPCC and any that wish to participate shall execute an agreement substantially similar to this Agreement.

b. The parties recognize existing Agreements between them and among other Control Areas in NPCC. The parties will work with other interested control areas and interested market participants on issues of general regional concern such as system planning.

c. The parties do not intend to preclude the formation of cooperative relationships and agreements with other market operators and/or transmission owners outside the NPCC by virtue of this Agreement.

2. Continue Existing Cooperation

The parties agree to continue to expand existing cooperative efforts as set forth below. The Coordinating Committee will present a set of joint recommendations and milestones for furthering these efforts to the Board of Directors of each party on or before May 15, 2003.

2.1 Coordinate Transaction Procedures

The Coordinating Committee shall:

a. Complete and put into effect the coordination process by which schedules for cross-boundary transactions by the parties are confirmed;

b. Develop information sharing protocols for monitoring "failed" cross-boundary transactions;

c. Consider the progress of on-going efforts at developing "one-stop shopping" scheduling mechanisms and augment those efforts as necessary to ensure the objective is met.

2.2 Calculate, Coordinate and Publish Transfer Capabilities

The Coordinating Committee shall:

a. Establish procedures to ensure that the transfer capabilities between the Control Areas in all time frames are calculated consistently, coordinated on a multi-system basis and published to all of their market participants;

b. Continue coordination with the NPCC/NERC initiatives to address Lake Erie loop flows. It shall also review, and adjust as necessary, established parallel path flow arrangements before the Ontario-Michigan PARs enter service.

2.3 Operating Reserves

The Coordinating Committee shall:

a. Develop arrangements for sharing operating reserves between their Control Areas, building on the analysis being performed by the NPCC Task Force on Coordination of Operations.

2.4 Coordination of Maintenance

The Coordinating Committee shall:

a. Enhance present notification and coordination of maintenance outages of generation and transmission lines that impact the transfer capability between their control areas. Outage notification to secure reliability occurs at present with regard to a significant set of transmission and generation assets (e.g., NPCC "Critical Facilities" list). This project would increase the coordination function to minimize adverse impacts to reliability and generation adequacy.

2.5 Planning Cooperation

The Coordinating Committee shall:

a. Conduct joint system impact studies and facilities studies for those projects that have inter-control area effects;

b. Build upon the NPCC Task Force on Coordination of Planning's regional planning processes (e.g., resource adequacy reviews, area transmission reviews) to expand the list of uniform planning assumptions;

c. Seek to ensure that beneficial transmission projects are considered appropriately from the broader regional perspective, including, but not limited to, relieving "bottled generation" restrictions and prioritizing transmission constraints in need of resolution.

d. Consider issuing joint, region-wide, planning assessments.

2.6 Congestion Management

The Coordinating Committee shall:

a. Investigate the success of NYISO's Congestion Management Pilot with PJM and report on its usefulness as a congestion management tool for the NYISO/IMO Interface.

2.7 Continue NPCC Operations Initiatives

The Coordinating Committee shall:

a. Consider the progress of the on-going ACE Diversity Interchange Pilot Project and augment those efforts as necessary to ensure the objective is met.

b. Consider the progress of the on-going 100 MW Reserve Sharing Pilot Program and augment those efforts as necessary to ensure the objective is met.

3. Short-Term Market Development Initiatives

The Coordinating Committee will present a set of joint recommendations and milestones for achieving the Short-Term Market Development Initiatives set forth in this section to the Board of Directors of each party on or before May 15, 2003.

3.1 Enhancements to Existing Market Features

The Coordinating Committee shall consider mutually beneficial enhancements to:

a. Establish market-based mechanisms that encourage market participation by a broad range of generation and demand response resources and promote the dispatch flexibility of such resources;

b. Solve commitment anomalies for energy limited resources;

c. Promote greater alignment between the IMO's Financial Transmission Rights and NE/NY's Transmission Congestion Contracts; and

d. Expand the coordinated notification of maintenance outages of generation and transmission lines that impact cross-boundary flows in order to secure market sufficiency in addition to securing reliability sufficiency.

e. Develop Inter-Control Area Ramp Management techniques to facilitate cross-boundary trading and reduce transaction curtailments.

3.2 Day-Ahead Market

The Coordinating Committee shall consider mutually beneficial market enhancements to:

a. Form a single Day-Ahead Market or compatible Day-Ahead Markets that will increase efficiency of the Day-Ahead Markets for the New York, New England and Ontario jurisdictions and enable market participants to engage in seamless Day-Ahead transactions between these jurisdictions and their neighboring markets.

3.3 FERC Standard Market Design

The Coordinating Committee shall consider mutually beneficial market enhancements to:

a. Evaluate FERC's Standard Market Design (SMD) concepts, as adapted to meet the requirements of New York and New England and, as appropriate, pursue alignment of the IMO practices to the SMD requirements and of the SMD practices to the IMO's requirements in order to provide market participants with seamlessly integrated services between Ontario, New England and New York.

3.4 Adequacy Assurance

The Coordinating Committee shall consider mutually beneficial market enhancements to:

a. Ensure that adequate resources remain available to meet customer demand in all timeframes in a manner that is compatible with procedures that are employed in adjoining jurisdictions.

b. Coordinate this effort with the work of the Joint Capacity Adequacy Group and its "General Principles for Installed Capacity."

3.5 Market Monitoring Functions

The Coordinating Committee shall consider mutually beneficial market enhancements to:

a. Enhance consultation and collaboration between the market monitoring units of each party and between the independent market advisors of each party.

4. Medium-Term Market Development Initiatives

The Coordinating Committee will present a set of joint recommendations on the feasibility of and milestones for achieving the Medium-Term Market Development Initiatives set forth in this section to the Board of Directors of each party on or before March 15, 2004.

4.1 Elimination of Export Charges

Eliminate "border charges" for exports from U.S. or Canadian suppliers in order to facilitate improved competition over a larger region.

4.2 Coordinate System Planning

Coordinate system planning and identify opportunities for further integration of system planning by NERTO and participating Canadian entities.

4.3 Institute Shared Market Monitoring Activity

Utilize a common set of rules and sanctions for each party's market monitor function (even if different jurisdictions enforce sanctions).

4.4 Shared Transaction Scheduling

Expand scheduling technology to ensure customers wishing to transmit energy anywhere between, through or out of the multiple systems can avail themselves of "one-stop-shopping" for all necessary arrangements.

5. Long-Term Market Development Initiatives

The Coordinating Committee will present a set of joint recommendations and milestones for evaluating the feasibility of pursuing the Long-Term Market Development Initiatives set forth in this section to the Boards of Directors of each party on or before July 15, 2004.

5.1 Strengthen Market Harmonization

Adopt a market structure, common to New England, New York and the IMO, to provide non-discriminatory, open access transmission and a seamless market across the facilities of the participating entities and their neighboring jurisdictions, consistent with the decisions and orders of U.S. and Canadian regulatory authorities. This structure to contain provisions that are common or compatible with respect to the following matters:

- Market information technical standards
- Information confidentiality practices
- Publishing market information
- Service tariff designs
- Market design and rules
- Business practices
- Standards of conduct
- Market-based congestion management system
- Energy, ancillary services, transmission rights and resource adequacy markets

5.2 Cross-Border Dispatch

Develop a market-based process for solving cross-border dispatch and parallel flow issues.

6. Miscellaneous

6.1 Term and Termination

This Agreement comes into effect on the date of execution of the Agreement. Any of the parties may terminate their participation in this Agreement upon sixty (60) days notice to each of the other parties.

6.2 Notices

Any notice under this Agreement shall be given in writing and delivered by overnight courier to the following addresses:

If to ISO-NE:

Kathleen A. Carrigan
Vice President, General Counsel and Corporate Secretary
ISO-NE
One Sullivan Rd.
Holyoke, Massachusetts. 01040
kcarrigan@iso-ne.com

If to NYISO:

Robert E. Fernandez
General Counsel and Secretary
NYISO
3890 Carman Rd.
Schenectady, New York 121303
rfernandez@nyiso.com

If to IMO:

Roy Stewart
General Counsel and Secretary
The IMO
655 Bay Street, Suite 410
Toronto, Ontario M5G2K4
roy.stewart@theimo.com

6.3 Relationship of Parties

The parties are not forming a partnership or other legal entity and no party is authorized by this Agreement to act as agent for any other party. Each party shall be responsible for all of its own expenses incurred in connection with this Agreement, including, but not limited to, the costs of travel to meetings, administrative costs and legal or other consulting fees.

6.4 No Third Party Beneficiaries

There are no third party beneficiaries to this Agreement.

6.5 Successors

Upon its formation, NERTO will succeed to the rights and responsibilities of ISO-NE and NYISO under this Agreement. Otherwise, this Agreement may not be assigned.

EXECUTION

The parties have executed this Agreement as of June 11, 2002.

INDEPENDENT ELECTRICITY MARKET OPERATOR

By: David Goulding
Title: President and CEO

ISO NEW ENGLAND INC.

By: Gordon vanWelie
Title: President and CEO

NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

By: William J. Museler
Title: President and CEO