

131 FERC ¶ 61,017  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;  
Marc Spitzer, Philip D. Moeller,  
and John R. Norris.

PJM Interconnection, L.L.C.

Docket Nos. ER09-650-001  
ER09-650-002

ORDER ADDRESSING REHEARING REQUEST  
AND COMPLIANCE FILING

(Issued April 15, 2010)

1. Hess Corporation (Hess) requests rehearing of a Commission order issued in this proceeding on April 3, 2009.<sup>1</sup> In addition, on May 4, 2009, PJM Interconnection, L.L.C. (PJM), submitted a compliance filing and, on November 9, 2009, filed supplemental information in response to a Deficiency Letter issued by the Commission on October 8, 2009. For the reasons discussed below, we deny rehearing of the April 3 Order. We also accept, in part, and reject, in part, PJM's compliance filing.

**Background**

2. On February 3, 2009, PJM proposed to revise its existing credit policies by implementing: (i) weekly billing and payment procedures; (ii) a reduction in its per-member Unsecured Credit Allowance; (iii) elimination of its Unsecured Credit Allowance for future Fixed Transmission Rights (FTR) trading; and (iv) procedures authorizing PJM to close out and liquidate a defaulting participant's forward FTR positions, upon the occurrence of a default.

3. In the April 3 Order, the Commission conditioned its acceptance of PJM's filing on the submission, by PJM, of: (i) tariff revisions amending PJM's Net Seller Credit Allowance provision, as proposed by intervenors and agreed to by PJM in its

---

<sup>1</sup> *PJM Interconnection, L.L.C.*, 127 FERC ¶ 61,017 (2009) (April 3 Order).

March 10, 2009 answer (March 10 Answer),<sup>2</sup> and (ii) an explanation and accompanying tariff revisions, as necessary, addressing appropriate credit requirement reductions for load serving entities (LSE) in the case of LSEs that use counterflow FTRs to hedge their purchases to serve load.<sup>3</sup>

## **Discussion**

### **A. Request for Rehearing**

4. Hess seeks rehearing of the April 3 Order. Hess asserts as error the Commission's approval of PJM's proposed weekly billing and payment requirements as they relate to payments PJM will be required to make to generators. Hess asserts that while the April 3 Order appropriately weighed the merits attributable to PJM's revised billing and collection requirements (and correctly noted the risk reduction benefits obtainable through this accelerated process), the Commission failed to address the corresponding merits attributable to accelerated payments to generators. Hess contends that accelerated collection by PJM does not necessitate accelerated payments to generators and accelerated payment is outside the realm of credit policy. Hess argues that these accelerated payments will not reduce credit risk to PJM, encourage market participation, or result in any other market or credit benefit. Hess adds that no benefit associated with this requirement has even been alleged in this case.

5. Hess asserts that accelerated payments to generators will deprive PJM of the use of these funds (a benefit, Hess argues, for all market participants to the extent PJM's operating expenses would be reduced). Finally, Hess argues that PJM's proposal should more appropriately be considered in proceedings addressing the cost structure of capacity, energy or other markets, not in the context of a credit filing, because the rate at which generators get paid is a determinant in the amount of value that generators receive from participating in these markets.

### **1. Commission Determination**

6. We deny Hess' request for rehearing. We do not agree that it would be appropriate for PJM to retain funds that it receives from load that are owed to generators if it is feasible for it to remit such funds, even if by doing so, it may reduce its operating costs. PJM acts as an intermediary in billing load for generation and, just as it has done

---

<sup>2</sup> Under the agreed-to change, a seller would be required to maintain a set sell position on a monthly basis (i.e., for each of the prior 12 months), not a weekly basis (i.e., for each of the prior 52 weeks). See April 3 Order at P 34.

<sup>3</sup> *Id.* P 37.

prior to implementing weekly billings and collections, should remit the amounts collected from load to generators as soon as it is feasible for it to do so. PJM appropriately has not sought to benefit from its role as an intermediary and we reject Hess' assertion that it should do so. Instead we find it reasonable for PJM to remit payments it has received from load to generators as soon as is feasible under PJM's systems.

**B. PJM's Compliance Filing**

7. On May 4, 2009, PJM submitted its compliance filing. Regarding the Net Seller Credit Allowance provision, PJM states that it has revised its tariff to substitute a 12-month timeframe for its previously proposed 52-week timeframe when determining whether a participant has been a net seller. As noted above, PJM's proposed revision responds to intervenor requests. PJM also states that this revision is consistent with the commitment made by PJM in its March 10, 2009 answer.<sup>4</sup>

8. Also in its compliance filing, PJM proposes reductions to FTR credit charges for certain LSEs. PJM notes that in its initial filing, it had proposed to eliminate the Unsecured Credit Allowance for all FTR transactions, given their risk potential. To ensure that LSEs do not face undue financial costs to serve end-users, PJM proposes to revise its initial proposal by: (i) allowing 25 percent of an LSE's current planning year Auction Revenue Rights (ARR) credits to be recognized as a credit offset to each planning year's undiversified credit requirements under PJM's Long Term FTR Auctions; and (ii) excluding negatively priced (counterflow) FTRs that sink at an LSE's load location from determination of portfolio diversification and the associated FTR credit requirement calculation.

9. PJM also proposes to clarify the defined term "FTR Portfolio Auction Value." PJM states that, currently, this term is defined as the sum, calculated on a monthly basis, across all FTRs, of the FTR price times the FTR volume in MW. PJM proposes to add to this definition the clarification that for the purposes of determining portfolio diversification and the associated FTR credit requirement for an LSE, negatively priced FTRs that sink at the LSE's load location will be excluded from the calculation. PJM states that, additionally, to prevent the possibility of speculative positions receiving the possible benefit of this qualification, an additional qualifier specifies that for the purposes of this calculation, the MW quantity of FTRs will not exceed the peak load of the LSE at each location. PJM states that with this added clarification, the exclusion of negatively priced FTRs from the portfolio diversification will be used solely to assist in hedging congestion to serve load and not utilized for purely speculative purposes.

---

<sup>4</sup> *Id.* P 34.

10. Further, PJM explains that previously DC Energy, LLC (DC Energy) had expressed concern that even if an LSE is serving its load through the path in question, another problem is that an LSE's ARR calculation is up to its peak load, which by definition is a rare occurrence so the vast majority of hours are potentially over-hedged, resulting in potential settlement risk that is not offset by energy sales/purchases. PJM states that it understands DC Energy's statement and agrees that it is possible for an LSE to purchase counterflow FTRs in an amount greater than its actual load at a point in time. However, PJM asserts that energy flows are, by nature, a fluctuating commodity, and an LSE should not be penalized for hedging its load exposure by establishing an arbitrary level here that is less than its actual historical load. PJM states that it believes the risk associated with the concerns expressed by DC Energy are minimal in this instance because the LSE will necessarily be serving load, and as such, will be exposed to the resulting congestion that it needs to hedge. PJM states that an LSE cannot, in the face of highly congested paths, decide whether or not it wants to serve load.

11. Finally, PJM maintains that this proposal does not exempt any party from posting secured credit in the FTR Market, but rather provides an adjustment to the calculation of the appropriate credit required by a participant.

**1. Notice of Filing, Procedural Issues and Responsive Pleadings**

12. Notice of PJM's compliance filing was published in the *Federal Register*, 74 Fed. Reg. 23180 (2009), with protests and interventions due on or before May 26, 2009. A motion to intervene and comments in support of PJM's filing were submitted by PSEG Companies (PSEG). The Illinois Municipal Electric Agency (IMEA) submitted comments in support of the compliance filing. A protest was filed by DC Energy. On May 10, 2009, PJM filed an answer to DC Energy's protest.

13. Commission staff sent PJM a deficiency letter on October 8, 2009, asking for additional information. On November 9, 2009, PJM submitted responses to the Commission's requests. Notice of the amendment was published in the *Federal Register*, 74 Fed. Reg. 61342 (2009), with interventions, answers and protests due on or before November 30, 2009. None were filed.

14. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2009), the timely, unopposed motion to intervene serves to make the entity that filed it a party to this proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2009), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept PJM's answer because it has provided information that assisted us in our decision-making process.

15. In its protest, DC Energy argues that PJM's proposed FTR credit allowances will produce avoidable unsecured credit risk and reflect an arbitrary value judgment regarding the level of risk associated with certain FTR positions. First, DC Energy argues that the potential exists for LSEs to manipulate these proposed provisions for speculative ends. DC Energy notes that congestion flow direction can easily change on a daily basis, while the fact that an LSE is serving load does not necessarily mitigate the risk this poses. DC Energy states that, as such, there is no guarantee that FTRs will be used only as a hedge for congestion simply because the MW quantity of FTRs will not be permitted to exceed the peak load. DC Energy asserts, to the contrary, that FTRs are inherently speculative and the fixed volume nature of FTRs prevents any entity from employing an FTR as a complete hedge.

16. DC Energy further argues that the fluctuating nature of the load profile across seasons, and even over the course of the day, implies that a fixed volume hedge, like an FTR, will always leave an LSE under- or over-hedged. DC Energy asserts that, in the case of an FTR portfolio that matches one's peak load, the LSE will almost always be over-hedged. DC Energy adds that in the case of an FTR hedging strategy that matches a baseload generator to a load zone to cover the baseload level of the load, the LSE will almost always be under-hedged. DC Energy states that while this avoids the load profile issue if the FTR volume is matched to the baseload generator output, it is still susceptible to system redispatch, which will alter the character of the hedge instrument, especially if the baseload generator is no longer dispatched.

17. DC Energy proposes that all market participants be required to provide collateral to cover all FTR positions, including counterflow and flow undiversified positions. In the alternative, DC Energy suggests that all FTRs be excluded from the FTR auction portfolio calculation that are matched by one's ARR allocation. DC Energy asserts that this would include negative-priced FTRs as well as positive-priced FTRs. In addition, DC Energy contends that PJM should not allow the offsetting up to the peak load, but instead use something more indicative of the typical load levels, i.e., allow a partial offset on FTR volume related to one's ARR allocation, prorated to the base load or average load factor instead of peak load. DC Energy argues that base or average load is more indicative of how often load may be hedging congestion rather than taking a speculative position.

## **2. PJM's Answer**

18. In response to DC Energy's protest, PJM reiterates that, conceivably, an LSE could purchase counterflow FTRs in an amount greater than its actual load at a given point in time. PJM argues, however, that the resultant risks are minimal. PJM further argues that limiting the FTR volumes used in its risk calculation to the LSE's peak load is also consistent with an LSE's ability to request rights up to its peak load in the allocation

process while, simultaneously ensuring that an LSE purchasing a possibly speculative counterflow position will have to post additional security commensurate with these risks.

19. PJM reiterates that its proposal does not exempt any party from posting secured credit in the FTR Market. PJM states that, instead, its proposal merely provides an adjustment to the calculation of the appropriate credit required. PJM adds that its proposal is reasonably and carefully calibrated to allow an adjustment to the formula by which credit requirements for undiversified FTR portfolios are calculated.<sup>5</sup> Finally, PJM asserts that, in practice, there are few LSEs that have undiversified FTR requirements and few that will be affected by PJM's proposal.

### **3. Deficiency Letter and PJM's Response**

20. On October 8, 2009, the Commission staff issued a Deficiency Letter requesting further information and support for PJM's proposal, including: (1) an explanation of why it is reasonable to provide the same reduction in credit requirements to all counterflow FTR holders that are LSEs with load at the counterflow FTR's sink, regardless of the amount of load required to be served at the sink relative to the MWs of counterflow FTRs, and regardless of whether the LSEs had contractual rights or ownership of generation at the source; (2) an explanation of how the proposal would be justified in a case in which the LSE does not have a fixed price generation contract at the source; (3) an explanation of how the proposal minimizes the risk of default if it does not require that the LSE has a fixed price generation or equivalent contract for quantities at least equal to the counterflow FTR obligations it holds; (4) an explanation of whether the rationale for reducing collateral would apply regardless of whether the counterflow FTR holder is an LSE if the counterflow FTR holder has a fixed price generation contract at the source; (5) clarification on whether the proposal takes into account the possibility that the amount purchased by the LSE for load will not be equivalent to the MW amount of counterflow FTR it holds, and if not, why the risk does not need to be taken into account; and (6) an explanation of whether the "unbounded risk" rationale for imposing more onerous collateral requirements on counterflow FTRs was applicable in the situation when LMP falls at the LSE's sink.

21. In its response, PJM explains that the Commission's questions address two legitimate yet separate risks that LSEs utilizing FTRs often face. First, PJM addresses what it calls FTR congestion risk, stating that the risk in the instant proposal is the risk

---

<sup>5</sup> PJM explains that the risk that a member could, and would, utilize these provisions for speculative positions has been weighed by its stakeholders and that its stakeholders have determined that the detriment of overcollateralization of an LSE's position outweighs any real, or perceived, risk.

that the congestion value of an FTR may vary, and, when compared with the price of the FTR, may expose the holder to losses. According to PJM, this is a risk that is created by virtue of acquisition of the FTR when no risk existed before the FTR was acquired. PJM states that its undiversified credit requirements were created to address this risk.

22. Next, PJM addresses the issue of energy price risk. PJM characterizes this risk as the risk that the price of energy to serve the LSE's load may vary, thus exposing the LSE to uncertain energy costs. PJM asserts that this is a legitimate business risk that many LSEs choose to mitigate through fixed price energy contracts, but that the Commission does not require LSEs to employ fixed price contracts to mitigate this risk. PJM states that its proposed tariff changes are intended to address only the FTR congestion risk.

23. PJM states that when an FTR sinks at a given load location, an energy market price change at that location affects, equally, both the FTR congestion value and the price of energy to serve the load.<sup>6</sup> PJM states that, accordingly, when a load obligation is paired with an FTR sinking at this load location, the price the LSE pays to serve its load is the price at the source of the FTR, not the price at the actual load location. According to PJM, by pairing the FTR with the load obligation at the sink, the FTR congestion risk is significantly mitigated and the predominant remaining exposure is the energy price risk at the source. PJM states that the energy price risk is not new because it already existed by virtue of the obligation to serve load. Rather, it merely shifted price point locations from the sink to the source through the pairing with the FTR.

24. PJM also states that its proposal does not contemplate the same reduction in credit requirements to all counterflow FTR holders. PJM states that, instead, the MW quantity of counterflow FTRs would not exceed the peak load service participant at each location, thus establishing a more precise measure of an appropriate credit reduction than a general reduction in credit requirements for all load serving participants with counterflow FTRs. PJM states that this limitation ensures that the exclusion of negatively-priced FTRs from the portfolio diversification are solely used to assist in hedging congestion to serve load and not utilized for purely speculative purposes. Further, PJM asserts that limiting the FTR volumes in this calculation to the LSE's peak load is consistent with the LSE's ability to request rights up to its peak load in the ARR allocation process while, simultaneously, ensuring that an LSE purchasing a possibly speculative counterflow position will have to post additional security commensurate with the risks. According to

---

<sup>6</sup> As an example, PJM explains that pairing a load obligation at point B with a counterflow FTR from point A to point B causes the LSE FTR holder to have: (i) an obligation to pay to PJM of Value B (for energy to serve its load obligation), along with; (ii) a payment to the LSE of Value B minus Value A (the FTR value). The net result for the owner is an obligation to pay of Value A (i.e., the price of energy at point A).

PJM, to the extent that FTR MWs are less than the LSE's load, the difference merely represents an un-hedged position, and does not present any FTR risk, nor does it affect the FTR credit calculations.

25. PJM also addresses the Commission staff's question about whether it is reasonable to provide the same reduction in credit requirements to all counterflow FTR holders that are LSEs with load at the counterflow FTR's sink, regardless of the LSE's contractual or ownership position with generation at the source. PJM asserts that this question confuses FTR risk with energy risk. PJM asserts that owning supply would hedge the energy price volatility that an LSE experiences, but that this is a separate business issue from the issue of risk associated with the FTR. PJM adds that requiring an LSE to hedge its load obligations with fixed price contracts is not a requirement which the Commission has previously imposed on LSEs.

26. PJM states that the risk associated with not having a fixed generation contract is the risk that the LSE will be subject to variable energy prices due to market price fluctuations and congestion. PJM asserts that if an LSE chooses to contract for energy at a fixed price, it can eliminate price uncertainty, but in the process it could ultimately pay more for that fixed price energy than if it had taken the floating prices without the fixed price contract, a business decision for all LSEs. PJM states that this is a decision that is not necessarily changed by virtue of owning a FTR that sinks at its load point, since such ownership merely shifts the price point or the energy supply. PJM explains that the undiversified credit requirement was instituted to protect against unbounded market losses for counterflow FTR positions bought for speculative purposes. According to PJM, ownership by an LSE of such a counterflow FTR sinking at the LSE's load zone does not create such an exposure, but merely reflects a shift in the location at which the energy price is exposed and so it does not make sense to add the undiversified credit requirements to such FTRs.

27. Further, PJM asserts that all of the normal credit requirements still hold true for counterflow FTRs. PJM states that the proposal does not exempt any party from posting secured credit in the FTR market if the posting of credit is indicated by the normal credit requirement calculation, but rather provides an adjustment to the calculation of the amount of the appropriate credit required by the participant. PJM asserts that if an individual FTR sinking at the owning LSE's load point position has historically not been profitable, there will be an FTR credit requirement for that FTR; it will just not have an undiversified credit requirement as well.

28. PJM explains that its proposal was not necessarily about minimizing risk, per se, but about not imposing undue requirements where relative risk was not increased by virtue of acquisition of the counterflow FTR. PJM states that when an LSE owns an FTR sinking at the load zone, the FTR merely shifts the price exposure from the load zone to the FTR source point. PJM asserts that ownership of the FTR by the LSE does not

necessarily minimize the risk, but also does not necessarily increase risk either. Rather, PJM explains, it is merely a shift in price point exposure and to require an additive credit requirement where the risk is not additive would be an undue burden on those seeking to serve load.

29. PJM states that the reduction of collateral would only apply to LSEs to be consistent with a LSE's ability to request ARR in the allocation process up to its peak load. Also, in its response to Commission staff's question, PJM states that the proposal takes into account the possibility that the amount purchased by the LSE for load will not be equivalent to the MW amount of counterflow FTR it holds because the reduction in credit requirements only applies to FTR MWs up to the LSE's peak load, which is consistent with the exposed congestion that they need to be able to hedge. In response to Commission staff's final question, PJM asserts that there is no increased risk in the situation where LMP falls at the sink. According to PJM, regardless of whether an FTR is forward flow or counterflow, as long as the sink is at an LSE's load location and the FTR MW are less than the LSE's load, if the price at the sink falls, then, necessarily, the price for energy to serve the load has fallen by an equal or greater amount. PJM asserts that the existence of the LSE obligation to serve load thus serves to bind the potential exposure of an FTR.

#### **4. Commission Determination**

30. As explained below, we accept, in part, and reject, in part, PJM's compliance filing. In the April 3 Order, the Commission accepted, as reasonable, PJM's proposed retention of its 12-month measurement as applicable to its Net Seller Credit Allowance, i.e., the proposal made by PJM in its March 10 Answer in response to intervenor concerns. PJM's compliance filing appropriately implements this proposal and is therefore accepted.

31. In the April 3 Order, the Commission required PJM to further address and, as necessary, revise its proposed FTR Unsecured Credit Allowance as it relates to certain LSE transactions involving counterflow FTRs. PJM, in response, proposes to reduce its collateral requirements as they relate to these transactions. We find, however, that PJM has not provided sufficient support to justify its proposal, as explained below. Therefore, we reject the relevant tariff sheets, without prejudice to PJM filing a fully supported proposal in the future.<sup>7</sup>

---

<sup>7</sup> DC Energy's protests to PJM's proposal to afford credit reductions to LSE's holding counterflow FTRs that sink at their load are moot, as we are rejecting PJM's proposal.

32. PJM has previously filed proposals with the Commission that imposed more stringent collateral requirements on counterflow than on forward flow FTR holders due to the uncertain obligations associated with counterflow FTRs and the potentially unbounded losses that could result.<sup>8</sup> However, PJM's proposal fails to adequately explain how PJM's stakeholders would be protected against such "unbounded" losses attributable to counterflow FTRs that sink at an LSE's load location. The Deficiency Letter addressed (and required PJM to respond) to the circumstance in which an LSE having no contract with generation could face a significant risk by acquiring a counterflow FTR whose sink is at the location of the LSE's load. In response, PJM, while not disputing the existence of this risk, characterizes the risk as an energy price risk, not a congestion price risk. PJM asserts that, as such, the risk does not require credit requirements that are as stringent because the risk at issue is a business risk that the Commission has not required LSEs to mitigate.

33. PJM has failed to explain how this purported distinction justifies its proposal to reduce the collateral requirements applicable to certain LSE counterflow FTRs. Specifically, PJM has not shown that an LSE that acquires a counterflow FTR faces less congestion price risk associated with price volatility at the source of the counterflow than any other market participant that acquires the same counterflow FTR. PJM asserts that an LSE that purchases a counterflow as a hedge, and that serves load at the sink of the counterflow, will offset the counterflow risk, unlike a speculator that does not serve load. PJM also asserts that the effect of the LSE's counterflow is to shift price point locations from the sink to the source through the pairing with the FTR. However, while the use of a counterflow FTR may offset the risk of price fluctuations at the LSE's load and shift price point locations, it does nothing to mitigate the virtually unbounded risk at the source of the counterflow FTR. PJM has not explained how it is protected from such price volatility. This makes the unbounded energy price risk that is solely the result of the LSE holding the counterflow FTR, a risk that should be collateralized in the same way it would be if the counterflow FTR was held by any other entity. Therefore, we disagree with PJM's assertion that relative risk was not increased by virtue of an LSE's acquisition of the counterflow FTR, and believe that an additive credit requirement is appropriate, as it is for other holders of counterflow FTRs.

34. Therefore, we find that PJM has not justified its proposed reduction in collateral for LSEs holding counterflow FTRs that sink at their load. For the foregoing reasons, we reject such proposal, without prejudice.

---

<sup>8</sup> Although there is a \$1000/MWh limit on the price that can be bid at any point, the clearing price can increase above \$1000/MWh during transmission shortages. *See, New York Independent System Operator, Inc.*, 119 FERC ¶ 61,237 (2007).

The Commission orders:

(A) We hereby deny rehearing of the April 3 Order, as discussed in the body of this order.

(B) PJM's compliance filing is hereby accepted, in part, and rejected, in part, as discussed in the body of this order.

By the Commission.

( S E A L )

Kimberly D. Bose,  
Secretary.