

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Atlantic City Electric Company,
Delmarva Power & Light Company,
Potomac Electric Power Company

Docket Nos. EL06-55-001
EL06-55-002

v.

PJM Interconnection, L.L.C.

ORDER ON REHEARING AND COMPLIANCE FILING

(Issued November 6, 2006)

1. This order addresses a filing made on August 3, 2006, in response to the May 1, 2006 Order in the captioned docket,¹ by PJM Interconnection, L.L.C. (PJM), to be effective June 1, 2007. The proposed tariff sheets listed in Attachment B of that filing modified PJM's Tariff and Operating Agreement to implement a marginal cost methodology for the pricing and recovery of transmission line losses on the PJM system, as required by the May 1 Order. At this time there are also a number of requests for rehearing of the substantive and procedural requirements of the May 1 Order.
2. The Commission accepts the Tariff and Operating Agreement sheets in Attachment B of the filing, which embodies the majority proposal, to be effective June 1, 2007, and denies the rehearing requests. The Commission also rejects the alternative tariff provision in Attachment D to the August 3 filing.

Background

3. This case began on March 3, 2006, when the Atlantic City Electric Company and others filed a complaint alleging that PJM's current practice of recovering transmission line losses through an average cost method violated PJM's tariff. The Complainants asserted that PJM's tariff requires that the transmission line losses should be recovered

¹ *Atlantic City Electric Company, et al. v. PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,132 (2006) (May 1 Order).

through a marginal cost method when this became technically feasible. They argued that this was now the case and that PJM was unreasonably delaying implementation of that method because of stakeholder disputes on how to allocate the cost recovery surplus that would result. They argued that continued delay would result in misallocation of transmission line losses among load by as much as \$100 million per year, and concluded that the average cost method is inconsistent with the efficiency principles underpinning the locational marginal cost method that determines PJM wholesale prices. By contrast, most parties urged that PJM retain the average cost method of recovering transmission losses, or that implementation of the marginal cost method be delayed until June 1, 2007.

4. The Commission's May 1 Order concluded that PJM's tariff required use of the marginal loss methodology when it was technically feasible and that this was now the case. The Commission also affirmed that the marginal loss method was appropriate because it would allow PJM to change its dispatch of generators (by considering the effects of losses) in a way that would reduce the total cost of meeting load.² The Commission found that the marginal cost method effectively imposes different loss charges to customers at different locations as the loss component of the energy price varies for customers at different locations. That is, each spot market energy customer pays an energy price that reflects the full marginal cost – including the marginal cost of losses – of delivering an increment of energy to the purchaser's location. Since losses vary in delivering energy to different locations, marginal losses increase as the number of megawatts of power moved increases. As a result, charging for marginal losses will result in collecting more revenues than needed to cover total loss costs.³ The Commission further found that PJM would need to develop a method to credit any overcollections. The Commission therefore directed PJM to file its proposed method for implementing marginal losses no later than August 3 and implement that methodology on October 2, 2006. The Commission also directed PJM to escrow any surplus if there was no agreement on an allocation method by that date.

5. On June 2, 2006, PJM filed a motion requesting deferral of the October 2 date to June 1, 2007, asserting that this would permit a more orderly transition to the marginal method. Certain of the issues related to the operation of market, reliability, and settlement, and others to the changes in patterns of dispatch that would result. PJM agreed with certain of its stakeholders that prices paid for current FTRs assumed an average loss method based on patterns of dispatch that would result from that method. As such, a delay would lessen the risk of loss, the disruption of existing patterns, and the likelihood of commercial litigation. PJM stated it would comply with the obligation to

² See May 1 Order, 115 FERC ¶ 61,132, at P 22.

³ See *Id.* at P 5.

file its proposed method on August 3. The request was strongly supported by many of the parties, including those supporting the conclusions of the May 1 Order, and was unopposed by the Complainants. The Commission granted the motion on June 19, 2006.

Rehearings

6. Requests for rehearing of the May 1, 2006 Order were filed by PJM Stakeholders,⁴ the PSEG Companies,⁵ Reliant Energy, Inc., Allegheny Energy Supply Company, LLC, Constellation Energy Group Companies,⁶ Dominion Resources, Inc., and PPL Electric Utilities Corporation and PPL Energyplus, LLC. All of these rehearing requests ask the Commission to delay the effective date of its May 1 Order until June 1, 2007, in order to avoid disruption of the current FTR market and other positions taken by these parties in early 2006, to determine the method for allocating the overcollection of revenues, and to mitigate the impact of overcollections on the efficiency gains claimed to result from adopting a marginal loss method for recovering transmission line losses.

7. Old Dominion Electric Cooperative and Delaware Municipal Electric Corporation filed a joint rehearing request that asked the Commission to reject the complaint addressed by the May 1 Order because the adoption of the marginal loss method would not obtain the economic efficiency claimed by the complaint. Alternatively, they request the Commission to extend the May 1 effective date to resolve the problems that would flow from any overcollection of revenues.

8. Requests for late intervention and for rehearing were filed by Lehman Brothers Commodity Services (Lehman Brothers) and Morgan Stanley Capital Group Inc. (Morgan Stanley). When late intervention is sought after the issuance of a dispositive order, the prejudice to other parties and burden upon the Commission of granting the late intervention may be substantial. Thus, movants bear a higher burden to demonstrate good

⁴ The PJM Stakeholders include: American Electric Power Service Corporation on behalf of its affiliates Appalachian Power Company, Columbus Southern Power Company, Indiana Michigan Power Company, Kentucky Power Company, Kingsport Power Company, Ohio Power Company and Wheeling Power Company; Duquesne Light Company; PJM Industrial Customer Coalition; Dayton Power & Light Company; Sempra Energy Trading Corp; and the Public Utilities Commission of Ohio.

⁵ Public Service Electric and Gas Company and PSEG Energy Resources and Trade, LLC.

⁶ Constellation Energy Commodities Group, Inc., Constellation Generation Group, LLC, Baltimore Gas and Electric Company, and Constellation NewEnergy, Inc.

cause for granting such late intervention.⁷ Lehman Brothers and Morgan Stanley have failed to meet their burden to justify the granting of their late interventions in this proceeding. Neither of these two parties has provided cogent reasons why they should be permitted to intervene at this point and neither makes arguments not raised by the parties that intervened in a timely manner. Accordingly, the Commission denies these late interventions. The Commission also dismisses the request for rehearing because, under Rule 713(b) of the Commission's regulations,⁸ only a party to a proceeding is entitled to request rehearing of a Commission decision.

Interventions, Protests and Comments

9. The compliance filing was noticed on August 10, 2006, with comments due by August 24. Timely motions to intervene with comments or protests were filed by: Allegheny Electric Cooperative; Allegheny Energy Supply Company, LLC; American Electric Power Service Corporation; Blue Ridge Power Agency; Bluestar Energy Services, Inc.; the Borough of Chambersburg, Pennsylvania; BP Energy Company; the City of Hagerstown and the Town of Thurmont, Maryland, filing jointly (Maryland Municipalities); Constellation Energy Group Companies;⁹ DC Energy, LLC; the Delaware Municipal Electric Corporation, Inc.; Duquesne Light Company; Epic Merchant Energy, LP; Edison Mission Energy, Edison Mission Marketing & Trading, Midwest Generating EME, Inc., and Williams Power Company, Inc., filing jointly; Exelon Corporation; the FPL Energy Generators, NRG Companies, and Mirant Parties,¹⁰ filing jointly; the Long Island Power Authority and Neptune Regional Transmission System, LLC; Old Dominion Electric Cooperative (ODEC); Pepco Holdings, Inc, Potomac Electric Power Company, Delmarva Power & Light Company, and Atlantic City Electric Company; and the PSEG Companies.

⁷ See, e.g., *Midwest Independent Transmission System Operator, Inc.*, 102 FERC ¶ 61,250 at P 7 (2003); *Florida Power & Light Co.*, 99 FERC ¶ 61,318, at 62,358 (2002); *Garnet Energy LLC*, 99 FERC ¶ 61,165, at 61,672 (2002); *Edison Mission Energy*, 96 FERC ¶ 61,032, at 61,082-83 (2001).

⁸ 18 C.F.R. § 713(b) (2006).

⁹ There are four affiliates listed on the first page of the filing, whose intervention is accepted.

¹⁰ These consist of ten FPL affiliates, eight NRG affiliates, and four Mirant affiliates as specifically listed on page one of the filing, whose intervention is accepted.

10. Timely motions to file without comments were filed by Duke Energy Shared Services, Inc., Illinois Municipal Electric Agency, and the Joint Consumer Advocates.¹¹ Motions for late intervention and comments were filed by Direct Energy Services, LLC, the FirstEnergy Companies,¹² Strategic Energy, L.L.C., and J.P. Morgan Ventures Energy Corporation, pursuant to Rule 212. Lehman Brothers submitted late-filed comments. The Commission grants late intervention pursuant to Rule 212 because this proceeding will not be unduly delayed and no other party will be prejudiced thereby. While we have reviewed Lehman Brothers' comments, we note that it is not a party to the proceeding.¹³ In addition to the substantive comments discussed below, fifteen intervening parties supported PJM's suggestion for a technical conference (or settlement judge procedures) and five concluded that such procedures would have no useful purpose.

The Filing

11. PJM's August 3 filing modified its tariff to provide the necessary mechanics for utilizing the marginal cost method to recover transmission line losses. These portions of the filing are generally uncontested, as are certain housekeeping matters related to other portions of PJM's operations.¹⁴ PJM also proposed three different methods for allocating the surplus that will result from the marginal cost method. Two are contained as proposed tariff language, one of which reflects a majority provision that all surplus revenues should be allocated to load on a megawatt load ratio basis. A minority position would allocate 40 percent to generation, 40 percent to load, and 20 percent to help cover any shortfall PJM may incur in meeting its FTR payments. A third concept advanced by PJM, but was not included as tariff language, would allocate surplus revenues first to fully fund FTRS and then to load using the megawatt load ratio method. This latter proposal did not even obtain a vote under PJM's stakeholder process.

12. The majority proposal is generally supported by load members and would allocate all surplus revenues to load based on the megawatt ratio each load to total load across the entire PJM system. This proposal received a weighted vote of 3.29 (65.8 percent) in

¹¹ Consisting of the Pennsylvania Office of Consumer Advocate and Office of the Peoples Counsel for the District of Columbia.

¹² Jersey Central Power & Light Company, Metropolitan Edison Company, and Pennsylvania Electric Company.

¹³ *See supra* P 8.

¹⁴ Maryland Municipalities also suggests that PJM's proposed, but relatively narrow, changes to the FTR provisions require further explanation, but does not clearly identify the concern. The Commission will not pursue this comment further in light of the broad acceptance of these technical changes and the absence of a well defined relief.

favor and 1.17 (34.2 percent) against, or slightly less than the 3.35 required to obtain a super-majority under PJM's stakeholder process. The proposal would not distribute the surplus based on the ratio of how the surplus is incurred. It would, however, distribute the surplus monthly based on proportional megawatt usage, or in rough proportion to each load member's obligation to support the fixed and administrative costs of the grid. In this regard, Maryland Municipalities argues for a more refined definition of the areas used to define the load ratio rather than the entire PJM system to avoid possible cross subsidies.

13. The comments favoring the majority position do so based on its simplicity, the fact it came very close to the required super majority, and that fact that generation does not incur costs to sustain the grid. Rather, the operating and fixed costs are paid by load in proportion to use, and line loss transmission is an operating cost that load has traditionally paid for. Thus, since load supports the operation of the grid based on the relative megawatt use, any surplus should be distributed on that basis. The opponents assert that load has used its dominance in the PJM stakeholder process for simple self-enrichment since load has no entitlement to the surplus. They also argue that the PJM has not justified why the simplicity involved renders the majority proposal just and reasonable, particularly given the impact the marginal loss method will have on pricing and commercial patterns. Twelve comments support this option or variations on it.

14. The minority proposal would allocate the surplus 40 percent to load, 40 percent to generation, and 20 percent to cover any funding shortfalls from the FTR program. The supporting comments were filed primarily by generators, which argue that there is no entitlement to the surplus under the May 1 Order and that both generation and load contribute to the issue. Thus, it is equitable that both sides of a wholesale transaction share in the surplus. These comments also argue the proposal would bring greater stability to the FTR program and compensate somewhat for the additional risk that the use of marginal loss pricing would impose on commercial transactions. It will also ameliorate the impact on the competitive position of individual generators that will result when the marginal loss method is effective. Opponents to this proposal assert that generation makes no contribution to the capital structure of the grid or its maintenance and operating costs. They assert that, as such, it is less true to the findings of the May 1 Order because the impact of distance and volume sensitive costs would be reduced.

15. The PJM staff developed a third proposal that would allocate the entire surplus to cover any shortfall of FTR payments in any given year, with any residual being allocated to load on a megawatt ratio basis. While this proposal has support in five comments, almost all from the trading or financially oriented parties, it received no support during the stakeholder process. Several comments assert that this proposal was decisively rejected at the stakeholder level and that PJM agreed not to advance it further, and then turned around and did so in its filing. They assert that this undercuts the stakeholder process, which after many suggestions and proposals discussed resulted in only two being

presented for a formal vote. The comments opposing the PJM FTR proposal also assert that any shortfall in PJM's FTR payments should be addressed on the economic merits of that matter and not be subsidized from another source, particularly since some FTRs are purchased for speculative purposes rather than to provide for the reliable delivery of power.

16. Pursuing a different point, ODEC asserts that the present filing is premature. It notes that the May 1 Order required PJM to implement a marginal cost method by October 2 and to resolve how to allocate the surplus through the PJM stakeholder process. It asserts that since the instant filing is not a compliance filing because it includes a proposal that has not received stakeholder approval, and as such is inconsistent with the May 1 Order. Finally, LIPA and Neptune assert that the PJM filing does not explain how the marginal cost method will impact the Neptune system given that it is a merchant transmission line and not conventional load such as a load serving entity. They therefore object to the filing until the possible impacts on the Neptune system can be resolved.

Discussion

A. ODEC's Party Status

17. ODEC asserts on rehearing that the Commission ignored its motion to intervene and its protest. Although ODEC's intervention was inadvertently not mentioned in the May 1 Order, that order responded in the body of the order to the concerns that it raised. The Commission grants ODEC's rehearing request and makes it a party to the proceeding as of the May 1 Order.

B. The requests for rehearing

18. Other than ODEC, the rehearing requests of the May 1 Order assert that it is impractical to implement a marginal cost method of recovering transmission losses by August 2 and request that the implementation be delayed until June 1, 2007. A related rehearing point is that the marginal loss method should not be implemented until the allocation issue is resolved. The Commission granted PJM's June 2 motion to delay the effective date until June 1, 2007, thereby mooting these requests for rehearing. This order resolves the allocation issue and affirms that the marginal loss method will be implemented on June 1, 2007, thereby mooting the rehearing requests on those points.

19. The PJM Stakeholders request clarification of whether the Commission's May 1, 2006 Order was based on an interpretation of PJM's tariff or in fact required PJM to implement the marginal loss method even if the stakeholders were not supportive of this method. ODEC also asserts that the Commission erred in accepting the complaint without conducting any analysis under section 206 of the FPA.

20. In the instant complaint the Commission found that PJM violated its current tariff by not implementing the locational marginal loss method for recovering transmission line losses. Section 206 is invoked if the Commission acts to modify a tariff on the grounds that it is unjust and unreasonable. In this case, the PJM Operating Agreement stated:

Whenever the Office of Interconnection has in place the appropriate computer hardware, software, and other necessary resources **to account for marginal losses** in the dispatch of energy, and the calculation of Locational Marginal Prices, **loss accounting shall be determined on that basis**, and the provisions of this section shall be revised accordingly. Until such time, the following accounting provisions for losses shall apply. (Emphasis added).¹⁵

The May 1 Order did not require modification of this provision or any other tariff provision, but rather enforced it, given PJM's admission that it was feasible to implement the marginal loss methodology.

21. ODEC asserts that the Commission erred in allowing the complainants to bypass the stakeholder process. The Commission here simply enforced the existing tariff as it stands. Should the stakeholder process devise an alternative just and reasonable method of measurement, it can submit that proposal under section 205 of the FPA for Commission consideration.

22. ODEC also argues that the projected \$100 million in efficiencies is speculative. Even if the figure is incorrect, PJM's tariff required PJM to implement the marginal loss method when it was technically feasible to do so. Moreover, as discussed in the prior order,¹⁶ use of the marginal loss method provides an efficient pricing structure because it ensures that each customer pays the proper marginal cost price for the power it is purchasing. Moreover, by changing to the marginal losses method, PJM would change the way that it dispatches generators by considering the effects of losses. As a result, the most efficient generator to serve load would be dispatched.

23. ODEC also asserts that the Commission erred in its determination that marginal losses reinforce PJM's use of locational marginal prices (LMP) to price electricity. The Commission denies rehearing. As discussed in the May 1 Order, our primary rationale for ordering PJM to implement marginal losses is to enforce PJM's existing tariff provision. As also discussed here and in the May 1 Order, locational marginal prices are at the core of the PJM pricing methodology, because marginal prices send the proper price signals about the cost of obtaining generation. The marginal cost of meeting

¹⁵ Section 3.2.5(a) of the Operating Agreement.

¹⁶ May 1 Order, 115 FERC ¶ 61,132, at P 4 and P 22, n. 22.

additional load at any location includes the cost of the marginal losses incurred in moving energy from the generation source to the load. For example, suppose that the bid of the highest price (least efficient) generator dispatched to serve load is \$50/MWh, and moving energy from the generator's location (Point A) to meet an increment of load at Point B would result in 10 percent marginal losses. As a result, meeting an additional 1 MWh of load at Point B would require that the generator produce 1.1 MWh of energy (*i.e.*, 1 MWh to meet load and 0.1 MWh to cover the 10 percent marginal losses).

24. Thus, the marginal cost of meeting load at Point B – and the just and reasonable price at Point B – would be the marginal cost of producing 1.1 MWh of energy at Point A, *i.e.*, \$55/MWh (which is \$50/MWh times 1.1 MWh). As explained in detail in the May 1 Order, the use of the marginal loss method properly determines the impact of a customer's decision to use a generator far from its load rather than one close to its load. For example, if ODEC wishes to buy power from a generator in West Virginia offering a lower price than a generator on the Delmarva Peninsula, ODEC should be charged the marginal cost of supplementing line losses that choosing the farther away generator imposes on the PJM system. Charging only average line losses underestimates the impact of using the remote generator and, therefore, does not promote efficient allocation of resources. The May 1 Order correctly adopted the marginal loss methodology.

C. The August 3 Filing

25. In the May 1 Order, the Commission recognized that a method needed to be determined for disbursing the overcollected amounts, since PJM could not hold such amounts in perpetuity. In order to give the stakeholders additional time to consider the appropriate method of distribution, the Commission required PJM to make a compliance filing not later than 60 days prior to October 2, 2006, to resolve this issue. The Commission's only requirement was that "the method for disbursing the amounts of any over collections should not directly reimburse customers for their marginal loss payments, as such a collection would interfere with the goal of basing prices on marginal losses."¹⁷

26. The stakeholder process failed to reach the required consensus on any one proposal, and PJM made its compliance filing setting forth the three methods that had been considered: a majority proposal, which came close to reaching consensus, a minority proposal, and a staff proposal that was not considered by the stakeholders.

27. All three of the proposals meet the principle established by the Commission that the methodology for reimbursement not undermine the purpose of implementing marginal loss pricing, since none of these proposals would allocate the surplus to customers in proportion to the amount of each customer's payment of marginal losses.

¹⁷ *Id.* at P 24.

Therefore, the customer will face the correct price signal when determining whether to purchase power from a remote generator. The Commission will accept the majority proposal contained in Attachment B of PJM's filing, which the Commission finds is just and reasonable and also has the greatest support. The Commission recently accepted a similar proposal by the California ISO for disbursing the revenue surplus pro-rata on the basis of load.¹⁸

28. This proposal allocates any revenue surplus using a megawatt ratio of each monthly load to total load. This allocates the surplus based on monthly demand (and hence monthly charges for use), but does not allocate the surplus based on the amount of transmission line loss charges PJM bills to a specific load customer. Thus, contrary to the protesters, this method does not dampen the price signals that result for the marginal loss method, because a customer buying power closer to its load would receive the same distributed amount as it would if it purchased from a remote generator. Further, it is fair to distribute surpluses back to load customers since they pay for the fixed costs of the grid.

29. Some protesters argue that generators should be able to share in the surplus since remote generators may be negatively impacted by use of the marginal loss method. However, the Commission finds it reasonable to allocate the overcollections to the parties paying network and point to point transmission charges since marginal losses are part of the payment for transmission service. All generators, including the less expensive but more remote generators, will be facing a competitive market for their generation, which is the opportunity the PJM market is designed to provide. Two protesters argue for first applying the surplus to FTRs. This proposal however, can best be addressed in a proceeding specifically dealing with FTR undercollections where all the ramifications can be analyzed.

30. ODEC maintains that it is premature to adopt this proposal and circumvent the stakeholder process. Instead, it would prefer that PJM maintain an escrow account while the stakeholder process continues. PJM, and the other parties, however, maintain that a decision on the method of distributing overcollections should be made now so that parties have the ability to plan their generation and hedging strategies prior to the implementation of the marginal loss method. Since the majority proposal is just and reasonable, the better course is to adopt that proposal now to give parties the advance notice they request.

¹⁸ See, *California Independent System Operator Corporation*, 116 FERC ¶ 61,274, at PP 90-97.

31. Neptune does not challenge the adoption of the majority proposal; it only states that it has not yet received clarification from PJM as to whether the marginal loss proposal will be applied to its DC merchant transmission line, which is not yet operational. Neptune states that it is in the process of discussing the application of the marginal loss methodology to its line. Neptune has failed to raise any basis for rejecting the current filing.

The Commission orders:

(A) The requests for rehearing are denied or dismissed as moot for the reasons stated in the body of this order.

(B) The requests for a technical conference or settlement procedures are denied.

(C) The tariff sheets in Attachment B of PJM's August 3, 2006 filing are accepted, effective June 1, 2007.

(D) The alternative tariff sheets listed in Attachment D of PJM's August 3, 2006 filing are rejected.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.