132 FERC ¶ 61,180
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

PJM Interconnection, L.L.C. — Docket Nos. ER09-650-003

ORDER ON REHEARING

(Issued August 27, 2010)

1. The Illinois Municipal Electric Agency (IMEA) and Allegheny Electric Cooperative, Inc. (Allegheny) (collectively, IMEA-Allegheny) and PJM Interconnection, L.L.C. (PJM) seek rehearing of the April 15, 2010 order issued in this proceeding.[1] For the reasons discussed below we grant PJM's request for rehearing. We deny IMEA-Allegheny's request for rehearing.

Background

2. On February 3, 2009, PJM proposed to revise its existing credit policies by, among other things, eliminating its Unsecured Credit Allowance for future Financial Transmission Rights (FTR) trading. In an order issued by the Commission on April 3, 2009, the Commission conditioned its acceptance of PJM's filing on the submission, by PJM, of 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.[2]

3. On May 4, 2009, PJM submitted its compliance filing, including two amendments relative to its proposed reduction and/or offset to FTR credit requirements for LSEs. Specifically, PJM proposed: (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

[1] *PJM Interconnection, L.L.C.*, 131 FERC ¶ 61,017 (2010) (April 15, 2010 Order).

[2] *PJM Interconnection, L.L.C.*, 127 FERC ¶ 61,017, at P 37 (2010) (April 3, 2009 Order).

planning year's undiversified credit requirements under PJM's long term FTR auctions; and (ii) excluding negatively priced (i.e., counterflow) FTRs that sink at an LSE's load location from determination of portfolio diversification and the associated FTR credit requirement calculation.

4. On October 8, 2009, Commission staff issued a deficiency letter requesting further information regarding PJM's counterflow FTR proposal.[3] In its response, submitted November 9, 2009, PJM provided additional support for its proposal.

5. In its April 15, 2010 Order, the Commission accepted, in part, and rejected, in part, PJM's compliance filing. With respect to counterflow FTRs, the Commission found that PJM had not provided sufficient support to justify its proposal as it would apply to counterflow FTRs that sink at an LSE's load location when an LSE has no contract with generation. The Commission found that this makes the unbounded energy price risk, which 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. Accordingly, the Commission rejected PJM's assertion that relative risk was not increased by virtue of an LSE's acquisition of the counterflow FTR, and found that an additive credit requirement is appropriate, as it is for other holders of counterflow FTRs.[4]

<u>Requests for Rehearing</u>

6. PJM requests rehearing regarding its proposal to allow 25 percent of an LSE's current planning year ARR credits to be recognized as a credit offset to each planning year's undiversified credit requirements under PJM's long term FTR auctions. PJM states that, while the Commission addressed and rejected PJM's proposal to reduce the amount of collateral required for LSEs holding counterflow FTRs that sink at their load, the Commission failed to expressly authorize or reject PJM's related, but separate, proposal relative to the proposed 25 percent ARR credit offsets.

7. PJM states that its proposal would allow a portion of an LSE's current ARRs to be recognized as a credit offset to credit requirements established in long term FTR auctions. PJM states that, because many entities serve roughly the same load each year, their year-

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[3] Among other things, the deficiency letter sought 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.

[4] April 15, 2010 Order, 131 FERC ¶ 61,017 at P 31-34.

to-year ARR credits are relatively stable and that, as such, PJM proposed to allow 25 percent of current planning year ARR credits to be allowed to offset each future planning year's undiversified credit requirement that may arise from purchases in the long term FTR auctions. PJM states that empirical review of historical ARR credits indicates that, on average, LSEs obtain 67 percent of a year's ARR credits in the subsequent two years and that, accordingly, the 25 percent ARR credit in years two and three of a long term FTR contract would be an appropriate conservative credit.

8. PJM adds that its proposed forward recognition of current ARR credits would cease for an individual year subsequent to the ARR allocation process preceding the annual FTR auction for that year, given that the allocation process would, itself, provide the full value of ARR credits to the participant for the relevant time period. PJM states that, as a result, its proposed tariff revisions clarifying that, for portfolios which are FTR flow undiversified in the months subsequent to the current planning year, the incremental FTR flow undiversified credit amounts, as calculated on a monthly basis, would be reduced by an amount up to 25 percent of the monthly value of ARR credits that are held by a participant (but that in no case would the reduction be below zero).[5]

9. IMEA-Allegheny also seeks rehearing, and asserts as error the April 15, 2010 Order's rejection of PJM's proposal to reduce the collateral requirements applicable to certain LSE's counterflow FTRs. IMEA-Allegheny notes that the Commission rejected PJM's proposal, to the extent it would apply to potentially unbounded losses attributable to counterflow FTRs that sink at an LSE's load location when there is no contract in place from the generation source. IMEA-Allegheny argues that, in rejecting this proposal, the Commission also rejected its applicability to an LSE's counterflow FTRs that are supported by generation contracts. IMEA-Allegheny asserts that in doing so, the Commission, in effect, "threw out the baby with the bath water."

10. IMEA-Allegheny notes that IMEA purchases counterflow FTRs on paths from its own generation facilities on PJM's approved list of historical generation to its load. IMEA-Allegheny argues that, as such, all transmission charges payable to PJM by IMEA for holding counterflow FTRs are offset by day ahead energy credits, such that there is no increase in risk to the marketplace attributable to IMEA's purchase.

11. IMEA-Allegheny argues that, by contrast, were IMEA not to buy counterflow FTRs, due to the imposition of prohibitive collateral requirements, PJM's market risks would rise due to IMEA's exposure to volatile energy prices. Alternatively, IMEA-Allegheny asserts that, if it is required to pay the additional collateral required as a result of the Commission's ruling, the costs involved will be onerous (in the case of IMEA

[5] *See* Proposed Tariff Changes at PJM OATT, Attachment Q, Section V.G.

alone, equal to three times the amount of the benefit received from holding the counterflow FTRs).[6]

12. IMEA-Allegheny asserts that its FTR purchasing practices present a situation that both PJM and the Commission have not been concerned with, i.e., an LSE serving its own load from PJM-approved historic generation, and thus not an LSE that: (i) has no contract with generation; and (ii) purchases counterflow FTRs at amounts equal to or less than its peak load.[7] IMEA-Allegheny concludes that it presents a different, demonstrably lower risk profile, if any risk at all, i.e., a circumstance not addressed by the April 15, 2010 Order.

13. IMEA-Allegheny suggests that while, as the Commission found, there may be unbounded risks when an LSE purchasing counterflow FTRs to sink at its load has no contract with generation, these risks would be reduced under PJM's proposal. IMEA-Allegheny argues that the Commission failed to address these specific conditions.

14. IMEA-Allegheny also argues that the Commission's ruling is inconsistent with its prior decision addressing another aspect of PJM's counterflow FTR credit requirements.[8] IMEA-Allegheny argues that, in that order, the Commission recognized that PJM's credit requirements were appropriately raised for undiversified FTR portfolio participants with net counterflow positions and that PJM's credit requirements worked by precisely matching a participant's credit requirements with its actual FTR risks.[9]

15. Finally, IMEA-Allegheny asserts as error the Commission's failure to provide guidance regarding what revisions to PJM's proposal might have passed muster under the standard applied by the April 15, 2010 Order.

[6] IMEA-Allegheny asserts that Allegheny operates under a similar business model regarding its purchase and need for counterflow FTRs, and has experienced the same type of disproportionate and unanticipated credit requirements as a result of the April 15, 2010 Order.

[7] IMEA-Allegheny Rehearing Request at 9, (citing April 15, 2010 Order, 131 FERC ¶ 61,017 at P 32).

[8] *PJM Interconnection, L.L.C.*, 122 FERC ¶ 61,279, at P 78 (2008) (FTR Credit Order).

[9] FTR Credit Order, 122 FERC ¶ 61,279 at P 36.

Discussion

16. For the reasons discussed below, we grant PJM's request for rehearing. We deny IMEA-Allegheny's request for rehearing.

17. PJM requests rehearing regarding its proposal to allow 25 percent of an LSE's current planning year ARR credits to be recognized as a credit offset to each planning year's undiversified credit requirements under PJM's long tern FTR auctions. PJM's proposal would allow a portion of an LSE's current ARRs to be recognized as a credit offset to credit requirements established in long term FTR auctions.

18. We grant PJM's rehearing and will accept those portions of PJM's filing relating to ARR credits. We agree with PJM that, because many entities serve roughly the same load each year, their year-to-year ARR credits, which are allocated based on load, are relatively stable. Thus, we find that PJM's proposal to allow 25 percent of current planning year ARR credits to offset credit requirements for each future planning year is appropriate.[10] We will therefore accept Second Revised Sheet No. 523I.05c to PJM's FERC Electric Tariff, Sixth Revised Volume No. 1.

19. We deny IMEA-Allegheny's request for rehearing, however. IMEA-Allegheny argues that the Commission erred in rejecting PJM's proposal to exempt LSEs from the requirements to post collateral for counterflows because in some cases LSEs, such as IMEA-Allegheny, pose little credit risk because the counterflow FTRs they purchase are completely offset by underlying day ahead energy credits.

20. PJM's section 205 proposal was not limited to the situation posited by IMEA-Allegheny. It would have exempted LSEs from counterflow FTR collateral requirements in all situations. PJM made this clear in its response to the deficiency letter where PJM stated that its proposal would be justified even when the LSE does not have a fixed price generation contract at the source.[11] The Commission thus determined that PJM's full proposal was not just and reasonable because PJM had not adequately explained why in

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[10] PJM's off-set allowance is embodied in its currently-effective tariff. *See* PJM OATT, Sixth Revised Volume No. 1, Attachment Q, Section V.G, Second Revised Sheet No. 523I.05c. As such, a compliance filing reflecting the clarification granted herein is not required.

[11] *Compare* October 8, 2009 Letter to Robert V. Eckenrod, Esq., PJM Interconnection, L.L.C. at 2 (example of using a generation contract as a hedge), *with* PJM's November 9, 2009 Response at 6-8 (explaining that the example was not the justification for its filing).

all circumstances an LSE holding a counterflow FTR would be less risky than any other party holding that counterflow FTR. As the Commission explained:

> 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.[12]

The question of whether a more limited proposal, such as that advocated by IMEA-Allegheny, would be just and reasonable therefore is not at issue in this proceeding. The Commission, however, indicated that its rejection was without prejudice to PJM filing another proposal.[13]

21. IMEA-Allegheny also argues that, while there may be risks attributable to an LSE's purchase of counterflow FTRs, where there is no corresponding contract with generation, these risks would have been reduced under PJM's proposal. However, there was no evidence presented by PJM, or by any other party, suggesting that PJM's proposal would ameliorate the unbounded risks identified by the Commission in the April 15, 2010 Order. Nor has IMEA-Allegheny presented any such quantification on rehearing.

22. We also reject IMEA-Allegheny's argument that the April 15, 2010 Order cannot be reconciled with the FTR Credit Order. In the FTR Credit Order, the Commission accepted tariff revisions providing added protection to PJM's members by increasing collateral requirement for undiversified FTR portfolio participants, thereby reducing the risk of their default. In doing so, the Commission stated, as a general proposition, that PJM's collateral requirements should be correlated with the risk exposure in the FTR market.[14] This principle was not ignored, or left unaddressed, in the April 15, 2010 Order. To the contrary, the Commission rejected PJM's proposal precisely because it failed to show that the mere fact that an LSE holds a counterflow FTR ameliorates the unbounded risk posed by the counterflow FTR.[15]

23. Finally, we reject IMEA-Allegheny's argument that the Commission erred, in the April 15, 2010 Order, by failing to provide specific guidance regarding the revisions that

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[12] April 15, 2010 Order, 131 FERC ¶ 61,017 at P 33.

[13] *Id*. P 34.

[14] FTR Credit Order, 122 FERC ¶ 61,279 at P 36.

[15] April 15, 2010 Order, 131 FERC ¶ 61,017 at P 33.

might have been required to PJM's proposal such that it could have been accepted. Under section 205 of the FPA, the Commission can accept or reject a proposal made by the public utility, but is not required to opine on what might be an acceptable filing. As noted above, PJM can make another section 205 filing including a more limited one along the lines posited by IMEA-Allegheny if it believes it can justify its proposal.[16]

The Commission orders:

(A) PJM's request for rehearing is hereby granted as discussed in the body of this order and Second Revised Sheet No. 523I.05c to PJM's FERC Electric Tariff, Sixth Revised Volume No. 1 is hereby accepted.

(B) IMEA-Allegheny's request for rehearing is hereby denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

[16] PJM or IMEA-Allegheny also could file a request for a Declaratory Order if it seeks Commission guidance on a specific proposed approach.