UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

PJM Interconnection, L.L.C. Docket No. ER05-12-000

ORDER ACCEPTING PROPOSED TARIFF REVISIONS,
IN PART, AND REJECTING PROPOSED TARIFF REVISIONS, IN PART

(Issued November 30, 2004)

1. On October 1, 2004, PJM Interconnection, L.L.C. (PJM) submitted for filing, pursuant to section 205 of the Federal Power Act (FPA),[1] proposed changes to its policies governing the establishment and maintenance of credit. For the reasons discussed below, we will conditionally accept for filing PJM's proposed tariff revisions, in part, to become effective December 1, 2004; we will reject PJM's proposed revisions to its Credit Score methodology.[2] This order benefits customers by clarifying PJM's Credit Policy.

Background

2. PJM states that that the proposed tariff changes included in its filing were identified by PJM following its recent experience in overseeing the requirements of its existing Credit Policy, which is set forth in Attachment Q of its open access transmission tariff (PJM OATT).[3] PJM states that its proposed revisions include miscellaneous minor modifications, improvements, and clarifications to its Credit Policy.

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[1] 16 U.S.C. § 824d (2000).

[2] *See* Appendix for accepted sheets.

[3] Attachment Q became effective on July 14, 2003, following the issuance of a Commission order, in Docket No. EL03-207-000, in which we required PJM to incorporate its then-existing Credit Policy into its OATT. *See* Outback Power Marketing, Inc. v. PJM Interconnection, L.L.C., 104 FERC ¶ 61,079 (2003).

3. First, PJM proposes to relax a number of its existing requirements. For example, PJM proposes to clarify its requirements relating to the submission of certain financial statements by a publicly-traded credit applicant, specifically, an applicant's submission to PJM of its Form 8-K Reports, as provided by the applicant to the Securities and Exchange Commission. PJM proposes to revise its Credit Policy to require the submission of these reports to PJM only when these reports disclose material changes.

4. PJM also proposes to relax its existing requirements regarding the submission by a credit applicant of its credit references or a corporate guarantee. While PJM's existing Credit Policy requires an applicant to provide at least one bank and three utility references, PJM proposes that this requirement be modified to permit PJM to require such references only upon its request. PJM also proposes to give its credit applicants greater flexibility in demonstrating how a corporate guarantee has been duly authorized. In addition, PJM proposes that greater flexibility be allowed under circumstances giving rise to an event of default following the expiration of a corporate guarantee. PJM notes that while its existing requirement states that failure to provide financial security to replace a corporate guarantee *is* an event of default, under PJM's proposed revision, that default would only be triggered three days following a request by PJM for any financial security that may be required to replace the corporate guarantee.

5. PJM also proposes to correct the outdated provisions of its OATT addressing certain deposit requirements (including section 17.3 of the PJM OATT). PJM states that these requirements are unnecessary because they have been superseded by the existing requirements of Attachment Q. Accordingly, PJM proposes to revise section 17.3 to state that "[a] party requesting Transmission Service shall provide the information specified in, and otherwise comply with, the 'PJM Credit Policy' set forth in Attachment Q, hereto."

6. In addition, PJM proposes to revise its requirement that collateral posted by virtual bidders must be retained by PJM for at least three months. Instead, PJM proposes to establish a reasonable timeframe not to exceed three months, but only if the market participant has been notified by PJM prior to making the deposit.

7. PJM also proposes to add certain new requirements to its Credit Policy that would have the effect of denying unsecured credit to market participants under circumstances that might not be permitted currently. First, PJM proposes to revise its methodology for calculating an applicant's Credit Score, *i.e.*, the analysis relied upon by PJM to determine an applicant's unsecured credit allowance.[4] PJM proposes to add to this analysis certain

[4] Under PJM's existing Credit Policy, a Credit Score is generated by PJM based on its review and analysis of various factors that it considers to be predictors of the applicant's financial strength and creditworthiness. "Key factors in the scoring process include, but are not limited to, ratings from credit rating agencies, financial ratios, and

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new "limiting factors," including a consideration of (i) the applicant's size (*i.e.*, its net worth) and (ii) the number of years that the applicant has been in business.[5] PJM states that this revised analysis will allow it to set certain minimum standards for applicants eligible to receive an unsecured credit allowance, recognizing that the creditworthiness of a company may be affected by its size and the number of years it has been in business as well as by the factors that PJM currently considers (*e.g.*, ratings from credit rating agencies and financial ratios).

8. PJM also proposes to revise the dollar cap and tangible net worth factors it utilizes in determining an applicant's maximum unsecured credit allowance.[6] Under PJM's existing dollar cap, unsecured credit is denied if the applicant's Credit Score is 40 or below, while a minimal unsecured credit allowance (up to $2,000,000) is granted to applicants with a Credit Score falling between 41 to 50 (covering 0.125 to 1.25 percent of the applicant's tangible net worth). In its filing, PJM proposes to increase these thresholds for purpose of denying unsecured credit to an applicant with a Credit Score of 50 or below, *i.e.*, if the applicant's Credit Score is 50, or below, its unsecured credit allowance would be $0. PJM explains that this revised benchmark is appropriate because a Credit Score of 50 or below, equates to a credit rating of less than BBB-, which is below investment grade.

Notice of Filing and Responsive Pleadings

9. Notice of PJM's filing was published in the Federal Register,[7] with interventions, comments, and protests due on or before October 22, 2004. Motions to intervene were timely filed by Exelon Corporation (Exelon), Allegheny Power and Allegheny Energy

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years in business." *See* PJM OATT at Attachment Q, Original Sheet No. 523F.

[5] In fact, while PJM proposes to include "minimum years in business" as a new factor in its Credit Score methodology, PJM's existing Credit Score methodology, as indicated in note 4, *supra*, already lists "years in business" as a factor. *Id.*

[6] Under PJM's existing Credit Policy, an applicant's maximum unsecured credit allowance, *i.e.*, its dollar cap, is determined based on the applicant's Credit Score and its tangible net worth. For example, an applicant with a Credit Score of 91 is permitted to have an unsecured credit allowance covering 6.375 percent of its tangible net worth, up to a maximum allowance of $150,000,000. Conversely, a Credit Score of 81 authorizes an unsecured credit allowance covering only 5.125 percent of the applicant's tangible net worth, up to a maximum allowance of $125,000,000.

[7] 69 Fed. Reg. 64,041 (2004).

Supply Company (Allegheny), American Municipal Power-Ohio, Inc. (AMP-Ohio), the North Carolina Electric Membership Corporation (NCEMC), Rockland Electric Company (Rockland), and Consumers Energy Company (Consumers). Protests and comments were submitted by Exelon, Allegheny, Consumers, and BlueStar Energy Services, Inc. (BlueStar). On October 29, 2004, Epic Merchant Energy LP and SESCO Enterprises LLC (Epic and SESCO) filed a motion to intervene out-of-time and protest. On November 8, 2004, PJM filed an answer. On November 17, 2004, BlueStar filed an answer to PJM's answer.

10. Consumers objects to PJM's proposed revision to section 17.3 of its OATT. While Consumers does not take issue with PJM's proposed removal of the outdated requirements in this provision regarding deposit requirements, Consumers asserts that the replacement language cross-referencing Attachment Q is unnecessary to the extent it would require a market participant that does not qualify for unsecured debt to be under a continuing obligation to provide to PJM the information specified in Attachment Q. Consumers asserts that this requirement is unnecessary and should be rejected because a market participant that does not rely on unsecured credit to meet its market requirements should be under no obligation to provide the information specified in Attachment Q.

11. BlueStar objects to PJM's proposed new restrictions on the ability of an applicant to receive unsecured credit. BlueStar asserts that PJM's proposed use of additional limiting factors in calculating an applicant's Credit Score, namely company size and the number of years that the market participant has been in business, has not been justified by PJM and should be rejected. BlueStar states that, in fact, this proposed criteria would not provide a reliable gauge regarding an applicant's true creditworthiness and would result in the denial of unsecured credit to market participants, like BlueStar, that are neither a public utility nor a large company, or an affiliate of a large company.[8] For these same reasons, BlueStar also objects to PJM's proposed revisions to the dollar caps and tangible net worth factors utilized to determine an applicant's maximum unsecured credit allowance.

12. In its answer, PJM responds to Consumers' protest regarding the obligation of a market participant, under PJM's proposed revision to section 17.3 of its OATT, to provide the information specified by Attachment Q, even in those circumstances where the market participant is *not* relying on an unsecured credit allowance to meet its credit requirements. PJM emphasizes that there is no requirement that a participant apply for, or obtain, an unsecured credit allowance and that a participant that does not do so would not be required to submit the information specified by Attachment Q.

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[8] *See also* Epic and SESCO protest at 3.

13. PJM also responds to BlueStar's assertions. First, PJM argues that in assessing the creditworthiness of any business entity, a consideration of the number of years the entity has been in business is a commonly-accepted practice because a new company has a higher failure rate than an established company and has only a limited record on which its future financial health can be assessed.[9] PJM also asserts that business size is a relevant factor given the magnitude of the sums commonly traded in PJM's markets and the obligations that can be incurred by a market participant in a single day.

14. PJM also clarifies, in its answer, how it intends to apply its proposed limiting factors. With respect to "years in business," PJM clarifies that it intends to use a three-year benchmark, *i.e.*, PJM would not use "years in business" to limit a company's unsecured credit if it has been in business for three years or longer.[10] In addition, PJM proposes to use a net worth of $2,000,000 as a benchmark with respect to its "company size" limitation, *i.e.*, PJM would not use company size to limit a company's unsecured credit if a company has a net worth of $2,000,000 or above. Finally, PJM emphasizes that these limiting factors would only be used by PJM in its consideration of an applicant's unsecured credit allowance.

Discussion

A. Procedural Matters

15. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,[11] the timely unopposed motions to intervene filed by Exelon, Allegheny, AMP-Ohio, NCEMC, Rockland, and Consumers serve to make these entities parties to this proceeding. We will grant Epic and SESCO's late motion to intervene given its interest in the proceeding, the early stage of the proceeding, and the absence of any undue prejudice or delay. Rule 213(a) of the Commission's Rules of Practice and Procedure,[12] prohibits an answer to a protest or an answer to an answer, unless otherwise permitted by the decisional authority.

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[9] PJM cites studies in its answer showing that about half of all new companies can be expected to cease operations within the first several years of their establishment. PJM notes that two such companies doing business within PJM in recent years have defaulted.

[10] PJM notes that the New York Independent System Operator takes a similar approach in requiring credit applicants to provide at least three years of financial data to obtain unsecured credit.

[11] 18 C.F.R. § 385.214 (2004).

[12] *Id*. at § 385.213.

We will accept PJM's and BlueStar's answers to the extent they have clarified certain issues, as discussed below.

B. Analysis

16. We will accept for filing PJM's proposed tariff revisions, in part (non-inclusive of proposed First Revised Sheet No. 523F), to become effective December 1, 2004, subject to conditions. However, we will reject the additional language regarding "limiting factors" proposed in Sheet 523F, because it has not been shown to be just and reasonable and may be unduly discriminatory or preferential.

17. PJM's current tariff provides for the calculation of a Credit Score for each applicant and specifically includes years in business as one of the relevant factors. Current section IIA of Sheet 523F states:

> A Credit Score will be generated from PJM's review and analysis of various factors that are predictors of financial strength and creditworthiness. Key factors in the scoring process include, but are not limited to, ratings from credit rating agencies, financial ratios, and years in business.

PJM's tariff also takes business size into account. The tariff limits the amount of unsecured credit for which a company qualifies through the company's tangible net worth. (Section IIB(1), Sheet No. 523G).

18. PJM has proposed to add the following additional language to its tariff: "PJM may include limiting factors in its credit scoring methodology, including, but not limited to, minimum years in business and minimum size." However, PJM has failed to justify the inclusion of this additional language in its OATT. In fact, the proposed provision does not make clear the difference between "limiting factors" and "key factors," nor does it make clear what, if any, additional actions the term "limiting factors" will authorize PJM to take. The provision further does not detail how or when PJM will apply these "limiting factors," or when PJM will exercise its apparent discretion not to invoke these factors. As BlueStar has pointed out, PJM has not demonstrated that every small company, no matter what other relevant quantitative and qualitative factors exist, should be denied unsecured credit. Nor has PJM adequately explained why a small company that qualifies for unsecured credit under its formula, even in a small amount, should be denied that amount of unsecured credit.[13]

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[13] PJM claims that a company with a $2,000,000 net worth would receive $27,000 in unsecured credit under its formula, and claims that this amount is insignificant. Blue Star, however, maintains that even $27,000 in unsecured credit can be significant, and

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19. The process for determining credit must be clearly disclosed by the transmission provider either in its tariff or on its website. Because this provision has not been shown to be just and reasonable and may be unduly discriminatory or preferential, the Commission rejects the proposed language.

20. We will deny BlueStar's protest as it relates to PJM's proposed revisions to the dollar cap and tangible net worth factors utilized by PJM in determining an applicant's maximum unsecured credit allowance. We agree with PJM that unsecured credit should not be extended to a participant with a credit rating below investment grade. First, we note that a denial of unsecured credit under these circumstances is generally consistent with the policies followed in other markets, *i.e.*, no other ISO/RTO market extends unsecured credit to participants with a credit rating below BBB-. Moreover, to extend unsecured credit to a participant under these circumstances would leave PJM's markets exposed to a level of financial risk that BlueStar fails to justify.

21. Finally, we will accept PJM's proposed revisions to its OATT addressing certain deposit requirements (including section 17.3 of its OATT). As PJM concedes in its answer, there is no requirement that a participant apply for, or obtain, an unsecured credit allowance. Specifically, a participant may elect to provide financial security in an amount fully covering its expected market activity, without recourse to an unsecured credit allowance. While PJM clarifies in its answer that a participant electing this option would not be required to submit the information specified in Attachment Q, PJM should make this clarification express in the context of the PJM OATT itself. Accordingly, we will accept PJM's proposed revision to section 17.3, subject to the inclusion of PJM's clarification regarding the applicability of this proposed language to participants not utilizing an unsecured credit allowance. PJM is directed to include this clarification in its compliance filing.

<u>The Commission orders</u>:

(A) PJM's proposed tariff revisions are hereby accepted for filing, in part (non-inclusive of proposed First Revised Sheet No. 523F), effective December 1, 2004, as discussed in the body of this order. PJM's proposed First Revised Sheet No. 523F is hereby rejected.

PJM did not explain why a firm should be denied unsecured credit to which it is otherwise entitled. Moreover, if a firm with $2,000,000 in net worth had a Credit Score of 71, it would qualify for $77,500 in unsecured credit, and PJM does not explain why simply because of size, the firm should not be extended the unsecured credit to which its Credit Score entitles it.

(B) PJM is hereby directed to make a compliance filing within 30 days of the date of issuance of this order as discussed in the body of the order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

Appendix

PJM Interconnection, L.L.C.
FERC Electric Tariff
Sixth Revised Volume No. 1
Docket No. ER05-12-000
Rate Schedule Designations
Effective: December 1, 2004

Accepted Sheets

First Revised Sheet No. 5
Third Revised Sheet No. 50
First Revised Sheet No. 51
First Revised Sheet No. 65
First Revised Sheet No. 81
First Revised Sheet No. 83
First Revised Sheet No. 285
First Revised Sheet No. 286
First Revised Sheet No. 290
Second Revised Sheet No. 523A
Second Revised Sheet No. 523B
Second Revised Sheet No. 523C
Second Revised Sheet No. 523D
Second Revised Sheet No. 523E
First Revised Sheet No. 523G
First Revised Sheet No. 523H
Original Sheet No. 523H.01
Second Revised Sheet No. 523I
First Revised Sheet No. 523I.01
First Revised Sheet No. 523I.01A
First Revised Sheet No. 523J
Second Revised Sheet No. 523K
Original Sheet No. 523K.01
Second Revised Sheet No. 523L

Rejected Sheet

First Revised Sheet No. 523F