123 FERC ¶ 61,323
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

PJM Interconnection, L.L.C. Docket Nos. ER08-569-000
ER08-569-001

ORDER ACCEPTING TARIFF SHEETS

(Issued June 30, 2008)

1. On February 15, 2008, PJM Interconnection, L.L.C. (PJM) filed revisions to its Credit Policy, Attachment Q of its Open Access Transmission Tariff (OATT).[1] The proposed revisions reduce qualified net sellers' Financial Security obligations by allowing unsecured credit in recognition of the potential value of consistent net positive sales positions (i.e., sales exceeding purchases) in the PJM Interchange Energy Market (PJM Market). PJM requests an effective date of April 15, 2008. This order accepts PJM's proposed tariff revisions, subject to conditions, as described below.

Background

2. PJM has recently submitted several filings to revise its Credit Policy in an attempt to balance its need for adequate credit and collateral against the risks of default. PJM's recent credit initiatives were targeted to address specific risks that were not adequately covered in the existing policy. The revisions have included correlating collateral requirements with the PJM membership's monthly risk exposure from trading activity in PJM's Financial Transmission Rights (FTR) market and allowing guaranties from entities located in foreign countries,[2] but PJM intended to continue working with its stakeholders to further enhance its credit requirements. The instant filing is PJM's most current submittal to refine its credit requirements by offering an additional source for unsecured

[1] *See* attached Appendix for a listing of the filed tariff sheets.

[2] *See PJM Interconnection, L.L.C.*, 122 FERC ¶ 61,279 (2008) and PJM Interconnection, L.L.C., Docket No. ER08-570-000 (April 3, 2008) (unpublished letter order).

credit that has not been offered before, but is meant to impact the collateral requirements of participants who have been deemed to have higher creditworthiness.

Notice of Filings and Responsive Pleadings

3. Notice of PJM's February 15, 2008 filing was published in the *Federal Register*, 73 Fed. Reg. 10,754 (2008), with interventions, comments and protests due on or before March 7, 2008. A timely motion to intervene and comments were filed by Edison Mission Energy and Edison Mission Marketing & Trading, Inc. (collectively the EME Companies). A motion to intervene and protest was filed by American Electric Power (AEP). Reliant Energy, Inc. (Reliant) filed a motion to intervene out of time and comments.

4. Commission Staff sent PJM a deficiency letter on April 10, 2008, asking for additional information. On May 1, 2008, PJM amended its initial filing with responses to the Commission's information requests. Notice of the amendment was published in the *Federal Register*, 73 Fed. Reg. 28,105 (2008), with interventions, comments and protests due on or before May 22, 2008. None were filed.

Filings, Comments, and Protest

A. PJM's February 15, 2008 Filing

5. In its February 15, 2008 filing, PJM states that in 2006, at the request of a member and with stakeholder consent, it began discussions with members regarding the use of a consistent Net Sell Position to reduce members' Financial Security obligations in markets such as the FTR market, where credit requirements are calculated independently of historical billed activity. PJM explains that prospective payments for sales in the PJM Market represent potential financial value to participants, but they cannot be considered an acceptable form of Financial Security because they are potential value to the participant rather than actual secured value to PJM. However, PJM submits that it is reasonable to consider that financial value in establishing credit obligations under the Credit Policy. According to PJM, its Credit Working Group agreed that consistent Net Sell Positions could provide a basis for granting unsecured credit, provided that rules were in place to mitigate the risk that such Net Sell Positions may not actually materialize. PJM notes that it currently does not allow net positive sales positions to impact participants' credit obligations, but its proposal in the instant filing was endorsed by a significant majority of PJM stakeholders.

6. PJM's proposed revisions establish "Seller Credit," which PJM defines as Unsecured Credit extended to participants that have a consistent long-term history of selling in PJM. PJM asserts that the Seller Credit is designed to give participants the credit benefit associated with the value of their established long-term history of net sales, while mitigating the risk presented to other PJM Members from such Unsecured Credit

by requiring that the credit be accompanied by an equal amount of current net accounts receivable from PJM. According to PJM, the risks associated with this new form of Unsecured Credit are mitigated by the following rules.

7. First, the Seller Credit is only available to participants that have maintained monthly net positive sales positions in the PJM Markets ("Net Sell Position") over a continuous 12 month period prior to the month in which the Seller Credit will apply. According to PJM, the Net Sell Position requirement is used as an indicator that expected future sales revenues will likely continue and serve as a basis for Unsecured Credit for future market activity, and not otherwise be completely offset in the relevant month by purchase obligations. PJM maintains that the 12 month requirement demonstrates the participant has consistently maintained Net Sell Positions over a reasonable historical period, including all four seasons, which provides an indication that it will continue to realize Net Sell Positions going forward to support the Seller Credit.

8. Second, a participant is eligible to receive Seller Credit in an amount equal to two-thirds of the third smallest Net Sell Position in the 12 month period prior to the month in which the Seller Credit will apply. PJM argues that the third lowest historical Net Sell Position strikes a reasonable balance between allowing a reasonable level of Unsecured Credit on the basis of expected future sales revenues, and mitigating the risk associated with using such unrealized potential value as the basis for that credit. In addition, PJM explains that the Net Sell Position is discounted two-thirds of the full monthly value because that is the minimum accrual point in each monthly billing cycle. According to PJM, the value remaining after the discount accounts for the amount of the historical revenues that would have actually been credited in a month, after the prior month's bill is settled.

9. Third, once a participant's Seller Credit is issued, it is required to maintain the Seller Credit and its "Total Net Sell Position"[3] in an amount at least equal to its overall credit requirement net of other established credit. According to PJM, the requirement to maintain Seller Credit ensures participants' credit at this level will always match, at a minimum, their credit obligations and the requirement to maintain Total Net Sell Position ensures participants have adequate net positive sales positions to support the issued Seller Credit.

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[3] PJM proposes "Total Net Sell Position" as a new defined term that is defined as the unpaid prior month's Net Sell Position plus the unbilled current month's Net Sell Position accrued to date, as determined by PJM on a daily basis. Stated simply, Total Net Sell Position is the amount that PJM owes the participant at any time.

10. Fourth, PJM will forecast the Net Sell Positions of all participants that receive Seller Credit and the forecasts will be based on at least a participant's Total Net Sell Position and recent trends in that position, such as generator outages, changes in load responsibility, and bilateral transactions impacting the participant. PJM maintains that if the forecast indicates the Total Net Sell Position of a participant may not be adequate to cover its credit obligations net of other established credit, the proposed rules give PJM the authority to request additional Financial Security to cover the difference. Any additional Financial Security that PJM deems is required after conducting its forecasts will be due immediately, provided that the participant would receive the benefit of the three-day cure process established in the Events of Default section of the Credit Policy. PJM argues that this process ensures a participant has adequate accounts receivable to support its Seller Credit, but provides the participant with adequate time to remedy any temporary shortfall in its Total Net Sell Position relative to its credit obligation. In addition, PJM states that Financial Security is returned to the participant as soon as practicable, i.e., once the Total Net Sell Position at least equals the participants credit obligations net of other established credit. Finally, PJM states that the proposed rules do not allow Seller Credit to be conveyed to another entity in the form of a guaranty.

11. PJM states that in addition to establishing the Seller Credit rules, its proposed revisions include resultant clean up changes and minor clarifications. PJM requests an effective date of April 15, 2008 for its proposed changes.

B. Comments in Support of PJM's February 15, 2008 Filing

12. Reliant supports PJM's proposed tariff revisions and contends the revisions provide eligible market participants a conservative credit benefit associated with the participant's long-term history of net sales in PJM markets. Reliant claims that PJM's proposal is reasonable and conservative, noting that the market participant is still responsible for any credit or collateral requirements associated with their market positions not otherwise covered by the Seller Credit. According to Reliant, the proposed tariff revisions will permit entities with long-standing Net Sell Positions to more efficiently allocate capital and provide greater liquidity in markets for which Seller Credit may be used, such as FTR markets. Finally, Reliant states that the safeguards applied are significant and enforceable.

13. The EME Companies also support PJM's filing and requests that the Commission accept the filing. The EME Companies explain that PJM's proposal was made only after discussions between PJM and its Members that took place over the course of more than one year. The EME Companies assert that the Unsecured Credit that PJM will grant to qualified net sellers reduces the cost of credit, enhances market liquidity, and reduces barriers to market participation by those participants. According to the EME Companies, PJM's proposal is in fact more conservative than the Credit Policy as it applies to net buyers because PJM establishes a working credit limit for a net buyer equal to 85 percent

of the net buyer's secured and/or unsecured credit with PJM, whereas a net seller will be asked for additional collateral if its collateral requirement exceeds 66 percent of its forecasted net sales for the month. In addition, the EME Companies argue that PJM's tariff gives it the right to setoff any payments due the net seller against any obligations of the net seller and also that PJM is improving its reporting systems to permit it to monitor actively and diligently the status of qualified net sellers. EME Companies state that the Commission has approved the New York Independent System Operator, Inc.'s policy (NYISO) permitting its market participants to use the right to accumulating net energy payments that accrue between monthly payments to the energy supplier as collateral for other transactions in the New York electric markets, similar to PJM's proposal. The EME Companies claim that there have been no difficulties or adverse risks connected with NYISO's policy. Finally, the EME Companies argue that PJM's filing is consistent with the stated policy of the Commission to permit market participants to net their various market activities against each other to reduce collateral costs.

C. Protest of PJM's February 15, 2008 Filing

14. In AEP's protest, it states that it does not believe it is just and reasonable to rely on the past history of a participant's net sales positions as means of extending unsecured credit without considering other factors affecting the participant's creditworthiness and the risk of default. AEP believes that PJM's proposed modifications should not be implemented in isolation from a more comprehensive approach that would include a more rigorous up-front credit evaluation and the establishment of corporate credit trading limits based upon the financial condition of a market participant, among other safeguards. AEP is concerned with the proposed reduction in the amount of collateral required that certain participants in PJM's FTR market could experience in light of the recent defaults of several members in the FTR market, arguing that even though PJM's proposal is applicable to the entire PJM Market, it will have the most dramatic impact on markets like the FTR market, where participants' credit requirements are currently calculated independently of their historical billed activity. According to AEP, once additional Unsecured Credit is extended to a participant, it will continue in effect, apparently without regard for the participant's overall financial health, until the actual unpaid and accrued amounts that PJM will owe to the participant during the then-current PJM billing cycle become less than the Seller Credit. AEP states that in such circumstances PJM intends to recalibrate the Seller Credit extended to the participant. AEP asserts that a significant component of PJM's forecast methodology is actually a backward-looking evaluation of the historical trends in the participant's Total Net Sell Positions. AEP protests that PJM does not mention why, if it truly has the ability to determine a participant's Total Net Sell Position on a daily basis, it does not use that more accurate amount as the means for extending additional Unsecured Credit. AEP objects that the Total Net Sell Position, which is the actual accrued and unpaid net sales amount of a participant, is used only as a check-and-balance of the more cumbersome and less

accurate historical measure of the participant's net sales activity that forms the Seller Credit in PJM's proposal.

15. AEP asserts that PJM's proposal will weaken PJM's Credit Policy by placing further reliance on historical measures of participant activity, in isolation from other factors affecting a participant's creditworthiness, to predict future participant activity and default risk. AEP argues that PJM's proposal to require additional security provides inadequate protection because the participant would receive the benefit of a three day cure process should it fail to respond to the request and because PJM has not demonstrated its ability to forecast market events or values, as evidenced by the recent defaults in the FTR market. AEP believes that by the time problems arise and are caught by PJM through its forecasts, it may be too late to obtain additional collateral and mitigate the effect of defaults on the PJM membership. AEP suggests that PJM refocus its efforts on enhancing its capabilities to measure and monitor member credit exposure in real-time, before extending unsecured credit based on historical net sales positions.

D. Deficiency Letter Response

16. On April 10, 2008, the Commission staff issued a Deficiency Letter requesting further information and support for PJM's proposal, including: (1) an explanation of how often PJM will conduct the Total Net Sell Position forecasts for comparison to the participants' net credit obligations; (2) an explanation of the impact of participants' providing additional Financial Security on PJM's proposed requirements; (3) clarification of how the proposed rules would apply to FTR market participants; (4) an explanation of how the proposal does not contradict other recent PJM filings to tighten credit obligations; and (5) clarification on how PJM's proposal will address net purchaser defaults.

17. In response, PJM states that it will encode its credit system so that the Total Net Sell Position forecasts calculations run automatically each time PJM receives a position update for market participants, which PJM currently receives approximately twice weekly.

18. PJM states that it will use month-end invoices to calculate the 12 months of historical Net Sell Positions. PJM maintains that even if a forecast requires collateral for a short period of time, or even if an intra-month report shows a temporary net buy position, as long as the participant has a Net Sell Position by the date of the issuance of the month-end invoice, then the temporary buy position or collateral call based on forecast will not preclude the participant from continuing to receive Seller Credit. However, according to PJM, when an invoice at the end of the month is net-negative, the participant would have to achieve 12 more months of net positive sales to re-qualify for Seller Credit.

19. PJM explains that it is possible, but unlikely, that both concurrent and counterflow FTR holders with no other activity could qualify for Seller Credit based solely on their FTR activities because to do so would require that the auction clearing prices for their portfolios be sufficiently profitable that each of the 12 months individually results in a profit, despite the seasonality of congestion. PJM states that it is more likely that FTR participants with balanced portfolios could qualify for Seller Credit. According to PJM, the reason it stated that Seller Credit would be most applicable to markets such as the FTR market is because the FTR market has a separate credit calculation unrelated to monthly invoices. PJM states that except for the Reliability Pricing Model market, PJM's only other credit requirement at this time is based on Peak Market Activity which, is calculated based on historical net buy invoices in the past 12 months and cannot, by definition, co-exist with Seller Credit, which requires that there be no months of net buy invoices in the past 12 months.

20. PJM argues that its recent credit initiatives were targeted to address specific risks that were not adequately covered in the existing policy, specifically the measurement of credit exposure in the FTR markets. PJM maintains that Seller Credit does not seek to alter any such measurements of credit exposure, but rather looks at the creditworthiness of members in certain circumstances to see if it would be appropriate to grant unsecured credit in those cases. PJM explains that its proposed initiative is targeted at a particular source of credit to meet credit requirements and as such will impact the collateral requirements of some companies, not because their credit exposure has been deemed less, but rather because their creditworthiness has been deemed higher. While PJM admits that this does not guarantee that risk is not increased, PJM argues that its members deemed that, for this particular scenario, the incremental risk was acceptably small. PJM claims its foremost objective is to ensure that its credit requirements in both amount and duration are correctly calibrated.

21. In response to the inquiry about net purchaser defaults, PJM states that the nature of its markets is that all sells and buys are pooled, so that an individual defaulting party cannot directly impact an individual seller, but rather will impact the pool overall. According to PJM, recent defaults have not materially affected the value of Net Sell Positions and, generally, defaults are unlikely to materially impact Seller Credit and so PJM does not propose any special provisions to address the modest reductions that may result from other member defaults.

22. However, PJM explains that if a participant experiences a situation in which a default allocation turns around one month of a participant's marginal Net Sell Position and makes it into a net buy, such a difference would cause Seller Credit to be eliminated entirely for 12 months. PJM recognizes that such a toggle effect, when caused by an uncontrollable external factor, may be somewhat harsh. PJM states that it would not object to a directive from the Commission that would enable an adjustment in this circumstance. If the Commission approves this filing without such direction, PJM states

that it will raise the issue in the stakeholder process and allow stakeholders to decide whether to move the issue forward.

Discussion

A. Procedural Matters

23. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2007), all timely filed motions to intervene and any motions to intervene out-of-time filed before the issuance date of this order are granted. Granting late intervention at this stage of the proceeding will not disrupt this proceeding or place additional burden on the existing parties.

B. Commission Determination

24. The Commission will accept, subject to conditions, PJM's proposed tariff revisions, effective April 15, 2008, as described below. PJM and a large majority of its stakeholders reasonably propose that participants with financial histories of receiving payments from PJM for a period of 12 months are more creditworthy, which should be recognized in their unsecured credit allowance. The additional unsecured credit from the Seller Credit provision will help participants to meet their credit requirements, while providing reasonable safeguards to protect PJM and its members. The requirement for a consistent net positive sales position over a 12 month period limits the Seller Credit to those participants with a sufficient financial history to warrant higher unsecured credit. Further, participants will be required to maintain their Seller Credit and their Total Net Sell Position in an amount at least equal to their overall credit requirement net of other established credit, which PJM will monitor on a regular basis. Additionally, if PJM forecasts that a participant's Total Net Sell Position may not cover its credit obligation, it can require additional Financial Security.[4]

25. The Commission, however, will condition its acceptance of the filing on PJM submitting a revision to First Revised Sheet No. 523G.01. The proposed revision states "Such Financial Security shall be due immediately, subject to the three day cure period established in Section VI." This provision is ambiguous, i.e., it is not clear whether PJM would require payment immediately (e.g., the same day) or within three days. Further, while in its transmittal letter PJM states participants would receive the benefit of the three-day cure process established in the Events of Default section of the Credit Policy,

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[4] In its response to the deficiency letter, PJM has raised an issue about the effect of a default on Seller Credit, and has indicated that this issue will be raised in the stakeholder process. Should PJM determine that an adjustment is needed in this respect, it can submit a filing under § 205 of the Federal Power Act to make such an adjustment.

the tariff sheet refers to the three-day cure period established in Section VI, which is the Forms of Financial Security section. Neither reference to three days in Section VI or VII would appear to apply to the situation PJM discusses in its instant proposal because an event in which PJM determines additional Financial Security is required by a party is not equivalent to a substitution of Financial Security (Section VI) or a default (Section VII). Participants need to be given a reasonable, specified time period in which to provide additional Financial Security. Therefore, the Commission accepts the filing subject to PJM clarifying this provision to state the time period for Seller Credit participants to submit additional Financial Security.

26. AEP argues that PJM's proposal should not be implemented in isolation from a more comprehensive approach that would include a more rigorous up-front credit evaluation based upon a participant's financial condition. However, PJM already performs a complete credit evaluation that includes a review of a participant's financial statements, rating agency reports, and other indicators of credit strength in order to establish an unsecured credit allowance.[5] The instant proposal provides another way to obtain unsecured credit and is based on a different evaluation factor – a participant's Net Sell Position, which allows a measure of creditworthiness that will only impact the collateral requirements of those companies who have been deemed to have higher creditworthiness. Although this basis for unsecured credit uses a different measure than a participant's financial condition, AEP has failed to show that a participant's Net Sell Position is not a reasonable indicator of a participant's ability to meet its credit obligations in the PJM markets, particularly given the safeguards incorporated into the proposal.

27. AEP is also concerned with the reduction in the amount of collateral that certain participants in PJM's FTR market would have to provide if PJM's proposal is accepted. PJM explains that it is unlikely that both concurrent and counterflow FTR holders with no other activity could qualify for Seller Credit based solely on their FTR activities, but rather FTR participants with balanced portfolios would be more likely to qualify for Seller Credit. Therefore, while Seller Credit would be available to participants in the FTR market, it would not be available to those holding riskier unbalanced FTR portfolios. We cannot find that PJM's determination to provide unsecured credit to FTR participants with balanced portfolios unjust and unreasonable.

28. AEP also objects to PJM's use of historical information in its forecasts of Net Sell Positions. While historical trends in a participant's Total Net Sell Positions must necessarily be used in PJM's forecasts, it is not the only component, as PJM will also

[5] See Part I, Credit Evaluation, of the PJM Credit Policy in Attachment Q of PJM's OATT.

consider anticipated generator outages, changes in load responsibility, and bilateral transactions impacting the participant. Thus, there is a balance between historical trends and a forward looking evaluation of events in the forecast of participants' Net Sell Positions, and we cannot find that this balance is unjust and unreasonable.

The Commission orders:

PJM's tariff sheets listed in the Appendix of this order are accepted, subject to conditions, effective April 15, 2008, as discussed above in the body of the order.

By the Commission. Commissioner Wellinghoff dissenting with separate statement attached.

(S E A L)

Kimberly D. Bose,
Secretary.

Appendix

PJM Interconnection, L.L.C.
FERC Electric Tariff
Sixth Revised Volume No. 1

Tariff Sheets Conditionally Accepted Effective April 15, 2008

Third Revised Sheet No. 523
Fourth Revised Sheet No. 523E
First Revised Sheet No. 523F.03
First Revised Sheet No. 523G.01
Third Revised Sheet No. 523H
Third Revised Sheet No. 523I
Second Revised Sheet No. 523I.01A
Third Revised Sheet No. 523I.05
Sixth Revised Sheet No. 523L.01
Fifth Revised Sheet No. 523M
Second Revised Sheet No. 523M.01

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

PJM Interconnection, L.L.C. Docket Nos. ER08-569-000
ER08-569-001

(Issued June 30, 2008)

WELLINGHOFF, Commissioner, dissenting:

The majority approves PJM's proposal to expand its use of unsecured credit by establishing an unsecured Seller Credit. Because I conclude that PJM has not adequately supported its proposal, I respectfully dissent from today's order.

I share AEP's concern that as a result of PJM's proposed tariff modifications, defaults may be greater than they otherwise would have been, and customers may be assessed additional charges to cover the defaults.[6] Several aspects of PJM's proposal contribute to this concern. For example, a temporary buy position or collateral call based on a forecast of net obligations will not preclude a Market Participant from continuing to receive the Seller Credit. Thus, even if a Market Participant becomes a net buyer at a point during the month, that Market Participant could continue to benefit from the Seller Credit during the entire month. Moreover, a Market Participant in this situation would not trigger the safeguard that in order to be eligible for the Seller Credit, a Market Participant must remain a net seller for 12 months prior to the transaction.

My concern about PJM's proposal is heightened by the fact that a participant in PJM's FTR markets, which have been a focus of recent PJM credit policy changes, could be a potential beneficiary of the Seller Credit. Because a Net Sell position is based on the aggregate of participation in all of the PJM markets, a large net seller position in the energy market, for example, could be used to support transactions in the FTR markets. It is noteworthy in this regard that PJM has previously advised us of the risk posed by FTR portfolio positions whose value is heavily reliant on uncertain future events.[7]

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[6] *See* Motion to Intervene and Protest of American Electric Power Service Corporation, March 7, 2008, at 3.

[7] *See* PJM's January 31, 2008 filing in Docket No. ER08-520-000 at 2.

PJM acknowledges that its proposal presents additional risk to its membership.[8] In my view, PJM has not demonstrated sufficient benefits to consumers of its proposal to justify that increased risk and possible costs.

For these reasons, I respectfully dissent from today's order.

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Jon Wellinghoff
Commissioner

[8] *See* PJM's February 15, 2008 filing at 3.