

132 FERC ¶ 61,244
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 No. ER10-2280-000

ORDER ACCEPTING TARIFF REVISIONS

(Issued September 17, 2010)

1. On August 18, 2010, PJM Interconnection, L.L.C. (PJM) submitted revisions to sections 1.10.1(b) and 5.5 of Schedule 1 of its Amended and Restated Operating Agreement, as well as the parallel provisions of Attachment K - Appendix to PJM's open access transmission tariff (tariff) as a temporary solution to prevent alleged manipulation of PJM's energy markets. PJM requests expedited treatment and waiver of the 60-day prior notice requirement, and requests the tariff sheets be accepted to be effective September 17, 2010. As discussed below, the Commission will accept these proposed tariff sheets, effective September 17, 2010, as requested.

I. Background

2. Up-To Congestion transactions, which are the focus of this filing, originally were created as a mechanism to hedge in the Day-ahead Energy Market the exposure to price differentials from the source to the sink of their physical energy deliveries into, out of, or through PJM in the Real-time Energy Market, and to allow market participants who want to wheel power through PJM to set the maximum dollar value of congestion they would be willing to pay to wheel that power. In fact, the Commission directed PJM in the *Atlantic City* order to consider this option "for alleviating price uncertainty."¹ In its compliance filing in *Atlantic City*, PJM described Up-To Congestion bidding as follows:

‘Up-to’ congestion bids permit transmission customers to specify how much they are willing to pay for congestion by bidding a certain maximum amount for congestion between the transaction source and sink. If the congestion charges are

¹ *Atlantic City Elec. Co.*, 86 FERC ¶ 61,147, at 61,523, 61,529-30 (1999) (*Atlantic City*).

less than the amount specified in the bid, then the transaction will be scheduled in the day-ahead schedule. These ‘up-to’ bids protect transmission customers from paying uncertain congestion charges by guarantying that they will pay no more than the amount reflected in their bids. Transmission customers also may use an increment and decrement bid pair to accomplish the same type of hedging strategy, which further enhances their price certainty options. In the Commission’s words, these types of bids ‘allow transmission customers to specify the maximum price they are willing to pay for congestion in much the same way that energy market participants place bids for energy.’^[2]

3. PJM’s Up-To Congestion transactions have been a focal point in an ongoing complaint proceeding related to the distribution of over-collected transmission line loss charges resulting from PJM’s marginal line loss calculation method, which is briefly reviewed below.³

4. In 2006, Atlantic City Electric Company and others filed a complaint alleging that PJM’s practice of recovering transmission line losses through an average cost method violated PJM’s tariff and that PJM’s tariff required that the losses should be recovered through a marginal transmission line loss collection methodology when this became technically feasible, which it had become. The Commission concluded that PJM’s tariff

² PJM Interconnection, L.L.C., Compliance Filing, Docket No. ER00-1849-000, at 7 (Mar. 10, 2000).

³ Originally filed under *Black Oak Energy, L.L.C., et al. v. PJM Interconnection, L.L.C.*, Docket No. EL08-14-000, and *EPIC Merchant Energy NJ/PA, L.P., et al. v. PJM Interconnection, L.L.C.*, Docket No. EL10-40-000, the Commission has addressed these two, related and ongoing complaints and subsequent filings in: *Black Oak Energy, L.L.C., et al. v. PJM Interconnection, L.L.C.*, 122 FERC ¶ 61,208 (2008) (December 3, 2007 Complaint Order); *Black Oak Energy, L.L.C., et al. v. PJM Interconnection, L.L.C.*, 125 FERC ¶ 61,042 (2008) (October 16, 2008 Rehearing Order); *Black Oak Energy, L.L.C., et al. v. PJM Interconnection, L.L.C.*, 126 FERC ¶ 61,164 (2009) (February 24, 2009 Clarification Order); *Black Oak Energy, L.L.C., et al. v. PJM Interconnection, L.L.C.*, 128 FERC ¶ 61,262 (2009) (September 17, 2009 Compliance Order); *Black Oak Energy, L.L.C., et al. v. PJM Interconnection, L.L.C.*, 131 FERC ¶ 61,024 (2010) (April 15, 2010 Rehearing Order); *see also EPIC Merchant Energy NJ/PA, L.P.*, 131 FERC ¶ 61,130 (2010) (May 10, 2010 Complaint Order).

required use of the marginal loss method;⁴ the Commission explained that the marginal loss method effectively imposes different loss charges to customers at different locations, as the loss component of the energy price varies at different locations. Besides this effect of distance, line losses also increase as the number of megawatts of power moved increases.⁵ As a result, charging for marginal losses results in collecting more revenues than needed to cover total loss costs.⁶ Subsequently, the Commission addressed the allocation of the over-collected amounts.⁷

5. In 2007, Black Oak Energy, L.L.C., EPIC Merchant Energy, L.P., and SESCO Enterprises, L.L.C. (collectively, Complainants) filed a complaint challenging the marginal line loss method and the related allocation methodology in PJM's tariff.⁸ Specifically, they argued that the financial transactions of "virtual traders" or "financial marketers" do not create the flow of physical energy and the concomitant transmission line losses and, therefore, they should not be assigned marginal line losses. Alternatively, they argued that if their financial transactions are assigned marginal line losses they should receive a share of the surplus over-collected amounts. In its order denying the complaint, the Commission *inter alia* concluded that no party is entitled to receive any particular amounts of the surplus that inevitably results from using the marginal line loss methodology, since the price each party is paying is the correct marginal cost for the energy that each party is purchasing.⁹ The Commission found that PJM's proposed

⁴ *Atlantic City Elec. Co. v. PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,132, at P 19 (2006) (May 1, 2006 Order).

⁵ It is a principle of mathematics that whenever any variable is continuously increasing, the marginal value of the last unit exceeds the average of all the units. Thus, where an average method considers all the units and produces an "average" transmission line loss (e.g., 2 percent is the average of an initial line loss of 1 percent that escalates as units increase to 3 percent), a marginal method would consider the losses incurred by the last unit(s) (e.g., 3 percent) and produces a "marginal" transmission line loss figure to be incorporated into the price of delivered energy (in that case, 3 percent). The marginal loss method, therefore, will always result in a higher figure than the average loss method.

⁶ May 1, 2006 Order, 115 FERC ¶ 61,132 at P 4-5.

⁷ *Atlantic City Elec. Co. v. PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,169 (2006) (November 6, 2006 Order).

⁸ Financial Marketers, identified with the first complaint, subsequently filed a second complaint. *See* May 10, 2010 Complaint Order, 131 FERC ¶ 61,130.

⁹ December 3, 2007 Complaint Order, 122 FERC ¶ 61,208 at P 46.

method of distributing line losses to those that pay to support the fixed costs of the transmission grid is reasonable.

6. Complainants filed a request for rehearing, arguing, among other things, that they are entitled to receive a share of the marginal line loss surplus because they too contribute to the fixed costs of the transmission system. The Commission granted rehearing on the issue of the allocation of the over-collected amounts.¹⁰ The Commission directed PJM either to revise its tariff to include a credit to others who pay for the fixed costs of the transmission system in proportion to the load represented by their transmission usage or to show cause why its existing tariff provision is just and reasonable. In a subsequent order, the Commission clarified that it did not intend to exclude virtual traders from eligibility for the credit related to the surplus to the extent that those traders make transmission payments that contribute to the fixed costs of the transmission grid, without regard to whether such parties serve load.¹¹

7. On March 26, 2009, PJM submitted revisions to section 5.5 of the appendix to Attachment K of its tariff and to the corresponding section of Schedule 1 of its Operating Agreement in compliance with the Commission's directive and clarification.¹² PJM stated that section 5.5 had been revised to allocate the total transmission loss charges accumulated by PJM to each Network Service User and Transmission Customer in

¹⁰ See October 16, 2008 Rehearing Order, 125 FERC ¶ 61,042.

¹¹ See February 24, 2009 Clarification Order, 126 FERC ¶ 61,164 at P 10, 13, 14-15.

¹² March 26, 2009 Compliance Filing, Docket No. EL08-14-002, at 3. Showing the proposed additions and deletions, PJM's revised section 5.5 read as follows:

The total Transmission Loss Charges accumulated by the Office of Interconnection in any ~~hour~~month shall be distributed pro-rata to each Network Service User and Transmission Customer in proportion to its ratio shares of the total MWhs [megawatt-hours] of energy delivered to load (net of operating Behind The Meter Generation, but not to be less than zero) in the PJM Region, or the total exports of MWh of energy from the PJM Region, or the total MWh of cleared Up-To Congestion transactions (that paid for transmission service during such hour)~~and the total exports of MWhs of energy from such region during such month by all Transmission Customers.~~

Id. at Attachment B.

proportion to its ratio share of the total megawatt-hours of energy delivered to load in the PJM region.¹³ PJM further stated that revised section 5.5 “allocates total transmission loss charges to the total exports of megawatt-hours of energy from the PJM Region, or the total [megawatt-hours] of cleared Up-To Congestion transactions (that paid for transmission service during such hour).”¹⁴

8. PJM stated that it believed its proposed revisions satisfy the Commission’s concern that collected marginal line losses be distributed equitably among all parties that support the fixed costs of the transmission system, without regard to whether such parties serve load.¹⁵ PJM stated that Network Service Users will still receive an allocation of surplus marginal line loss collections in proportion to their ratio shares of the total megawatt-hours of energy delivered to load in the PJM region, but that allocation now will also include “Transmission Customers,” which includes load-serving customers such as those taking point-to-point transmission service under Part II of the tariff.¹⁶

9. PJM explained that the allocation methodology for these customers is still based upon the Commission’s accepted principle that the allocation method is fair because it distributes the surplus back to customers who pay for the fixed costs of the transmission system.¹⁷ PJM stated that it further modified section 5.5 to capture allocation of surplus marginal line losses to those customers engaging in Up-To Congestion transactions in proportion to the total megawatt-hours of those cleared transactions (that paid for transmission services during such hour).¹⁸ PJM averred that each customer identified in revised section 5.5 contributes, through transmission charges, to the overall costs of the transmission grid; therefore, through the proposed revisions, each will receive a distribution of the surplus over-collected marginal line loss charges.¹⁹

10. In its compliance order, the Commission found that PJM’s proposed revisions comply with the directive to credit those who pay for the fixed or embedded costs of the

¹³ *Id.* at 3.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.* at 4-5.

¹⁷ *Id.* at 4.

¹⁸ *Id.*

¹⁹ *Id.*

transmission system.²⁰ The Commission acknowledged, as did PJM, that some virtual traders (financial marketers) pay transmission access charges related to Up-To Congestion transactions, which contribute to the fixed costs of the transmission system, and which should be included in the allocation process for disbursement of any surplus resulting from the over-collection of transmission line loss charges.

11. PJM states that the impetus for its instant proposal is recently-observed market behavior in which parties are submitting allegedly uneconomic (wash transaction) Up-To Congestion bids simply because such a transaction allows an entity to reserve transmission and thereby collect the marginal line loss credit that exceeds the non-firm transmission cost. In one pattern of behavior, parties submitted Up-To Congestion transactions with sources and sinks at the exact same interface. In this situation, PJM states the participant had no risk of gain or loss because the points had no price separation. Another pattern of behavior involved Up-To Congestion transactions with different source and sink points but where equal, offsetting transactions were submitted in both directions between the same two points. In this situation too, the transaction posed no risk of loss or gain because the settlement of the transactions in the opposite directions would offset each other in both the Day-ahead and balancing markets.²¹

II. Proposed Tariff Revisions

12. PJM proposes, as a short-term solution, to eliminate the requirement to obtain transmission service for Up-To Congestion. PJM also proposes to change the method for allocating transmission line loss charges prescribed in section 5.5 of Schedule 1 of its operating agreement so that the credit to non-firm transmission service customers reflects the discounted rate they pay for transmission service. PJM further proposes to initiate a stakeholder process to analyze whether better alternatives to PJM's proposed rule changes exist, to assess the impact of the proposed rule changes on Up-To Congestion transactions, to assess the incentive that may be created by the proposed allocation methodology, and to produce a report by no later than December 31, 2010, regarding the effectiveness of the proposed rule changes.²²

²⁰ September 17, 2009 Compliance Order., 128 FERC ¶ 61,262 at P 26.

²¹ We note that the Commission referred possible violations of the Commission's regulations, including section 1c.2 (Prohibition of electric energy market manipulation), that may have occurred in connection with, or related to, certain Up-To Congestion transactions in PJM to the Office of Enforcement for a non-public investigation. *Order of Non-Public, Formal Investigation*, 132 FERC ¶ 61,169 (2010).

²² Filing at 13.

13. PJM's first proposal would remove the transmission reservation-related charge associated with Up-To Congestion bids and hence would eliminate the line loss credit. PJM justifies this proposal stating that there is no need for such transmission service reservations via the Open Access Same-time Information System (OASIS) unless there is a physical transaction in the Real-time Energy Market, which is not the case for the purely financial Up-To Congestion transactions.²³

14. PJM's second proposal is designed to discount the marginal loss allocation to non-firm transmission service customers consistent with the discounted charge for transmission reservation for these customers.²⁴ PJM states that the discounted non-firm point-to-point transmission service border rate is currently \$0.67 per megawatt-hour. PJM calculates the firm rate to be \$2.162 per megawatt-hour. Thus, the non-firm rate is approximately 31 percent of the firm rate. PJM proposes to allocate the surplus marginal losses on the basis of that ratio.²⁵

15. PJM notes that Monitoring Analytics, LLC (Monitoring Analytics), its external Independent Market Monitor (IMM) presented an alternate proposal that would only revise section 5.5 by adding a qualification to any disbursement of the marginal loss surplus revenue as follows: "except that no such distribution to any non-firm Transmission Customer for such hour shall exceed the total charges for transmission service for such hour."

16. PJM also submits revisions to correct a non-substantive clerical error in section 1.10.1.

III. Notice and Responsive Pleadings

17. Notice of the filing was published in the *Federal Register*, 75 Fed. Reg. 52,521 (2010), with interventions and protests due on or before September 2, 2010. The following submitted timely motions to intervene: JPMorgan Ventures Energy Corp.; Exelon Corp.; Ameren Services Co.; Old Dominion Coop.; North Carolina Electric Membership Corp.; Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc.; Long Island Power Authority and LIPA; the Borough of Chambersburg, Pennsylvania; and Powhatan Energy Fund LLC. The Public Service Commission of Maryland submitted a notice of intervention.

²³ PJM will continue to require the reservation of transmission service for Up-To Congestion transactions involving the physical transfer of power in the Real-time Energy Market.

²⁴ Filing at 7 (footnote omitted).

²⁵ See Filing at 11.

18. The following submitted timely motions to intervene and comments: American Public Power Association (APPA); Allegheny Energy Cos. (Allegheny); Dayton Power and Light Co. (Dayton); American Municipal Power, Inc. (AMP); Dominion Resources Services, Inc. (Dominion); American Electric Power Service Corp. (AEP); and Financial Marketers.²⁶

19. The following submitted timely motions to intervene and comments and protests: DC Energy, LLC (DC Energy); Duke Energy Carolinas, LLC (Duke); and Monitoring Analytics, the IMM.

20. On September 9, 2010, PJM submitted an answer, and Financial Marketers subsequently submitted an answer to PJM's answer.

21. AEP, on behalf of its affiliates,²⁷ and Dominion support the PJM proposal. AEP states that the revisions will eliminate market participants' ability to improperly submit Up-To Congestion bids for the sole purpose of obtaining an allocation of the marginal loss revenue surplus.

22. Financial Marketers support PJM's proposal and describe it as a fair means to eliminate the incentive for market participants to profit solely from the transmission reservation component of Up-To Congestion transactions. Financial Marketers argue that eliminating the requirement that purely financial transactions reserve and pay for transmission service recognizes the fact that almost 99 percent of Up-To Congestion transactions do not use the PJM transmission system.²⁸ Financial Marketers strongly support the existing Up-To Congestion product and agree with PJM that preserving this trading in its current form is important. Further, because PJM has proposed to eliminate the requirement that financial Up-To Congestion transactions reserve and pay for transmission service, Financial Marketers state that they support PJM's proposal to concurrently reduce the marginal line loss allocation to non-firm customers.

²⁶ In this filing, Financial Marketers include: SESCO Enterprises, LLC; Black Oak Energy, LLC; MET MA, LLC; JPTC, LLC; West Oaks Energy, LLC; Red Wolf Energy Trading, LLC; Twin Cities Power, LLC; City Power Marketing, LLC; and Dyon, LLC.

²⁷ AEP's affiliates include: Appalachian Power Company, Columbus Southern Power Company, Indiana Michigan Power Company, Kentucky Power Company, Kingsport Power Company, Ohio Power Company and Wheeling Power Company, AEP Appalachian Transmission Company Inc., AEP Indiana Michigan Transmission Company Inc., AEP Kentucky Transmission Company Inc., AEP Ohio Transmission Company Inc., and AEP West Virginia Transmission Company.

²⁸ Financial Marketers Comments at 7.

23. Financial Marketers describe the transactions that created the impetus for this tariff filing.²⁹ According to Financial Marketers, the targeted trades were performed by just a small number of companies, all of which ceased making such trades once the IMM asked that they be terminated. Financial Marketers hope that these recent incidents will not cloud the record of the Up-To Congestion trading sector, nor obscure the benefits these transactions provide to the PJM system. In particular, they state that these transactions help alleviate price uncertainty by allowing transmission customers to set the maximum price for congestion that they are willing to pay and act as a risk-hedging mechanism. Up-To Congestion transactions across a congested path can also greatly aid the PJM system, Financial Marketers argue, by increasing liquidity and competition and decreasing congestion at otherwise constrained trading nodes.

24. Finally, Financial Marketers state that PJM rightly rejected the IMM proposal, which they state is unduly discriminatory because it improperly favors firm transmission customers over non-firm transmission customers by only imposing a price cap on the marginal line loss surplus allocations applicable to non-firm transmission customers. They further argue that Up-To Congestion trades would have received a double financial hit under the IMM proposal—not only would they have lost the full and fair value of receiving marginal line loss refunds, but they would have also been required to continue reserving and paying for non-firm transmission service that they do not use.

25. Dayton generally agrees with PJM's proposal. It expresses a concern, however, that the proposal does not address a core problem, namely, the manner in which line losses are calculated. Dayton contends that a different method is necessary to make the loss calculation more consistent with the actual losses monitored for reliability and congestion. Dayton contends that the delay in proposed reforms to the calculation method is due in part to the fact that some market participants financially benefit from the current method. Dayton suggests a method by which losses would be computed and excess losses returned on a more regional basis similar to the method employed by the Midwest Independent Transmission System Operator, Inc. It asks the Commission to direct PJM to find additional mechanisms to reduce the amount of over-collections and reduce the incentive for gaming the system.

26. Allegheny states that in Order No. 670, the Commission adopted regulations prohibiting market manipulation, and noted that wash trades and transactions creating and relieving artificial congestion “are examples of prohibited manipulation, all of which are

²⁹ See Financial Marketers Comments at 10-11.

manipulative or deceptive devices or contrivances, and are therefore prohibited activities under this Final Rule, subject to punitive and remedial action.”³⁰

27. Allegheny states that it supports the Commission’s investigation into the market behavior to see if there was a violation of the Federal Power Act or the Commission’s regulations prohibiting energy market manipulations.³¹ Allegheny urges the Commission to take all appropriate remedial and punitive actions should inappropriate behavior on the part of PJM market participants be confirmed, including the ordering of refunds of any benefits gained through the exercise of market manipulation.³² Similarly, Dominion states that hearings should be ordered in the investigation proceedings to establish a refund amount.³³

28. APPA states that it has become increasingly concerned over the past two years about the Commission’s failure to vigorously police the markets in Regional Transmission Organizations (RTO) and to discipline market participants that engage in activities that may comport with the letter of an RTO’s tariff but have no discernable commercial purpose except to make money for the participants engaging in them.³⁴ APPA states that the entities engaging in the gaming practice unjustly and unreasonably raised costs to other market participants, chiefly load-serving entities and the consumers they serve, and that the time has come for the Commission to act to protect consumers from the adverse impact of such unjust and unreasonable practices by ordering, at a minimum, disgorgement of the proceeds of such market activities.³⁵

29. AMP states that the penalties imposed by the Commission on parties in various circumstances appear not to bear a predictable or rational relationship to the nature of the conduct involved.³⁶ AMP states that the Commission recently approved a settlement that imposed a multi-million dollar penalty on a utility whose violation of the North American

³⁰ Allegheny Comments at 5 (citing *Prohibition of Energy Market Manipulation*, Order No. 670, FERC Stats. & Regs. ¶ 31,202, at P 59 (2006)).

³¹ *Id.* at 4 (citing *Order of Non-Public, Formal Investigation*, 132 FERC ¶ 61,169); *see also* Dominion Comment at 4.

³² *Id.*

³³ Dominion Comment at 4.

³⁴ APPA Comment at 4.

³⁵ *Id.* at 6.

³⁶ AMP Comment at 8.

Electric Reliability Corporation Reliability Standards was found to be unintentional.³⁷ Yet at the same time the Commission has refused to order disgorgement of unjust profits obtained by entities through deliberate conduct, according to AMP.³⁸ AMP also questions “whether consumers truly benefit when a ‘market’ is created for nearly every conceivable component of wholesale power service and when the resulting rules grow to such length and complexity that no single individual can possibly grasp them all.”³⁹ AMP maintains that the Commission can discourage manipulative conduct by simply declining to accept Enforcement Staff settlements where the negotiated penalty payment is substantially less than the unjust profits extracted from the market by a violator.⁴⁰ AMP states that participation in competitive markets should be rescinded when a party abuses the privilege of participating in such markets by engaging in manipulative behavior.⁴¹ AMP states that to the extent the Commission believes it lacks this authority it should seek from Congress any necessary clarification of its statutory powers.⁴² AMP recommends that the Commission also seek an explanation of the reasons why PJM’s market monitoring apparatus failed to detect the unusual OASIS activity.

30. Duke supports PJM’s proposal. Duke notes that removing the requirement of transmission reservations for Up-To Congestion transactions will make transmission capacity available for import and export transactions that correspond with actual usage of the transmission system and thus promote maximization of the PJM markets.

31. Duke opposes, however, PJM’s proposal to discount the marginal loss allocation for non-firm transmission customers. It contends that this proposal harms exporters who have not engaged in the alleged improper behavior. Duke questions why the first part of PJM’s proposal—to no longer require transmission reservations for Up-To Congestion transactions—would not be sufficient to remedy the identified problem.

32. Duke contends that PJM should adopt its first proposal and, only if it finds it necessary, should PJM propose to establish additional mechanisms. Even in that case,

³⁷ *Id.* (citing, e.g., *Florida Blackout*, 129 FERC ¶ 61,016 (2009)).

³⁸ *Id.* (citing Commission precedent in support).

³⁹ *Id.* at 7.

⁴⁰ *Id.* at 9.

⁴¹ *Id.* (citing Statement of Commissioner Wellinghoff, Docket No. RM04-7-001 (Apr. 17, 2008) (“[T]he authority to sell electricity at market-based rates is a privilege, not a right.”)).

⁴² *Id.* at 10.

Duke contends that PJM should adopt an approach that is targeted to ferret out the illicit market behavior with which it is concerned instead of adopting a wholesale solution that sweeps blameless parties into its scope.⁴³

33. Finally, Duke expresses concern over the larger-than-predicted marginal line loss over-collection, which it says results in unhealthy incentives for market participants. Duke states that it disagrees with the current plan to delay the implementation of reforms to the marginal line loss calculation process. It also suggests reexamining the manner in which the over-collection is allocated.

34. DC Energy asserts that the first element of PJM's proposal—to eliminate transmission reservations for Up-To Congestion bids—is adequate to address the “gaming” issue.⁴⁴ DC Energy explains that, by removing the fundamental component that made Up-To Congestion transactions eligible for the loss allocation credit, PJM has eliminated the profit motive for all the identified “gaming” transactions. However, DC Energy disagrees with PJM's statement that the proposed revisions eliminate transmission reservations associated with purely *financial* Up-To Congestion transactions; rather, DC Energy contends that PJM's proposed change eliminates transmission reservations for *all* Up-To Congestion transactions and, therefore, covers a broader set than the specified “gaming” Up-To Congestion transactions.⁴⁵ DC Energy submits that, to the extent feasible, a just and reasonable response should only target the identified “gaming” transactions and should not result in unrelated rule changes that act to discriminate against or eliminate non-gaming transactions that benefit the market.

35. DC Energy contends that PJM's second proposed change is an attempt to address an unrelated element of the market, i.e., whether some physical transactions should receive a larger allocation of the loss credits than other physical transactions. DC Energy contends that PJM has failed to consider that the implementation of the second element of its proposal will negatively affect many non-firm physical transactions. DC Energy states that PJM also fails to take into account the impact of the second element of its proposal on Commission-encouraged inter-control area transactions that bring convergence between higher- and lower-priced control areas and promote more economic and reliable dispatch.⁴⁶

⁴³ Duke Protest at 6.

⁴⁴ DC Energy Protest at 1.

⁴⁵ *Id.* at 4-5.

⁴⁶ *Id.* at 7-8.

36. According to DC Energy, in asserting that non-firm transaction customers should not have an equal allocation of loss surplus revenue credits, PJM is departing from Commission precedent by implying that non-firm transactions have an unequal standing in the market with respect to how they should be settled financially.⁴⁷ DC Energy states that PJM is unnecessarily increasing the risk exposure of non-firm transmission service in a fundamentally new way. In addition, DC Energy states that the proposed allocation of marginal loss revenue surplus will tend to favor participants who lock-up transmission availability under longer-term firm reservations and thus decrease the availability of transmission for hourly service and increase the market power of entities who can more easily justify holding large blocks of firm transmission capacity.⁴⁸

37. Monitoring Analytics, the IMM, asserts that PJM's existing tariff deviates from the Commission's logic that those transactions that contribute to the fixed costs of the grid should share in the surplus marginal loss revenues.⁴⁹ Instead, the IMM asserts that the marginal loss surplus is allocated based on scheduled energy, which results in an under-allocation of the surplus to firm transmission customers. Monitoring Analytics explains that while firm transmission service cannot be purchased on an hourly basis, non-firm transmission service can. Therefore, according to Monitoring Analytics, market participants can purchase non-firm service for only the hours against which they wish to schedule energy; the result is that 100 percent of their contributions go to the fixed costs of the grid and, thus, are eligible to receive an allocation of the marginal loss surplus greater than their transmission costs.⁵⁰ By contrast, on-peak, firm transmission customers must buy, at a minimum, a daily block of transmission service and could schedule on the 16 peak hours of energy, which means that only two-thirds (i.e., 16 hours) of their transmission service is entitled to an allocation of the marginal loss surplus. Further, Monitoring Analytics asserts that it defies logic that the allocation of the surplus based on contributions to the grid could exceed the actual transmission rates because the total loss surplus is less than the total cost of the grid.

⁴⁷ *Id.* at 8.

⁴⁸ *Id.* at 9.

⁴⁹ Monitoring Analytics Comments at 3 (citing February 24, 2009 Clarification Order, 126 FERC ¶ 61,164).

⁵⁰ Monitoring Analytics states that under the current methodology, non-firm transmission customers collected marginal loss surplus allocations, which were \$10 million or 220.7 percent greater than their transmission costs. Further, it notes that although non-firm transmission customers only accounted for 3.5 percent of the total cost of transmission, they received 15.9 percent of the total loss allocation. Monitoring Analytics Comments at 25.

38. Monitoring Analytics encourages the Commission to reject PJM's proposed temporary solution because the alleged manipulative behavior has ceased. In addition, Monitoring Analytics asserts that PJM's proposed revisions are too broad and would change other market rules unrelated to the problem. Monitoring Analytics notes that in its calculations of hourly non-firm transmission (\$0.67 per megawatt-hour) and yearly firm transmission by hour (\$2.16 per megawatt-hour) PJM ignores the cost of network integration transmission service. Therefore, Monitoring Analytics concludes that PJM's proposal inappropriately compares hourly rates for firm and non-firm transmission and should not form the basis for an allocator designed to allocate losses based on contributions to transmission costs.

39. Monitoring Analytics also disputes PJM's proposal to eliminate transmission purchases for Up-To Congestion transactions. Monitoring Analytics acknowledges that eliminating the requirement to purchase transmission would eliminate the mismatch between the cost of transmission and the allocation of the surplus, but Monitoring Analytics asserts that PJM ignores the unintended consequences of its proposal. According to Monitoring Analytics, without the requirement to purchase transmission service, Up-To Congestion bids will become identical to spread bids, which were previously rejected by stakeholders.⁵¹ More importantly, Monitoring Analytics asserts that PJM's solution does not directly address the underlying problem, which is that the marginal loss allocation method does not allocate based on a customer's contribution to the costs of the transmission system. According to Monitoring Analytics, under PJM's proposal other non-firm transmission customers that do not use Up-To Congestion bids will still have the financial incentive to schedule such that they receive a loss allocation greater than their contributions.

40. Instead, Monitoring Analytics recommends that the Commission direct PJM adopt a solution that fully complies with the Commission's February 24, 2009 Clarification Order, which would distribute the marginal loss surplus to each network service user and transmission customer in proportion to its ratio share of the total dollars contributed to the fixed costs of the transmission system, regardless of whether the service is scheduled in the Day-ahead or Real-time markets. Monitoring Analytics' recommended short-term solution is to cap the hourly marginal loss surplus allocation to the cost of non-firm transmission (i.e., \$0.67 per megawatt-hour) but still require Up-To Congestion bids to acquire transmission service. Monitoring Analytics asserts that its solution does not require additional business rule changes or introduce changes to unrelated markets and does not introduce the potential for unintended adverse market activity. In other words,

⁵¹ *See id.* at 29-30. "The spread bidding product that was previously proposed and then rejected by PJM participants would have allowed market participants to take a position at two buses internal to PJM. The proposed spread bidding product did not require the market participant to acquire transmission." *Id.*

according to Monitoring Analytics, its solution simply removes the financial incentive to engage in gaming activity. According to Monitoring Analytics, by eliminating the requirement to purchase transmission service for Up-To Congestion bids, PJM's proposal means that market participants could submit more bids in the Day-ahead market than could flow in real-time, based on Available Transfer Capability, thereby creating a potential divergence between the Day-ahead and Real-time markets. Given that the original intent of the Up-To Congestion bids has changed, Monitoring Analytics asserts that it would be better to eliminate Up-To Congestion bids rather than adopt changes with potential negative consequences.⁵²

41. In its answer, PJM states that Monitoring Analytics' comments on the marginal loss surplus revenue allocation are a collateral attack on prior Commission orders, which accepted the current marginal loss revenue surplus allocation methodology.⁵³ PJM asserts that the proper forum for Monitoring Analytics' concerns are the ongoing stakeholder process, where PJM notes it has created a new "Transactions Issues Task Force" to analyze alternatives to the current rule changes, spread bidding, and the incentives created by the marginal loss allocation. Furthermore, PJM disputes commenters' assertions that its proposal to reduce the allocations of surplus loss revenues distributed to non-firm transmission customers is unfair. PJM contends that its proposal to allocate 31 percent of the revenue surplus to all non-firm customers who pay for transmission service reflects the proportion to which such customers contribute to the cost of the transmission system.⁵⁴

IV. Discussion

42. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2010), the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

43. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2010), prohibits an answer to a protest or to an answer unless otherwise ordered by the decisional authority. We are not persuaded to accept PJM's answer or Financial Marketers' answer and will, therefore, reject them.

⁵² Monitoring Analytics notes that it previously recommended eliminating all internal PJM buses for use in Up-To Congestion bidding and for all import and export transactions in the Day-ahead and Real-time markets in its 2009 State of the Market Report for PJM. Monitoring Analytics Comments at 36.

⁵³ PJM Answer at 2 (referring to February 24, 2009 Clarification Order, 126 FERC ¶ 61,164).

⁵⁴ *Id.*

44. We accept PJM's proposal to: (1) eliminate the requirement to reserve transmission service for Up-To Congestion bids in the Day-ahead Energy Market; (2) limit the allocation of transmission loss charges surplus based on the ratio of non-firm point-to-point to firm point-to-point transmission service; and (3) initiate a stakeholder process, as discussed above. PJM's proposal is reasonable to ensure that parties are not engaging in transmission transactions solely because the marginal line loss credit exceeds the cost of entering into those transactions.

45. We find it reasonable to eliminate the transmission charge for Up-To Congestion bids as a mechanism to prevent gaming of marginal loss allocations as such elimination will make Up-To Congestion bids that involve no physical transmission in the real time energy market ineligible for allocation of the marginal loss surplus. Our understanding is that Up-To Congestion transactions with a physical tie to the Real-time market will still be able to purchase non-firm transmission service.⁵⁵ Similarly, we find it reasonable for PJM to base the credit on the relative percentage contribution to fixed cost recovery by firm and non-firm customers.

46. We are not persuaded by Duke's and DC Energy's arguments that the Commission should not accept PJM's proposed change to section 5.5 because it would distinguish among transmission customers for the allocation of surplus loss revenues and it is not needed respectively. To the contrary, we find that PJM's proposal equitably allocates these marginal loss charges among those paying for the fixed costs of the transmission system as it will discount the loss allocations for exports of non-firm point-to-point transmission customers based on the ratio of non-firm to firm point-to-point transmission service rates. Non-firm point-to-point transmission service is, by definition, less expensive than firm transmission service and it is therefore reasonable to proportion the marginal loss surplus accordingly.

47. Monitoring Analytics argues that the elimination of the transmission charge for Up-To Congestion transactions is tantamount to permitting spread bidding and the PJM stakeholders have not endorsed a spread bid product. PJM, however, already permits Up-To Congestion transactions, so this proposal does not result in a new product. All PJM's proposal does is eliminate a transmission charge for financial transactions that do not ultimately result in physical transmission.

⁵⁵ Filing at 10. "Notwithstanding the foregoing, Up-To Congestion transactions that do have a physical tie to the Real-time Energy Market and for which Non-Firm Point-to-Point Transmission Service is still required to be reserved and paid for should receive an allocation of the surplus marginal loss revenue." *Id.*

48. Monitoring Analytics also argues that PJM's current tariff along with its proposal here does not comport with PJM's original basis for allocating line losses insofar as it does not allocate credits to all those who support the fixed costs of the grid. For example, Monitoring Analytics asserts that the marginal loss surplus is allocated based on scheduled energy, which results in an under-allocation of the surplus to firm transmission customers. More fundamentally, Monitoring Analytics states that the current marginal loss surplus distribution method does not comport with the Commission's directive that all transactions that contribute to the fixed costs of the transmission system should receive an allocation of the surplus marginal losses.

49. These concerns go beyond the scope of this filing and, in effect, argue that PJM has incorrectly implemented the Commission-approved methodology for allocating line losses. While we do not find that these issues should result in the rejection of this filing, they may be considered in the stakeholder process to analyze possible alternatives to PJM's proposed changes to which PJM is committed, including *inter alia* the various issues raised by Monitoring Analytics.⁵⁶ Accordingly, following this stakeholder process, we will direct PJM to submit a report no later than December 31, 2010,⁵⁷ for informational purposes only, regarding the effectiveness of these rule changes.⁵⁸

The Commission orders:

(A) PJM's proposed revisions are hereby accepted, to be effective September 17, 2010, as discussed in the body of this order.

(B) PJM is hereby directed direct to submit a report for information purposes only, by December 31, 2010, as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

⁵⁶ See Filing at 13.

⁵⁷ PJM should request a "Report" designation for this submission.

⁵⁸ See Filing at 13. We note that this report is for informational purposes only and will not be noticed, nor require Commission action.