104 FERC ¶ 61,321
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

PJM Interconnection, LLC Docket No. ER03-1117-000

ORDER CONDITIONALLY ACCEPTING APPLICATION

(Issued September 23, 2003)

1. In this order, the Commission conditionally accepts a filing made by PJM Interconnection, LLC (PJM) regarding the mechanism by which PJM allocates the costs of default among its members, on the basis that PJM has not provided an explanation as to why one component of its allocation mechanism is just and reasonable. The filing will become effective on the date that the Commission issues an order accepting PJM's required compliance filing. This order benefits customers by ensuring that the mechanism used by PJM to allocate the costs of defaults does so in a just and reasonable manner.

Background

2. On July 25, 2003, PJM filed amendments to its Amended and Restated Operating Agreement (OA) establishing a new mechanism to determine the amount that PJM may assess and collect from different PJM members to compensate for the default of another PJM member. PJM's OA currently provides at Section 15.2 that the PJM board "may assess against, and collect from, the [PJM] members not in default, in proportion to their Weighted Interest, an amount equal to the amount the defaulting [PJM] member has failed to pay to the Office of the Interconnection, along with appropriate interest." A member's Weighted Interest is based 50 percent on the member's peak demand, 20 percent on the member's installed generation, 20 percent on the member's circuit miles of transmission capacity, and 10 percent on the total number of members. [1]

3. PJM states that its members now believe that the Weighted Interest formula does not allocate the risk of default by unsecured PJM members equitably among the

[1] See PJM OA, Section 1.49.

remaining PJM members. Therefore, PJM's Credit Working Group has developed a substitute mechanism, the Default Allocation Assessment formula. PJM states that this allocation mechanism will allocate the default payments more equitably among non-defaulting PJM members than the Weighted Interest calculation because the Default Allocation Assessment considers the PJM member's level of activity in the PJM markets. PJM states:

> Under the current Weighted Interest calculations, PJM members that own transmission lines (circuit miles), serve load, and have installed capacity carry the majority of the burden if another PJM member defaults, regardless of the level of their transactional activity in the marketplace. In contrast, other PJM members that own no transmission lines, serve no load, or have no installed capacity but are very active in the market (e.g. power marketers) carry very little of the responsibility. By considering a PJM member's activity level in the PJM markets in the new Default Allocation Assessment, the cost of a default is more fairly allocated across all members impacting the marketplace. As a result, more PJM members carry the burden of a potential default by another. [2]

4. PJM then states that the Default Allocation Assessment for any PJM member is based on two factors: 50 percent on the member's own risk profile, and 50 percent on the benefits the member receives from its PJM membership. The member's risk profile assessment will be determined by multiplying the default rate for the credit rating of that member's source of credit, as published by Standard and Poor's, by the member's 12-month peak historical exposure (greater of the member's highest two consecutive PJM monthly bills combined, or the member's highest single monthly PJM bill, in the last 12 months).[3] As to the 50 percent of the Default Allocation Assessment based on the benefits the member receives from PJM, 40 percent will be based on the member's gross activity (based on charges and credits for certain items listed on the PJM bills), and 10 percent (up to $10,000) will be based on a per capita assessment.

5. PJM states that the Default Allocation Assessment is the result of a PJM stakeholder process that culminated in a unanimous vote to approve the Default Allocation Assessment mechanism on July 10, 2003.

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[2] PJM transmittal letter at 2-3.

[3] PJM transmittal letter at 2; see also proposed OA Section 15.2.2.

6. Notice of PJM's filing was published in the Federal Register,[4] with motions to intervene and protests due on or before August 15, 2003. Reliant Resources, Inc. (Reliant), Baltimore Gas and Electric Company (BG&E), ISG Sparrows Points, Inc. and Consumers Energy Company (Consumers) filed timely motions to intervene.

Discussion

7. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. ' 385.214 (2003), the above timely, unopposed motions to intervene make the filing entities parties to this proceeding.

8. We note that this filing is one of several that have recently been made by ISOs and RTOs to revise provisions related to credit requirements for participation in the markets run by these organizations. While we recognize that the RTOs and ISOs have approved these filings through their stakeholder processes and will give such approval due deference, we nevertheless must address each filing on its merits and be able to find the proposal just and reasonable. It is incumbent, therefore, for the ISOs and RTOs to include in their filings support for their proposals. As discussed below, we find that PJM has not adequately justified one aspect of its filing.

9. Under PJM’s proposal, 50 percent of a member’s exposure to possible bad debt losses is based on that member’s risk profile – namely, how creditworthy that member itself is. PJM has failed, however, to provide a sufficient explanation as to the connection between a customer’s risk profile and its obligation to compensate PJM for another customer’s default. Thus, PJM has not demonstrated why it is just and reasonable to allocate a portion of bad debt costs to a member based on that member’s credit profile.

10. PJM has provided an explanation for the other factor that will determine a member's exposure -- the 50 percent that is determined by the member's level of activity in PJM. As PJM states, under its prior mechanism, parties such as power marketers who were very active in PJM's markets did not similarly pay a large share of bad debt losses. In a recently-approved proposal by the New York Independent System Operator (NYISO) to allocate the costs of bad debt losses among its customers,[5] the Commission approved a proposal under which NYISO

[4] 68 Fed. Reg. 46,598 (2003).

[5] New York Independent System Operator, Inc., 104 FERC ¶ 61,311 (2003) (NYISO).

> would allocate these costs [of bad debt losses] to all customers, including loads and suppliers, in proportion to the dollar volume of their transactions in the NYISO-administered spot markets. Customers that are more active in the NYISO markets and thus benefit more from the liquidity that the . . . bad debt loss rules bring would thus have greater financial obligations.[6]

11. Similarly, all parties who are active in PJM's markets will presumably benefit from the greater liquidity in those markets brought about by this change in rules; therefore, it is appropriate to base the allocation of bad debt costs to a party on the extent of that party's activity in PJM's markets.

12. Therefore, the Commission accepts PJM's filing on condition that PJM refile its proposal within 30 days of the date of this order and either (a) removes the risk profile factor from the allocation mechanism, so that the costs of bad debt losses to each member are based solely on that member's level of activity in the PJM market,[7] or (b) provides an explanation as to why it is appropriate to allocate the costs of bad debt losses to a PJM member based in part on that member's risk profile.

13. PJM's allocation mechanism will become effective upon the date that the Commission issues an order accepting PJM's compliance filing.

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[6] NYISO at P 11.

[7] As noted above, under the current Default Allocation Assessment proposal, PJM states that 40 percent will be based on the member's gross activity (based on charges and credits for certain items listed on the PJM bills), and 10 percent (up to $10,000) will be based on a per capita assessment. If PJM chooses to refile the mechanism using solely the member's level of activity in PJM's markets, it must specify, and justify, the appropriate percentage split between the member's gross activity and the per capita assessment.

<u>The Commission orders:</u>

PJM's tariff filing is accepted on condition that PJM makes a compliance filing within 30 days of the date of this order, as discussed above.

By the Commission. Commissioner Massey dissenting in part with a separate statement attached.

(S E A L)

Linda Mitry
Acting Secretary

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MASSEY, Commissioner, dissenting in part:

PJM's proposal was unanimously approved by the stakeholder committee. No protest was filed. The proposal is a reasonable one, and I would approve it without modification. For this reason, I respectfully dissent in part.

William L. Massey
Commissioner