



An Efficient Alternative for A Allocating FTR Underfunding Costs

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Principles to Govern FTR Funding Alternatives

- The development of a reasonable and efficient FTR funding alternative should:
 - ✓ Recognize that FTRs are financial instruments that should embody well-defined economic property rights; and
 - ✓ Be governed by sound economic principles.
- We propose the following principles:
 - ✓ Settlement obligations should be as well-defined as possible;
 - ✓ Settlements of FTRs should be non-discriminatory;
 - ✓ FTR shortfall costs should be allocated consistent with cost causation.
- The status quo in PJM is inconsistent with these principles and the PJM proposal makes it worse.



A Simple and Efficient Alternative for FTR Funding

- Step 1: Stop Allocating Balancing Congestion to FTR Holders
 - ✓ FTRs and their holders do nothing to create balancing congestion
 - ✓ Balancing congestion is unrelated to the portfolio of FTRs that an RTO has issued.
 - ✓ PJM's proposal in 2012 to allocate negative balancing congestion to transmission customers is reasonable.
- Step 2: Fully Fund All FTRs
 - ✓ Recognizes that FTR holders do not cause under-funding;
 - ✓ Makes FTRs more valuable for hedging and facilitating efficient trading and forward contracting;
 - ✓ Ensures that prevailing flow and counter flow FTRs settle in a non-discriminatory manner.



A Simple and Efficient Alternative for FTR Funding

- Step 3: Allocate shortfalls due to transmission outages to responsible transmission owners, and the balance to transmission customers.
 - ✓ Consistent with cost-causation and will provide efficient incentives for the transmission owners;
 - ✓ Transmission customers ultimately pay for FTR underfunding today through reduced ARR allocations and lower FTR revenues (FTR prices fall due to underfunding expectations).
 - ✓ Would likely reduce transmission customers' costs by removing the effects of FTR funding uncertainty from FTR prices.
 - ✓ The allocation to transmission customers can be deliberately designed to achieve equity objectives and minimize cost-shifting.
 - Allows for an equitable allocation of infeasible ARRs if that is deemed important.



Comparison to PJM Proposal

In contrast, the proposed PJM alternative would:

- Increase the discrimination against counterflow FTRs and restrict efficient FTR trading as a result;
- In times of FTR surpluses, this discrimination would create adverse (gaming) incentives to hold offsetting FTR positions.
- Provide no incentives for parties that actually cause underfunding to take actions to reduce it.
- Create significant cost-shifting by recovering negative balancing congestion costs largely through reduced ARR allocations/FTR revenues.
- Create a process that will predictably build transmission uneconomically.
 - ✓ The fact that ARRs are infeasible on a path does not indicate that investment is economic.
 - ✓ Inflating load forecasts will exacerbate this problem and raise costs to PJM's customers.