

108 FERC ¶ 61,116
FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

August 2, 2004

In Reply Refer To:
PJM Interconnection, L.L.C.
Docket No. ER03-1117-001

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Attention: Carrie L. Bumgarner
Attorney for PJM Interconnection, L.L.C.

Reference: Default Allocation Assessment

Dear Ms. Bumgarner:

1. On October 23, 2003, you filed with the Commission on behalf of PJM Interconnection, L.L.C. (PJM) an explanation justifying the inclusion of the risk profile component in PJM's proposed Default Allocation Assessment formula. The Commission rejects the explanation and the Default Allocation Assessment.
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. The proposed Default Allocation Assessment formula consists of 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 is 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 (the 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). The factor comprising the benefits the member receives from PJM is valued 40 percent on the member's gross activity (based on charges and credits for certain items listed on the PJM bills), and 10 percent on a per capita assessment.

3. In an order issued September 23, 2003,¹ the Commission conditionally accepted PJM's proposal, and directed PJM to provide within 30 days a sufficient explanation of the connection between a customer's risk profile and its obligation to compensate PJM for another customer's default. The Commission deferred the effective date of PJM's proposal until the Commission issues an order on PJM's compliance filing.

4. On October 23, 2003, PJM filed its explanation of the risk profile component of its Default Allocation Assessment formula to comply with the Commission's September 23, 2003 order. PJM explained that in 2002 it commissioned Standard and Poor's (S&P) to study PJM's default allocation methodology. S&P recommended that PJM include a risk component as well as a member benefit component into the allocation formula. The object of including a member risk component is to assess a portion of shortfalls arising from defaults to each PJM member in proportion to the share of risk each member brings to PJM markets. PJM asserts that this is based on a fundamental premise used in financial credit markets, *i.e.*, customers posing greater risks are required to pay greater costs, but that in the case of PJM members, the members pay the risk costs after default occurs, rather than before as with financial markets. PJM also states that, in determining the risk profile component, PJM takes into account that certain members with insufficient unsecured credit for their market activity have already posted collateral with PJM. PJM imputes a credit value for that member which takes into account that the member has posted collateral, thus the member is not paying twice for their risk to PJM's markets. PJM argues that, since the risk component of the Default Allocation Assessment formula was recommended by Standard & Poor's and was unanimously approved by PJM stakeholders, the Commission should approve this amendment to the OA.

5. Notice of the compliance filing was issued on October 29, 2003, with comments due by November 13, 2003. The PSEG Companies filed comments in support of PJM's explanation and its Default Allocation Assessment proposal. Consumers Energy Company (Consumers) filed a protest of the explanation. Consumers protested PJM's explanation on the grounds that PJM has failed to justify the inclusion of a risk component in the default allocation formula.

¹ 104 FERC ¶ 61,321 (2003).

6. The Commission does not find that there is a sufficient nexus between a member's credit rating and the share of default costs that a member should have to bear when another member defaults. Under PJM's proposal, a member with a lower credit rating would always have to bear a greater share of default costs, no matter if that member is in good standing and paying its bills on time. The Commission does not see a reason to treat that member differently from any other member in good standing. The Commission recently approved a New York Independent System Operator, Inc. (NYISO) proposal to allocate default costs on the basis of the remaining customers' activity levels within the market.² The theory underlying that methodology is that those who benefit most from activity in the NYISO's markets should pay a larger share of default costs. There, the connection between the benefits a member experiences and the level of costs shared is a logical one. For the above reasons the Commission rejects PJM's proposal.

By direction of the Commission.

Magalie R. Salas,
Secretary.

² 104 FERC ¶ 61,311 (2003).