

102 FERC ¶ 61,276
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

PJM Interconnection, L.L.C.

Docket No. ER03-406-000

ORDER ACCEPTING FOR FILING PROPOSED TARIFF
CHANGES, AS MODIFIED

(Issued March 12, 2003)

1. On January 10, 2003, PJM Interconnection, L.L.C. (PJM) submitted for filing, pursuant to section 205 of the Federal Power Act,¹ amendments to the PJM Open Access Transmission Tariff (PJM OATT) and PJM's Amended and Restated Operating Agreement (PJM Operating Agreement) to: (1) create an annual Financial Transmission Rights (FTR) auction and Auction Revenue Right (ARR) allocation process; (2) offer FTR Options in addition to FTR Obligations; and (3) enhance the existing monthly FTR auctions by including a 24-hour FTR product. PJM requests an effective date for its filing of March 11, 2003, consistent with the commencement of its 2003-2004 planning period.
2. As discussed below, we will accept PJM's proposed amendments for filing, as modified. PJM's proposed FTR revisions will facilitate greater price transparency and price certainty in PJM's FTR market, while preserving the rights of load serving entities (LSEs) to rely upon these FTRs to the same extent they currently can, *i.e.*, in the same circumstances and with the same hedging ability. PJM's filing also complies with the Commission's mandate that FTR rights on PJM's system follow load.² However, in response to the needs of PJM West members, who joined PJM only recently (on April 1, 2002), we will require PJM to provide a transition period before requiring these members to participate in PJM's annual FTR auction. In addition, we will require PJM to clarify

¹16 U.S.C. § 824e (2000).

²See *Occidental Chemical Corporation v. PJM Interconnection, L.L.C. and Delmarva Power & Light Company*, 101 FERC ¶ 61,005 (2002) (*Occidental*), order on reh'g and compliance filing, 102 FERC ¶ 61,275 (2003).

the operation of its proposed auction with respect to certain matters, discussed below, and will require PJM to submit tariff revisions, where appropriate, addressing these matters.

Background

3. Under PJM's locational marginal pricing (LMP) system, transmission prices are determined, in part, as the demand response to the existence (or non-existence) of transmission congestion. In turn, FTRs, which are allocated by PJM in relation to the transmission transfer capability of PJM's grid, allow market participants to cushion (or hedge) the variation in these prices. FTRs are financial rights that entitle the holders to receive transmission congestion credits. These credits can be used to hedge or offset transmission congestion charges in PJM's day-ahead market during periods in which transmission capacity is constrained.³ When PJM's LMP system was first established, in 1998, PJM allocated all FTRs to network and point-to-point transmission service customers, at the customer's request. PJM currently reallocates these rights on an annual basis, each June, and also administers a monthly FTR auction.

4. PJM states in its filing that these existing procedures require modification in order to create a more liquid and deeper market for FTRs, promote a more efficient allocation of scarce FTRs, provide greater flexibility for hedging risk, and to foster a more active secondary market for FTRs. To accomplish these objectives, PJM proposes to establish an annual FTR auction in place of its existing annual allocation of FTRs (PJM's existing monthly auction of FTRs would be retained). In lieu of PJM's annual reallocation of FTRs, PJM states that its network and firm point-to-point customers would receive, instead, ARRs, in a quantity based on PJM's existing "simultaneous feasibility" measure.⁴ PJM states that ARRs could then be converted ("self scheduled") into FTRs, at no cost, on a right of first refusal basis, or sold at auction to the highest bidder. ARR holders that wish to exercise the self-scheduling option will not be required to place actual monetary bids in the auction, rather, because the FTRs already passed the simultaneous feasibility

³ As a hedging instrument, FTRs are similar in nature to the Congestion Revenue Rights outlined by the Commission in its proposed rule on standard market design (SMD NOPR). See Remediating Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design, Notice of Proposed Rulemaking, FERC Stats. & Regs. ¶ 32,563, 67 Fed. Reg. 55,452 (Aug. 29, 2002).

⁴ Thus, the overall "pie" comprising PJM's existing FTR entitlements would remain unchanged, *i.e.*, it would neither expand nor contract in size due to the implementation of an FTR auction.

test when the ARR were allocated, all ARRs can be converted to FTRs without any additional cost. An ARR holder that self-schedules does not set the clearing price in the auction. If there are other bidders for the same FTRs, then those other bidders will set the clearing price. The self-scheduling ARR holder, however, always will receive the FTRs based on its right of first refusal under the self-scheduling option. While the ARR holder will have to pay the clearing price to obtain the FTR in those circumstances, as the ARR holder, it also will receive the identical amount in ARR revenues for a net cost of zero.

5. PJM states that an ARR could be converted into an FTR on the same source and sink points that would be associated with the LSE's ARRs, or alternatively, could be reconfigured on one or more alternative paths.⁵ PJM states that ARRs would also be made available to interconnection customers and that as loads shift from one LSE to another within a transmission zone, a pro rata share of ARRs would be reassigned automatically, consistent with the Commission's recent directive in Occidental.⁶ PJM states that its annual auction would take place in four rounds, with 25 percent of simultaneously feasible FTR capability awarded in each round.

6. PJM also proposes to introduce a new product, FTR Options, which would be sold in the FTR auction. PJM states that an FTR Option would be distinguishable from an FTR Obligation (which PJM currently offers), because the Option holder, while entitled to a credit when the sink LMP is higher than the source LMP, would not be liable for a congestion charge when the sink LMP is lower than the source LMP. PJM explains that FTR Obligations, by contrast, produce a positive credit when the sink LMP is higher than the source LMP, but impose a liability when the sink LMP is lower than the source LMP, i.e., when the designated path is in the direction opposite to the congested flow.

7. Finally, PJM states that in order to provide customers even more flexibility, it is proposing to establish a 24-hour FTR product in addition to the existing on-peak and off-peak products.

⁵Currently, network customers are required to designate FTRs along paths from unit specific capacity resources corresponding with the customer's aggregated load. PJM proposes a one-year transition period during which this requirement would remain in effect with respect to ARR designations. After this transitional period, however, the requirement would be eliminated in order to allow ARR designations from a combination of zones, generators, hubs and external interface buses.

⁶See 101 FERC at P17 .

Notice of Filing and Responsive Pleadings

8. Notice of PJM's filing was published in the Federal Register,⁷ with interventions, comments or protests due on or before January 31, 2003. Motions to intervene and notices of intervention were timely filed by the entities listed in the Appendix to this order. Motions to intervene out-of-time were filed by the Office of People's Counsel of the District of Columbia (People's Counsel), on February 3, 2003, by Dynegy Power Marketing, Inc. (Dynegy), on February 12, 2003, by Electricity Consumers Resource Council (ELCON), on February 14, 2003, by Public Service Electric and Gas Company⁸ (PSE&G, et al.), on February 19, 2003, and by PJM Market Participants, on February 24, 2003. Protests and comments were filed by the entities noted in the Appendix. Answers were filed by PJM, on February 19, 2003, Allegheny Power, on February 27, 2003 and by Occidental and Old Dominion Electric Cooperative, on March 6, 2003.

Discussion

Procedural Matters

9. Pursuant to Rule 214 of the Commission's Rules of Practice of Procedure,⁹ the notices of intervention and the timely, unopposed motions to intervene filed in this proceeding serve to make the entities listed in the Appendix parties. In addition, we will grant the motions to intervene out-of-time filed by People's Counsel, Dynegy, ELCON, PSE&G, and PJM Market Participants, given their stated interests, the early stage of this proceeding, and the absence of any undue prejudice or delay.

10. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure¹⁰ prohibits an answer to a protest unless otherwise permitted by the decisional authority. We will accept PJM's answer, based on its useful clarifications, as discussed below. We are not persuaded to accept the remaining answers and therefore will reject them.

⁷68 Fed. Reg. 4,186 (2003).

⁸Joined by PSEG Power LLC and PSEG Energy Resources & Trade LLC.

⁹18 C.F.R. § 385.214 (2000).

¹⁰Id. at § 385.213(a)(2).

Analysis

11. We will accept for filing, as modified, PJM's proposed FTR revisions. Based on our initial review, and subject to the modifications discussed below, we find that PJM's proposed revisions appear to be just and reasonable, and have not been shown to be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful.

A. Implementation of an Annual FTR Auction

1. PJM's Proposal

12. PJM asserts that its proposed annual FTR auction and allocation of ARR's will protect load against the costs of congestion as well as, or better than, PJM's existing FTR allocation procedures, while at the same time providing greater price certainty, price transparency, and more flexibility than exists today to manage congestion costs. PJM also submits that its proposed FTR amendments are generally consistent with the SMD NOPR and notes that its filing was the product of an extensive, year-long stakeholder process.

2. Protests and Comments

13. A number of parties argue that PJM's proposed auction procedures will increase customer costs while providing no guarantee that LSEs will be afforded a sufficient supply of FTRs to provide for load growth or otherwise meet their congestion management needs. These parties assert that until the root causes of congestion are addressed by PJM (including the addition of new transmission capacity and the introduction of new demand response programs) PJM's proposed auction procedures are premature.

14. Protestors also question the feasibility of PJM's proposed auction procedures. The Transmission Dependent Utility Systems (TDU Systems) and Continental Cooperative Services (CCS), for example, claim that smaller LSEs, in particular, are unlikely to have the resources necessary to forecast congestion or to estimate the value of needed FTRs. In addition, these parties assert that generators with extensive portfolios, including units in load pockets and units with local market power, will have the ability to affect the value of FTRs. Old Dominion Electric Cooperative (ODEC) adds that auction mechanisms pose potential adverse tax consequences for public power entities.

15. Protestors also question the fundamental fairness of an annual auction. ODEC and CCS assert that gaming would be possible where competing suppliers bid up the

price of the FTR in the auction beyond the forecast value of the FTR revenues. Occidental Chemical Corporation (Occidental) adds that subjecting congestion hedge rights to a mandatory auction, unlike an allocation based on load, would create an incentive for transmission owners to seek ways to maximize the potential for profit. Occidental also claims that PJM's proposed auction would discriminate against LSEs using network service because only a point-to-point customer would be able to self-schedule to convert all of its ARRs to the FTRs it needs. Occidental also asserts that transmission owners with both historical and real time bus bar specific load information will always have an unfair advantage in a mandatory FTR auction.¹¹

16. Finally, protestors characterize PJM's proposed tariff revisions governing its proposed FTR auction as incomplete, vague, or otherwise ambiguous. The Coalition of Municipal and Cooperative Users of New PJM Companies' Transmission (Municipal Coalition), for example, asserts that PJM's proposal fails to provide any details with respect to the process through which ARR holders would be allowed to self-schedule FTRs on the same path in the annual FTR auction. ODEC agrees and further asserts that these procedures should not be relegated to the PJM Manuals (which do not require Commission approval). The Illinois Municipal Electric Agency (Illinois Municipal) adds that PJM's filing lacks any detail as to how it would work to ensure that LSEs who hold ARRs will always receive payment equal to the full amount of their bids.

3. Commission Response

17. We will accept PJM's proposed FTR auction procedures for filing, subject to the modifications discussed below. PJM has operated under an LMP system with FTRs since 1998. The proposal to change from an allocation-based procedure to an auction procedure was developed as part of a stakeholder process involving market participants in the region. This move to an auction, moreover, is widely supported by these market participants that have been operating in PJM's markets. Most of the concerns about the move to an auction have been raised by entities that only recently joined these markets, as part of PJM West, and by other entities that intend to join PJM. In light of the widespread support within the region, we believe PJM's proposed auction procedures are, as a general matter, appropriate (subject to the modifications discussed below). Further, as discussed below, we believe the concerns expressed by protestors, regarding the protections that may be lost if congestion rights are subjected to an auction procedure, are misplaced. PJM's auction procedures include a self-scheduling, right of first refusal

¹¹Based on these concerns, Occidental requests that PJM be required (as a prerequisite to implementing an auction) to post historic and real-time load data on its web site equivalent to the local load data available to electric distribution companies.

provision, which will allow a customer, at its sole discretion, to retain the full value of its congestion management rights. If a customer wishes, it need not participate in PJM's auction.

18. Specifically, under PJM's FTR revisions, there is no change in the allocation of FTRs to existing entities. Those entities entitled to an allocation of FTR's under PJM's existing procedures will be allocated the same rights, in the form of ARRs. These entities can then self-schedule FTRs to hedge against congestion costs. Thus, the existing congestion rights to which these parties are entitled (and the overall quantity of these rights as they exist systemwide) will neither expand nor contract as a consequence of PJM's proposed revisions.

19. The only change made in this filing is that PJM has instituted a once-a-year auction procedure by which FTRs can be sold. Such an auction will benefit the market by enabling both potential buyers and sellers of FTRs to obtain better information about the value of FTRs. But, as discussed above, transmission customers are not required to sell their FTRs in the auction, but can retain them under the right-of-first refusal procedure. Thus, the auction will provide these customers with better price information to determine whether they want to sell or retain their FTRs, but does not oblige them to relinquish FTRs, and will have no effect on the existing quantity of these congestion management rights or otherwise alter the methodology currently relied upon by PJM, currently, to allocate these rights.

20. Based on these findings, we reject the allegation that PJM's auction procedures will increase customer costs to an unreasonable level. In fact, PJM's FTR revisions will expand customer options and thus provide a more flexible means of addressing congestion on PJM's system. By encouraging greater competition in the market for FTRs, the true value of FTRs will be more accurately communicated to the market, signaling in turn, the need (where it may exist) for additional transmission and/or generation capacity. Additionally, the annual auction and expanded options available on both a monthly and annual basis, will allow FTRs to be more readily reconfigured by PJM's customers, when and where new capacity becomes available, or existing FTRs are no longer needed. For all these reasons, we also reject protesters assertions that PJM's filing is premature, or ineffectual, or otherwise fails to grapple with the root causes of congestion on PJM's system.

21. We also reject protestors' claims that PJM's FTR auction procedures will encourage the exercise of market power or otherwise lead to gaming or market manipulation. These allegations, which are largely speculative in nature, are not borne out by the right of first refusal protections which form a critical element of PJM's

proposed auction procedures. These protections allow a customer to keep its FTRs, if it so chooses, and thus would not lead to gaming or market manipulation. As PJM notes, moreover, the PJM Market Monitoring Unit has determined that PJM's proposed auction procedures will not facilitate gaming.¹² As noted above, moreover, PJM's auction procedures will expand customer options, not limit them, while leaving in place PJM's existing methodology for determining the overall quantity of FTRs (now ARR) on its system.¹³

22. In addition, we agree with PJM that the gaming of its FTR auction is unlikely. As PJM notes, there would be no discernable economic rationale for a competing supplier to bid up the value of an FTR path, for which it does not own the corresponding ARR, in the hope that it later would acquire the load and the ARR. Moreover, the transfer of ARRs between LSEs in a zone as load shifts is done on a pro rata basis. Because only aggregate ARR information will be publicly posted, LSEs that receive ARRs under the pro rata reassignment mechanism cannot control the reassignment process and have no way of determining in advance which ARRs they will receive in a re-assignment; therefore, they would have no incentive to attempt this gaming.

23. Nor will we consider, pursuant to section 206 of the FPA,¹⁴ protestors' challenges to PJM's existing FTR/ARR procedures, as incorporated and/or retained (either in form or substance), in PJM's filing. Specifically, we will leave in place PJM's existing practice of allocating congestion management rights to its network and firm point to point transmission customers (as opposed to the ultimate consumer). In fact, these rights are appropriately allocated to PJM's network and firm point to point transmission customers because it is these entities to whom PJM is contractually committed, under its OATT, and it is these entities who are directly responsible for PJM's revenue requirement.

24. We also dismiss protestors concerns regarding the possible loss of tax exempt status relating to the participation by municipal entities and rural electric cooperatives in

¹²To the extent gaming should occur, we note that PJM has market mitigation measures in place to address this potential.

¹³We further note that LSEs, small or large, should not be at a disadvantage in obtaining the information they need to participate in PJM's FTR auctions. PJM states in its answer, for example, that it posts load-weighted zonal prices for the day-ahead energy market, the real-time energy market and its existing FTR monthly auction. PJM states that this data may be used by participants to competitively determine FTR values.

¹⁴16 U.S.C. § 824d (2000).

PJM's FTR auction. In fact, under PJM's current FTR procedures, municipalities and cooperatives that hold FTRs already receive congestion revenues from entities that are not their members. PJM's proposed auction procedures will not fundamentally alter this arrangement. Moreover, as PJM notes in its answer, PJM is currently discussing business rules that would assign credit requirements based on the net of the FTR purchase price and the ARR valuation, i.e., the expected ARR revenues. PJM states that as a result, the ARR holder that utilizes the self-scheduling alternative would be assigned a zero credit requirement. Thus, the ARR credit would directly offset the FTR purchase price (a significant protection for customers wishing to retain their FTRs).

25. While we accept, in principle, the efficacy of PJM's proposed FTR auction, for all the reasons noted above, we agree with those protestors who assert that PJM's filing is, in certain respects, insufficiently developed. Specifically, we agree with ODEC that the procedures governing the self scheduling of FTRs are of sufficient importance to be incorporated into PJM's tariff in detail. Accordingly, we will require PJM to make a compliance filing within 30 days of the date of this order incorporating these provisions, as may be necessary.

26. B. PJM's Proposed Interim Procedures for New Regions

1. PJM's Proposal

27. PJM asserts that in the new regions in which it may be expanding,¹⁵ a direct assignment of FTRs would be warranted for a period of time because of the lack of transmission congestion pricing history in these new regions. Accordingly, PJM proposes to assign FTRs in these new regions in a number of megawatts equal to or less than the installed capacity summer megawatt rating of each designated network resource. Firm point-to-point customers would be assigned FTRs at the customer's election. PJM states that these FTR assignments would remain in effect until the first annual allocation of ARRs after the integration of a new PJM zone into the PJM market.

2. Protests and Comments

28. Protestors take different positions regarding what, if any, transition period may be appropriate prior to the implementation of PJM's proposed FTR auction procedures in new regions with no prior experience with PJM's LMP system. On the one hand, the PJM Industrial Customer Coalition, Coalition of Midwest Transmission Customers, and

¹⁵See Alliance Companies, et al., 100 FERC ¶ 61,137 (2002) (Alliance Companies).

Industrial Energy Users - Ohio (Industrial Coalition) favor no transition period at all, asserting that PJM's proposed interim procedures for new regions would effectively eliminate congestion hedging opportunities for customers that pursue competitive supply and would have far-reaching adverse effects on the retail marketplace in Ohio and potentially other Midwest states. The Joint Consumer Advocates, on the other hand, argue that a four-year transition period is necessary, claiming that PJM's proposed one-year transition period will provide an insufficient basis for market participants to properly value FTRs.

29. In addition, the Detroit Edison Company (Detroit Edison) states that the language in PJM's filing regarding the date on which the transition would end is unclear. Detroit Edison seeks clarification that the new zones would not enter the auction process until June 2004. Detroit Edison also requests that PJM have Business Practices in place governing this transition process.

30. Duke Energy North America, LLC (Duke Energy) requests that the Commission require PJM to allow Duke Energy's preexisting point-to-point service agreements in the new regions served by PJM to be converted to point-to-point transactions eligible to receive an allocation of FTRs, or, alternatively, allow these agreements to be annulled. Duke Energy also notes that PJM's proposal for its new regions is silent on the issue of whether, or how, FTRs would be allocated to transmission reservations that start or end withing PJM's initial 13-month allocation period. Specifically, Duke Energy asserts that PJM's proposal would put point-to-point customers with transmission service agreements of 12 months or less, or those that begin or end outside the start of the 13-month period, at a clear disadvantage in the initial allocation of FTRs, diminishing the value of their preexisting physical rights.

31. Detroit Edison argues that in order to adjust to the new June-to-June reservation period and to maintain its preexisting rights, PJM should be required to offer a rollover right until November of 2003. Detroit Edison and Wisconsin Electric Power Company (Wisconsin Electric) also argue that PJM's filing fails to address the Commission's directive requiring PJM to effectively hold harmless utilities in Wisconsin and Michigan from any loop flows or congestion that results from the proposed configuration of PJM and the Midwest Independent System Operator (Midwest ISO).¹⁶

¹⁶See Detroit Edison protest at 4, citing Alliance Companies, 100 FERC at PP.53 and 57.

3. Commission Response

32. We will require PJM to modify its proposed interim FTR procedures for new regions joining PJM.¹⁷ PJM recognizes, and we agree, that a direct assignment of FTRs may be warranted for a period of time due to the lack of transmission congestion pricing history in the new regions that will be served by PJM. However, protestors raise valid concerns regarding the sufficiency of PJM's proposed one-year transition period (ending June 2004). Therefore, we will require PJM to revise its tariff to provide that new members, at their election, will have until at least the second annual auction after they join PJM to participate in PJM's annual FTR auction.

33. Detroit Edison's and Wisconsin Electric's concerns regarding our hold harmless requirements, as set forth in Alliance Companies, the impact of loop flows and the physical occurrence and existence of congestion in the new regions served by PJM, are not implicated by the financial rights procedures at issue in this proceeding.

34. In addition, we will require PJM to clarify a number of issues raised by Consumers Energy Company (CEC). First, we agree with CEC that PJM has provided no definitional basis or illustrative examples demonstrating how an FTR request determined by PJM to be "not feasible" in a new zone, under Section 5.2.2(e)(iii) of the PJM OATT, would be pro rated and allocated in "inverse proportion to the effect on the binding constraints." Second, we agree with CEC that Section 5.2.5 is unclear as to what the sequence will be for the assignment of Congestion Charges when the total Target Allocations are greater than the total Transmission Congestion Credits for the hour.¹⁸ Third, we agree with CEC that Section 7.1.2 is unclear as to when, during the fiscal year, each round of the four designated auctions would take place, and whether dateline would be consistent year-to-year. We will require PJM to address each of these issues in its compliance filing.

¹⁷In doing so, we recognize that, in a press release posted on PJM's web site on March 3, 2003, PJM states that the full integration of these new regions into PJM, originally planned for May 1, 2003, would be delayed. Nonetheless, the provisions we approve here will apply when, and if, these regions become fully integrated within PJM.

¹⁸PJM fails to explain if these proportional shares would be assigned before, or after, all FTR target allocations having a negative Target Allocation value have been settled.

C. Elimination of PJM's Unit Specific Capacity Resource Requirement

1. PJM Proposal

35. PJM proposes a one-year transition period during which requested ARR source points must be unit-specific capacity resources, consistent with PJM's existing FTR procedures. Following this one-year transition period, PJM states that this requirement would be eliminated and replaced with the network customers designation of a subset of buses. In support of its proposal, PJM notes that its proposed transition mechanism constitutes a compromise between those stakeholders who supported no change in the existing requirement and those stakeholders who advocated its immediate elimination.

2. Protests and Comments

36. The Industrial Coalition argues that no legitimate purpose is served by phasing-in this proposal, as PJM proposes. Similarly, Occidental argues that the allocation of ARRs should not contain a preference for point-to-point service, even for a one-year transition period. The Joint Consumer Advocates, on the other hand, argue that if this requirement is eliminated, there will be an increased probability that the ARR allocation process will become a process for speculating on congestion costs rather than a means of hedging against congestion costs.

37. PPL EnergyPlus, LLC and PPL Electric Utilities Corporation (PPL Electric) asserts that PJM's proposal, once implemented, would diminish the existing property rights of LSEs with Provider of Last Resort (POLR) obligations that have made long-term investments in capacity to serve their POLR load, while providing no significant additional benefits to other LSEs. PPL Electric further asserts that PJM's current practice of limiting the source points for FTRs to unit-specific capacity resources has had the effect of encouraging the use of FTRs as a hedge for delivery and discouraging the use of FTRs simply to profit from congestion differentials. Protestors also raise concerns regarding the specificity of PJM's proposal.

3. Commission Response

38. We will conditionally accept PJM's proposal to eliminate its unit-specific FTR scheduling requirement, subject to the conditions outlined below. Elimination of PJM's unit-specific FTR scheduling requirement should have the effect of broadening customers' existing FTR rights, which should, in turn, make FTRs more tradable and thus

enhance competition (since the number of FTR sources will be increased).¹⁹ Thus, PJM's proposal appears to have merit. While the parties differ on their views regarding when, or if, this proposal should be implemented, we agree with PJM that its proposed implementation (after a one-year transition period), strikes a reasonable balance and reflects the broad consensus view of a majority of PJM's stakeholders.

39. The Municipal Coalition asserts, however, that PJM's proposal lacks specificity regarding the manner in which alternative source buses would be identified, or the criteria that would govern this identification process. We agree that PJM's filing lacks specificity with regard to these matters – regarding the criteria that will govern identification of buses that may be designated by network resources, or the extent of discretion that may be permitted in how these buses can be grouped. We also find that PJM has failed to adequately address the effects (including the cost effects) of its proposal on market participants.

40. PJM notes that details concerning these matters are still under discussion within PJM. Accordingly, because PJM's proposal will not become effective until June 2004, we will conditionally accept it, subject to PJM providing additional specificity in support of its proposal, no later than September 30, 2003. We will require PJM to clarify, among other things, (1) its procedure for determining subset buses; (2) the manner in which these subset buses would be grouped; (3) all relevant rules and guidelines to be followed by customers in nominating these subsets; and (4) the anticipated effect of these requirements on market participants.

D. PJM's Proposal to Allocate ARRs to Generators and Others Who Construct Network Upgrades

1. PJM's Proposal

41. PJM states that its proposed amendments would continue to allow interconnecting generators that pay for system upgrades to have flexibility in the way they select the ARRs that would be attributable to their upgrades.

¹⁹As discussed earlier, moreover, the existing rights of LSEs, whether they have or do not have POLR obligations, will not be materially diminished as a result of PJM's proposal, because these LSEs will retain ARRs (convertible to FTRs) for the same path as their previously-allocated FTRs.

2. Protests and Comments

42. Allegheny Power and Allegheny Energy Supply Company, LLC (Allegheny) assert that generators that pay for system upgrades should receive ARRAs that reflect the cost of the upgrade. If the cost of the upgrade exceeds the value of the ARRAs, then the generator should receive transmission credits in lieu of or in combination with the ARRAs so that the generator will be kept whole. ODEC opposes eliminating credits for upgrades.

3. Commission Response

43. PJM clarifies in its answer that under its proposed auction procedures, generation interconnection customers would be awarded incremental ARRAs on the same Commission-approved basis that they currently are allocated incremental FTRs for upgrades. Thus, PJM is not proposing to modify its existing practices and we see no need to do so here.

E. PJM's Proposed FTR Options

1. PJM's Proposal

44. PJM proposes to offer a new product, FTR Options, which it would offer in its auctions along with existing FTR Obligations. PJM states that FTR Options would be distinguishable from FTR Obligations in that FTR Options would not entail the downside risk associated with FTR Obligations.²⁰ PJM states that the hourly economic value of an FTR Option would be zero when the designated path is in the direction opposite to the congested flow, *i.e.*, the day-ahead LMP at the point of receipt is higher than the day-ahead LMP at the point of delivery. PJM further states that because the FTR Option holder would incur no liability when the sink LMP is less than the source LMP, the price of FTR Option on each path would likely be greater than the FTR Obligation price on the path.

2. Protests and Comments

45. ODEC asserts that because FTR Options do not incur charges related to counterflows, the counterflow congestion is presumably subsumed within the FTR

²⁰PJM notes that FTR Obligations produce a positive credit when the sink LMP is higher than source LMP, but impose a liability when the sink LMP is lower than the source LMP. FTR Options, on the other hand, would not have the liability component.

Option as part of PJM's simultaneous feasibility analysis for FTRs. As a result, the net amount of FTRs could be reduced by the number of counterflow FTRs that would no longer be available in order to accommodate the FTR Options. The Municipal Coalition shares these concerns, arguing that the existence of FTR Options would have unavoidable impacts on the number of FTR Obligations that could be made available to current transmission customers thereby increasing the exposure of current transmission customers to congestion costs.

46. In addition, the Joint Consumer Advocates warn that PJM may be taking on considerable financial risk in administering a market for FTR Options because the proposal simply assumes that the price paid for options will be sufficiently high to cover the cost of the counterflow capability required to support the options sold. Joint Consumer Advocates assert that the FTR Options may be best left to a secondary market, administered by private interests willing and able to bear the risks of these congestion derivatives. Finally, protestors raise concerns regarding the specificity of PJM's proposal.

3. Commission Response

47. We will accept PJM's proposed FTR Options product, subject to modification. As PJM notes, the sale and trade of FTR Options will not diminish the quantity or quality of ARR allocations by PJM to its transmission customers. This is so because the simultaneous feasibility of allocated ARRs (or FTRs) will be determined first; FTR Options could only be offered to the extent there is a residual capability. Therefore, offering FTR Options in PJM's auction will have no adverse impact on the amount of ARRs or FTRs that are available to customers. Nor is it true that the cost associated with FTR Option holders avoiding congestion charges during hours of "reverse" congestion is a cost that must be borne by others. Rather, that cost would be borne through the higher auction price for FTR Options.

48. PJM answers that Joint Consumers concerns for financial exposure of PJM in the offering of FTR Options is unwarranted. PJM states that the cost associated with FTR Option holders avoiding congestion charges during hours of "reverse" congestion is borne through the higher auction price for FTR Options. We accept PJM's explanation.

49. PJM's assurance that FTR Options will be based on residual capability is not reflected in the tariff sheets submitted by PJM in its filing or otherwise addressed by PJM. Accordingly, we will require PJM to submit revised tariff sheets stating that FTR Options will only be offered after the simultaneous feasibility of allocated ARRs (or

FTRs) has been determined and that the offer of FTR Options in the auction is from residual capacity.

F. Interim Provisions Relating To PJM West

50. Allegheny asserts that it has had less than one year of experience with congestion pricing in PJM since it joined PJM on April 1, 2002, and that this limited experience is virtually meaningless as a guide to valuing FTRs a month and a half from now when PJM proposes to go to a full FTR auction. Allegheny further asserts that during the less than one year during which it has been a part of PJM, PJM has significantly changed (and is further changing) the way external transactions are scheduled and priced. Under these circumstances, Allegheny requests that it be given a transition period through December 2004. We will grant Allegheny's protest. Allegheny's year-long membership in PJM has not provided sufficient time for Allegheny to gain experience with PJM's congestion management system. Accordingly, we will require PJM to afford its PJM West members an additional transition period (ending June 2005), consistent with the annual planning process envisioned in PJM's auction procedures. Further, we will require PJM to provide necessary data and information to PJM members and customers to enable them to make informed decisions regarding FTRs and congestion.²¹

G. PJM's Proposed Requirement that Transmission Property Rights Follow Load

1. PJM's Proposal

51. PJM states that ARR entitlements will be reassigned on pro rata basis within a transmission zone as load shifts between suppliers in that zone. PJM states that this change will allow all customers that are paying for transmission to receive the benefit of congestion hedges and should facilitate retail market entry. PJM also asserts that this change is consistent with the Commission's mandate in Occidental.²²

2. Responsive Pleadings

²¹We, however, will not require PJM to provide information and data that is of a confidential or competitively sensitive nature.

²²See PJM filing at 5-6, citing Occidental, 101 FERC at P.17.

52. Occidental asserts that PJM's filing fails to comply with Occidental, which required PJM to make a filing permitting FTRs to follow load. Occidental asserts that PJM could have straightforwardly complied with that order by providing for immediate reassignment of the FTRs associated with Occidental's load, rather than providing for a complex and far reaching overhaul of its congestion hedging system. If the Commission permits PJM to revise its congestion hedging system, Occidental argues that the new system does not provide for FTRs to follow load as prescribed in Occidental. Occidental states that ARRs do not, on their face, have the same value as FTRs. Occidental concludes that any market participant would be entitled to obtain an FTR without regard to whether it does, or does not, have a load serving obligation.

3. Commission Response

53. We find that PJM's proposed FTR auction and ARR allocation procedures appropriately permit congestion rights on PJM's system to follow load. While the Commission, in Occidental, required PJM to propose tariff provisions that permit FTRs to follow load, the Commission did not preclude PJM from including such a provision in an overall redetermination of its congestion rights system.²³

54. Occidental contends that the ARR allocation system would not provide it with the same value as a straightforward reallocation of FTRs. As discussed earlier, however, the allocation of ARRs, with the self-scheduling option, provides the same hedge against congestion as the current FTR allocation system provides. Those entities entitled to an allocation of FTR's under PJM's existing procedures will be allocated the same rights, in the form of ARRs. With respect to providing for congestion rights to follow load, PJM is providing that whenever load shifts to a new LSE that LSE will be provided with a pro rata assignment of ARRs for the remainder of the year prior to the next reallocation of ARRs. This provides the replacement LSE with the same relative hedge against congestion as the original LSE serving the load.

55. It is not clear from Occidental's pleading whether it is asserting that rather than receiving a pro rata allocation of ARRs (FTRs), the LSE should receive a specific allocation of FTRs associated with serving the load. However, if that is Occidental's argument, the Commission finds that PJM's pro rata allocation is reasonable, because the pro rata allocation would provide the same level of protection before the change in LSEs.

²³In a companion order issued today, we also find that PJM's proposal to allow ARR rights to follow load complies with the Commission's directive in Occidental. See Occidental Chemical Corporation v. PJM Interconnection, L.L.C. and Delmarva Power & Light Company, 102 FERC ¶ 61,275 (2003).

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For example, it may not be possible to identify, in every case, a specific unit used by the existing LSE to serve a specific load or whether the existing LSE had an FTR associated with that load. Thus, the Commission agrees with PJM that allocating ARR (FTRs) on a pro rata basis is a reasonable method of accommodating load shifts.

The Commission orders:

(A) PJM's proposed FTR revisions are hereby accepted for filing, as modified, without suspension or hearing, to become effective March 11, 2003, as requested

(B) PJM is hereby directed to make a compliance filing within 30 days of the date of this order, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

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Appendix

Intervenors

Allegheny Power and Allegheny Energy Supply Company, LLC *

BP Energy Company

Cities and Towns of Hagerstown, Thurmont, and Williamsport, Maryland and Town of
Front Royal, Virginia *

Consumers Energy Company *

Continental Cooperative Services *

Delaware Municipal Electric Corp.

Detroit Edison Company *

Duke Energy North America, LLC *

Dynegy Power Marketing, Inc. * **

Electricity Consumers Resource Council * **

FirstEnergy Corp.

H.Q. Energy Services (U.S.), Inc.

Illinois Municipal Electric Agency *

Mirant Americas Energy Marketing, LP, Mirant Chalk, LLC, Mirant Mid-Atlantic, LLC,
Mirant Peaker, LLC and Mirant Potomac River, LLC

National Rural Electric Cooperative Association *

North Carolina Electric Membership Corporation *

Occidental Chemical Corporation *

Old Dominion Electric Cooperative *

Office of Consumer Advocate of the Commonwealth of Pennsylvania, The Maryland
Office of People's Counsel, and the Ohio Consumers' Counsel *

Office of People's Counsel of the District of Columbia * **

PJM Industrial Customer Coalition, Coalition of Midwest Transmission Customers, and
Industrial Energy-Users - Ohio *

PJM Market Participants * **

PPL EnergyPlus, LLC and PPL Electric Utilities Corporation *

Public Service Electric and Gas Company, et al. * **

Public Utilities Commission of Ohio **

Reliant Energy Northeast Generation, Inc.

TransEnergie U.S. Ltd. *

The Coalition of Municipal and Cooperative Users of New PJM Companies'
Transmission *

The Maryland Public Service Commission

Transmission Dependent Utility Systems *

Virginia State Corporation Commission

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Wabash Valley Power Association, Inc.
Wisconsin Electric Power Company *

- * protest or comments
- ** motion to intervene out-of-time