119 FERC ¶ 61,144
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

PJM Interconnection, L.L.C. Docket Nos. ER06-1218-000
ER06-1218-001
ER06-1218-002
ER06-1218-003
ER06-1218-004

ORDER ON REHEARING, COMPLIANCE FILINGS, AND SETTLEMENT

(Issued May 17, 2007)

1. On November 22, 2006, the Commission accepted, subject to modifications, revisions to the PJM Interconnection L.L.C. (PJM) Open Access Transmission Tariff (Tariff) and the Amended and Restated Operating Agreement (Operating Agreement),[1] that established a Long-Term Transmission Rights (LTTR) product to comply with the Commission's Order No. 681.[2] In addition, in accordance with the November 22 Order, on January 22, 2007, PJM submitted a compliance filing (in Docket No. ER06-1218-003) proposing an uplift mechanism to provide PJM with a source of revenue to make up for shortfalls in congestion revenues that would otherwise prevent the full funding of Auction Revenue Rights (ARRs) and Financial Transmission Rights (FTRs) held by the recipients of LTTRs. PJM also submitted a compliance filing (in Docket No. ER06-1218-004) regarding incremental ARRs associated with network upgrades. In addition, following settlement judge procedures, PJM filed a Settlement to address the Commission's concerns with the LTTR allocation process. Parties filed requests for rehearing of the November 22 Order.

2. The Commission denies the requests for rehearing and provides certain clarifications regarding the November 22 Order. The Commission also accepts the Settlement and the compliance filings, subject to modifications, and directs further compliance filings.

[1] *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,220 (2006) (November 22 Order).

[2] *Long-Term Firm Transmission Rights in Organized Electricity Markets*, Order No. 681, 71 Fed. Reg. 43,564 (August 1, 2006), FERC Stats. & Regs. ¶ 31,226 (2006), *order on reh'g*, Order No. 681-A, 117 FERC ¶ 61,201 (2006).

I. **Background**

3. On July 3, 2006, PJM proposed revisions to amend the PJM Interchange Energy Market by establishing a LTTR product intended to allow load serving entities (LSEs) to hedge their energy market positions on a long-term basis by providing price certainty over the relevant period. PJM stated that the purpose of its LTTR proposal was to provide an LTTR product that met the needs of LSEs in the PJM region in a manner consistent with the requirements of the Energy Policy Act of 2005 (EPAct 2005), Order No. 681, and the existing PJM market design.

4. The PJM LTTR proposal modified PJM's two-stage allocation process for ARRs by sub-dividing stage 1 into stages 1A and 1B, with stage 1A being the long-term product. In stage 1A of the process, an LSE may request ARRs for a term covering ten consecutive PJM planning periods (June 1 through May 31) from a subset of historical resources; historical customers thus may nominate ARRs equal to or less than their pro-rata share of Zonal Base Load [3] increased each year by the projected load growth rate for the relevant zone, and up to 50 percent of historical Non-Zone Network Load.[4] LSE load in excess of this defined base load will be exposed to congestion costs, unless the LSE obtains additional ARRs in subsequent stages of the allocation process. In stage 1B of the process, LSEs are able to receive up to 100 percent of historical peak load in a manner similar to that available to them in the current stage 1 market. PJM's proposal also provides a mechanism for identifying upgrades and the associated costs needed to support requests for thirty-year incremental ARRs, *i.e.*, ARRs that result from system upgrades. PJM's proposal provides that all awarded ARRs, including new stage 1A ARRs, must be simultaneously feasible. If requested ARRs are not feasible, then the requests will be pro-rated.

5. On November 22, 2006, the Commission accepted the proposed revisions to the Tariff and Operating Agreement subject to modifications. Specifically, the Commission accepted PJM's LTTR proposal as complying with guidelines (1), (4), (6), and (7) but required modifications to PJM's LTTR proposal to better comply with guidelines (2), (3), and (5) of Order No. 681. Guideline (2) responds to the requirement in Federal Power Act (FPA) section 217(b)(4) that LSEs with service obligations be able to obtain "firm" transmission rights or equivalent financial or tradable rights on a long-term basis. With

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[3] Section 1.3.39 of PJM's Tariff and Operating Agreement defines Zonal Base Load as: the lowest daily zonal peak from the twelve month period ending October 31 of the calendar year immediately preceding the calendar year in which an annual ARR allocation is conducted, increased by the projected load growth rate for the relevant Zone.

[4] Section 1.27B defines Non-Zone Network Load as network load that is located outside of the PJM Region.

respect to guideline (2), the Commission required PJM to develop an uplift mechanism to provide PJM with a source of revenue to make up for shortfalls in congestion revenues that would otherwise prevent the full funding of FTRs held by the recipients of LTTRs.[5]

6. Guideline (3) provides for the award of transmission rights to entities that fund transmission upgrades and expansions through direct cost assignment (see guideline (3) described in the rehearing section below). In the November 22 Order, the Commission reserved making findings regarding PJM's provisions for incremental ARRs associated with network upgrades and required a compliance filing and, if necessary, status reports that explain the standardized process to support granting of incremental ARRs every 60 days.[6]

7. Guideline (4) permits regional flexibility in defining the terms of long-term transmission rights that are offered such as rollover protection and renewal rights. In the November 22 Order, the Commission concluded that the PJM LTTR proposal satisfactorily met the requirements of guideline (4) by providing long-term rights of at least 10 years.[7]

8. Guideline (5) deals with the protection of transmission rights used to satisfy native load service obligations. The Commission identified three principal problems with PJM's guideline (5) provisions. First, PJM's existing pro-rationing methodology limits the amount of congestion hedges that can be allocated to certain transmission customers, due primarily to the proximity of their loads to the constrained facilities. As a result, the Commission expressed concerns that the pro-rationing methodology may not provide adequate protection for certain LSEs' historical service obligations as required by Order No. 681. Second, the Commission questioned whether allowing entities with historical load to change their ARR requests from year to year may obstruct the ability of PJM to meet the Order No. 681's requirements. Third, the Commission stated that a greater share of the burden of unscheduled loop flows is placed on the participants that are more dependent on the congested facility compared with those that are less dependent on the facility. Consequently, the Commission stated that it would appear that the cost of loop flows should be allocated on a different basis.[8]

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[5] November 22 Order at P 27, 35-39.

[6] *Id*. P 40, 46-47.

[7] *Id*. P 52.

[8] *Id*. P 53-55, 78-90.

9. As a result, the Commission concluded that PJM had not demonstrated that the proposed stage 1 allocation method would be consistent with Order No. 681 and would produce a result that was just and reasonable. The November 22 Order instituted settlement judge procedures.

10. Guideline (6) requires transmission rights to be transferable to successors ensuring that they follow migrating load. In the November 22 Order, the Commission concluded that PJM's LTTR proposal was consistent with guideline (6) because it permitted stage 1A ARRs to migrate with load. However, in the November 22 Order, the Commission also concluded that PJM's recall provision (requiring that the LTTRs be subject to recall in secondary markets) applied only to LTTRs.[9]

II. <u>Rehearing Requests - Docket No. ER06-1218-002</u>

11. Rehearing requests were filed by the Borough of Chambersburg, Pennsylvania and the Town of Front Royal, Virginia (Chambersburg); the City and Towns of Hagerstown, Thurmont, and Williamsport, Maryland (Maryland Municipalities); Allegheny Power[10] and Allegheny Energy Supply Company, LLC (Allegheny Energy Companies); the Long Island Power Authority and LIPA, an operating subsidiary (LIPA); and PJM. In addition, PJM filed a motion for leave to file answer and an answer. LIPA filed a motion for leave to answer and an answer in opposition to PJM's motion for leave to answer.

12. Subsequent to the filing of the rehearing requests, PJM reached a Settlement with many of the parties to this proceeding, including Chambersburg and the Maryland Municipals, concerning the pro-rationing of LTTRs in stage 1A of the ARR allocation process. As explained below, some of the Settlement provisions resolved issues raised on rehearing.

<u>Commission Discussion</u>

13. The Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(d) (2006), does not permit answers to requests for rehearing. The Commission therefore rejects PJM's Answer and also rejects LIPA's Answer to PJM's Answer as moot.

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[9] November 22 Order at P 95.

[10] Allegheny Power is the trade name for Monongahela Power Company, Potomac Edison Company, and West Penn Power Company.

Guideline (2)

> The long-term firm transmission right must provide a hedge against locational marginal pricing congestion charges or other direct assignment of congestion costs for the period covered and quantity specified. Once allocated, the financial coverage provided by a financial long-term transmission right should not be modified during its term (the "full funding" requirement) except in the case of extraordinary circumstances or through voluntary agreement of both the holder of the right and the transmission organization.

Chambersburg's Request for Rehearing

14. Chambersburg asserts the Commission erred in finding that PJM's LTTR proposal was consistent with guideline (2). Chambersburg states guideline (2) requires that a long term transmission rights product "*must* provide a hedge against locational marginal pricing congestion charges or other direct assignment of congestion costs *for the period covered and the quantity specified.*"[11] Chambersburg points out that the ARRs granted under the PJM LTTR proposal are subject to an annual simultaneous feasibility requirement and may be pro-rated any time system conditions render them infeasible. Thus, Chambersburg asserts, the stage 1A ARRs lack the firmness required by Order No. 681. Chambersburg also asserts it is unlikely that upgrades will be built soon enough to prevent pro-rationing. Chambersburg adds it could take ten years to remedy congestion on the Bedington-Black Oak line.

15. Chambersburg also asks the Commission to clarify its statement that LTTR ARRs are only subject to pro-rationing for extraordinary circumstances with respect to PJM's LTTRs.[12] Chambersburg asserts that all ARRs in PJM, including stage 1A ARRs, are subject to pro-rationing when ARRs or FTRs are not simultaneously feasible.[13] Chambersburg asserts that the resulting unpredictability of and risk to the LSE with a service obligation are inconsistent with section 217 of the FPA and guideline (2).

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[11] *Citing* Order No. 681 at P 169 (emphasis added).

[12] November 22 Order at P 39 ("With regard to concerns about the need to pro-rate ARRs due to extraordinary circumstances, the Final Rule limits them to force majeure events and not for system contingencies and other assumptions that were modeled in the simultaneous feasibility test and thereby incorporated into the RTEP process.").

[13] *Id.* P 81.

Commission Decision

16. In the November 22 Order, the Commission found that PJM's proposal linking the simultaneous feasibility of the stage 1A ARRs to the transmission planning and expansion process satisfied the requirement of guideline (2) with respect to stability of the quantity of rights awarded.[14] Specifically, the Commission concluded that PJM's proposal minimized the risk of pro-rationing "to the extent reasonably practical."[15] However, with regard to concerns that the FTRs awarded to LTTR holders may be under-funded in the event of a shortfall in congestion revenues, the Commission found that PJM's proposal did not fully comply with guideline (2), and required PJM to modify its proposal to include an uplift payment or similar mechanism to provide PJM with a source of revenue to make up for any shortfalls in congestion revenues.[16] Additionally, the Commission raised concerns that LTTR requests may be subject to pro-rationing in stage 1A without providing the priority to historical use of the transmission system.[17]

17. In Docket No. ER06-1218-003 (discussed below), PJM has now provided an uplift payment for any shortfalls in congestion revenues to ensure that all FTR transmission rights, including stage 1A ARRs, are fully funded. We find that the Settlement will ensure that Chambersburg and the Maryland Municipalities receive priority access in amounts that satisfy their reasonable needs. To accomplish this, the Settlement restricts the application of PJM's pro-rationing methodology, except in cases of *force majeure*, in stage 1A of the annual ARR allocation. We find Chambersburg's request that the Commission clarify its statement that LTTRs are only subject to pro-rationing for extraordinary circumstances to be moot, given that Chambersburg signed the Settlement using language similar to that used in the November 22 Order regarding what constitutes extraordinary circumstances. Therefore, Chambersburg's request for rehearing is denied.

Guideline (3)

> Long-term transmission rights made feasible by transmission upgrades or expansions must be available upon request to any party that pays for such upgrades or expansions in accordance with the transmission organization's prevailing cost allocation method for upgrades or expansions.

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[14] November 22 Order at P 36-37.

[15] *Id.* P 37.

[16] *Id*. P 38.

[17] *Id*. P 39

Chambersburg's Request for Rehearing

18. Chambersburg asserts PJM's LTTR proposal is inconsistent with guideline (3), which, it states, provides that ARRs must be available upon request to any party that pays for upgrades or expansions.[18] Chambersburg states that, contrary to this requirement, section 7.8 of PJM's proposal requires that a network upgrade provide a simultaneously feasible set of incremental ARRs in order for the financing party to receive ARRs.[19] Chambersburg also states that consequently, even if it were willing to pay for needed upgrades that alleviate some of the congestion it faces, it could not obtain additional ARRs. Chambersburg asserts this result is unjust and unreasonable since, along with the other provisions of PJM's LTTR proposal, it precludes Chambersburg from obtaining a reasonable hedge against congestion.[20]

Commission Decision

19. In the November 22 Order, the Commission found that PJM had complied with guideline (3). The Commission agreed with PJM that, if requests were granted that could not be supported by the capacity of the system, the market would be undermined since they could not be financially supported by congestion revenues and inequities would occur among market participants.[21] The Commission also reserved making findings regarding the incremental ARRs associated with network upgrades; PJM explained that it had initiated internal discussions to address these issues and intended to move forward in a stakeholder process with a proposal that standardized the relevant processes as soon as possible. The Commission directed PJM to file these changes at least 60 days prior to the beginning of the next planning year, *i.e.*, June 1, 2007, and to file status reports for informational purposes every 60 days until the tariff revisions were filed.[22]

20. Chambersburg has not raised any arguments on rehearing that were not fully addressed in our November 22 Order.[23] The purpose of guideline (3) is to ensure that

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[18] *Citing* Order No. 681 at P 210.

[19] November 22 Order at P 45.

[20] We note that consistent with PJM's Tariff and Operating Agreement, the incremental ARR transmission rights allocated must be simultaneously feasible (*i.e.*, ensure revenue adequacy). In short, the allocation of incremental ARRs for new upgrades is dependent upon the magnitude of the increase in transfer capability.

[21] November 22 Order at P 46.

[22] *Id*. P 46-47.

[23] November Order at P 46.

entities that fund transmission upgrades that expand the transmission capacity receive rights commensurate with this expanded capacity.[24] This incremental capacity is determined through the feasibility test. Chambersburg's claim that it should receive incremental ARRs even if they are not simultaneously feasible lacks merit as explained in the November 22 Order. Therefore, we deny Chambersburg's request for rehearing.

Guideline (4)

> Long-term firm transmission rights must be made available with term lengths (and/or rights to renewal) that are sufficient to meet the needs of load serving entities to hedge long-term power supply arrangements made or planned to satisfy a service obligation. The length of term of renewals may be different from the original term. Transmission organizations may propose rules specifying the length of terms and use of renewal rights to provide long-term coverage, but must be able to offer firm coverage for at least a 10-year period.

Chambersburg's Request for Rehearing

21. Chambersburg asserts that PJM's LTTR proposal is inconsistent with guideline (4), which, it states, provides that any long-term transmission rights product "must be able to offer firm coverage for at least a 10-year period"[25] and enables long-term planning for power supply arrangements to satisfy a service obligation. Chambersburg states that, due to the simultaneous feasibility requirement, it will lack the certainty of congestion hedge rights that an LSE needs to secure long-term power supply arrangements.

Commission Decision

22. In the November 22 Order, the Commission found that the PJM LTTR proposal satisfactorily met the requirements of guideline (4) by providing long-term rights of at least 10 years. The Commission also found that the PJM LTTR proposal provides annual rollover protection to meet the renewal requirements of Order No. 681. Additionally, the Commission stated that the link to transmission planning and feasibility helped to ensure that long-term ARRs would be available.[26]

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[24] Order No. 681 at P 211. The matter of the feasibility of employing demand response resources as a cost-effective part of transmission infrastructure investment and what mechanisms (*e.g.*, market or regulated) should be considered for compensating such demand resources is under consideration on a generic basis in Docket No. AD07-11-000.

[25] *Citing* Order No. 681 at P 256.

[26] November 22 Order at P 52.

23. We are unpersuaded by Chambersburg's argument that making ARRs subject to an annual simultaneous feasibility requirement renders PJM's LTTR proposal inconsistent with guideline (4). We affirm our earlier finding that the PJM proposal satisfactorily meets the requirements of guideline (4) by providing long-term rights of at least 10 years (and annual rollover protection).[27] Moreover, Chambersburg's claim regarding uncertainty is without merit. As already noted, the Settlement effectively eliminates pro-rationing in stage 1A of the annual allocation process. Further, to the extent ARRs or FTRs are under-funded due to a shortfall in congestion revenues, they will be subject to the uplift mechanism discussed below. Thus, we deny the request for rehearing.

<u>Guideline (5)</u>

> Load-serving entities must have priority over non-load serving entities in the allocation of long-term firm transmission rights that are supported by existing transmission capacity. The transmission organization may propose reasonable limits on the amount of existing transmission capacity used to support long-term firm transmission rights.

<u>Pro-rationing methodology for stage 1A ARRs</u>

<u>Chambersburg's and the Maryland Municipalities' Requests for Rehearing</u>

24. Chambersburg and the Maryland Municipalities argue that PJM's proposal does not meet the requirements of Order No. 681's guideline (5) because stage 1A ARRs are subject to reduction by pro-rationing thereby reducing an LSE's stage 1A ARRs if those ARRs are not simultaneously feasible. They argue, that PJM's pro-rationing erodes the priority of LSEs' stage 1A ARRs and the ability of LSEs to obtain stage 1A ARRs that are equal to their Zonal Base Load.

25. Chambersburg also argues it is more severely pro-rated than other LSEs that use the Bedington-Black Oak line, even though the increased congestion on that line is due not to an increase in its use of the line, but to causes like loop flow, load growth, and increased nominations by other LSEs. Chambersburg and the Maryland Municipalities argue that PJM's pro-rationing methodology fails to provide priority for LSEs with service obligations in violation of section 217 of the FPA, and that it is inconsistent with principles of cost causation, thus imposing unjust, unreasonable, and unduly discriminatory charges on LSEs that are located closest to constrained facilities.

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[27] *Id*.

Commission Decision

26. In the November 22 Order, the Commission found that PJM's proposed stage 1A allocation process and the pro-rationing methodology does not meet the reasonable needs standard under Order No. 681 and is therefore not consistent with the Final Rule and FPA section 217. In making this determination, the Commission addressed the issues raised by Chambersburg which it reiterates in its request for rehearing, by stating that the stage 1A allocation process does not meet the reasonable needs of LSEs as defined by Zonal Base Load. In so doing, the Commission directed PJM to modify its proposal as necessary and made available a settlement judge.[28]

27. The resulting Settlement (discussed below) should ensure that Chambersburg and the Maryland Municipalities receive priority access in amounts that satisfies their reasonable needs.

Guideline (5)—Zonal base load

Chambersburg's and the Maryland Municipalities' Requests for Rehearing

28. Chambersburg and the Maryland Municipalities seek rehearing of the Commission's approval of PJM's limitation on stage 1A ARRs to Zonal Base Load, which is based on the concept of a minimum peak daily load. Chambersburg asserts Zonal Base Load would only provide LSEs with approximately 60 percent of their peak load. Chambersburg argues that its ARRs will be pro-rated in both stage 1A and stage 1B and it may not even receive ARRs equal to its Zonal Base Load.

29. The Maryland Municipalities argue there is no limitation on the use of historical firm transmission rights in section 217(b) of the FPA, but that LSEs are entitled to use all transmission rights held as of August 1, 2005 to deliver their generation output or purchased energy[29] and that LSEs are entitled to the quantity of rights that they need to meet their load.

Commission Decision

30. In the November 22 Order, the Commission found that the PJM definition of Zonal Base Load was consistent with the requirements of Order No. 681 in setting a

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[28] November 22 Order at P 87-88.

[29] *Citing Louisiana Energy and Power Authority,* 116 FERC ¶ 61,284, at P32-33, 35-36 (2006). The Maryland Municipalities state that for non-historical rights, (those defined as an LSE's "other generating facilities or purchased energy" in section 217(b)(2) of the FPA), there is a deliverability limitation so that non-historical firm transmission rights are available only "to the extent deliverable using the rights."

reasonable needs standard for LSEs.[30] The Commission added that it agreed with PJM that, while the definition of Zonal Base Load limits the amount of LTTR capacity available, the definition and resulting limitation do not impact the priority given to LSEs' load for LTTRs. The Commission explained that PJM's LTTR proposal retained the historical load priority for all transmission rights, including the newly created LTTRs.[31]

31. Parties fail in rehearing to bring forth additional facts that would show how Zonal Base Load is not in compliance with the final rule. Here, we affirm the Commission's finding that the PJM definition of Zonal Base Load meets the reasonable needs standard for LSEs. In addition, the Commission notes that, under the terms of the Settlement discussed below, PJM will effectively eliminate pro-rationing of stage 1A ARRs (LTTRs). Thus, Chambersburg and the Maryland Municipalities will receive LTTRs in the amount of their Zonal Base Load and will receive priority for historical load if ARRs are not feasible.

Guideline (5) -- Eligibility of external LSEs for long term firm transmission rights

LIPA's Request for Rehearing

32. LIPA states that, under PJM's LTTR proposal, long-term firm transmission rights are available only to LSEs within PJM. LIPA states that PJM's proposal unfairly precludes LSEs with load located outside the PJM footprint from obtaining such rights in the stage 1A. LIPA asks the Commission to clarify that such LSEs are eligible to receive rights as part of the stage 1A allocation and have a priority to stage 1A rights equal to that of LSEs within PJM.

33. LIPA argues that excluding external LSEs holding firm transmission withdrawal rights from stage 1A is contrary to section 217(b)(4) of the FPA and Order Nos. 681 and 681-A and is unjust and unreasonable and unduly discriminatory. LIPA argues that section 217(b)(4) of the FPA requires that LSEs be able to secure firm transmission withdrawal rights to support long-term supply arrangements to meet the LSE's load obligations. LIPA further argues that Order Nos. 681 and 681-A recognize that an external LSE should be eligible to receive such rights if it meets certain conditions. LIPA states these conditions are: (1) the LSE has an obligation to pay a share of the system embedded costs; (2) the transmission organization plans for and constructs its system to meet the LSE's obligation; and (3) the LSE pays its share of the costs incurred to support its withdrawal rights.

[30] November 22 Order at P 78.

[31] *Id*. P 79.

34. LIPA asserts it has met these conditions. LIPA argues that it pays the embedded costs of the PJM system through payment of the Border Rate for transmission service and is allocated costs under PJM's Regional Transmission Enhancement Plan (RTEP) for reliability upgrades that support their withdrawal rights. LIPA claims that PJM will plan and build out the transmission system in a manner that accounts for LIPA's firm transmission withdrawal rights and the associated use of the PJM Transmission System. LIPA argues that holders of firm transmission withdrawal rights should be included in the stage 1A allocation since they pay these costs.

35. LIPA asks the Commission to clarify that an LSE holding firm transmission withdrawal rights will be afforded LTTRs during stage 1A based on a reasonable percentage of its transmission reservation, rather than its pro-rata share of Zonal Base Load. LIPA states that Zonal Base Load is not an appropriate measure for an external LSE with firm transmission withdrawal rights because during the first year that it possesses such rights, it will have no share of the Zonal Base Load during the prior planning period and in later years it may not have a share of the Zonal Base Load because its intertie to the PJM grid could be out of service during the minimum peak load day.

36. Finally, LIPA claims that it is unduly discriminatory to allocate stage 1A ARRs only to LSEs within PJM. LIPA contends that it is no different from internal LSEs taking network service because PJM plans and constructs its grid to support the firm transmission withdrawal rights held by LIPA, LIPA pays its share of the reliability upgrades supporting these rights, and it pays a transmission service charge that covers the embedded costs of the PJM Transmission Owners on a long-term basis.

Commission Decision

37. The Commission finds that LIPA is not correct in its assertion, that PJM unfairly excludes external LSEs, that LIPA has mischaracterized PJM's LTTR proposal, and that LIPA has not shown that it is entitled to the preferential allocation of LTTRs in stage 1A.

38. In Order No. 681-A, the Commission did not preclude LSEs that serve load outside of the transmission organization's region from obtaining preferential long-term transmission rights. The Commission clarified that:

> …in cases where a load serving entity has an existing agreement with the transmission organization to pay a share of the embedded costs of the transmission system on a long-term basis to support load outside the region, that load serving entity should be given a preference in the allocation of long-term firm transmission rights for the external load equal to the

> preference given to load serving entities with loads that lie within the transmission organization's region.[32]

The Commission also stated that:

> …it would be unreasonable to require a transmission organization to provide a load serving entity with a preference in the allocation of firm transmission rights for specific loads…when the transmission provider has not planned and constructed its system to accommodate those loads, and when the loads have not contributed to the system's embedded costs.[33]

39. Thus, Order No. 681-A establishes a preference for LSEs serving load outside the transmission organization region to receive LTTRs provided these LSEs have an existing agreement with the transmission organization to pay a share of the embedded costs of the transmission system on a long-term basis.

40. Under PJM's market rules, transmission rights prioritization is principally based on the historical cost contribution to the transmission infrastructure.[34] The capacity made available for LTTRs reflects the historical investment in infrastructure, which was paid for by the historical load in the relevant zones prior to their integration into PJM. This priority reflects the funding of the PJM historical infrastructure by historical load that supports the stage 1A ARRs.

41. Under PJM's proposal, an external LSE may receive LTTRs in stage 1A if it is a transmission customer taking and paying for firm service and if it was serving load from resources within a zone at the time that zone was integrated into PJM.[35] Thus, under

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[32] Order No. 681-A at P 79.

[33] Order No. 681-A at P 78.

[34] The Commission has also approved transmission rights prioritization based on historical cost contribution (*i.e.*, the "perfect hedge" mechanism) in *California Independent System Operator Corporation*, 116 FERC ¶ 61,281 (2006).

[35] Proposed section 7.4.2(b) provides that a Qualifying Transmission Customer may obtain stage 1A ARRs. Fourth Revised Sheet Nos. 408 and 408A, PJM Tariff. Section 7.4.2(f) (formerly section 7.4.2(d)), Fourth Revised Sheet No. 409, *Id.,* provides that a Qualifying Transmission Customer is

> any customer with an agreement for Long-Term Point-to-Point Transmission Service, as defined in the PJM Tariff, used to deliver energy

PJM's LTTR proposal, an LSE that is a point-to-point transmission customer serving historical load outside PJM can obtain LTTRs in stage 1A of the allocation process.[36] This provision meets the Commission's intent in Order No. 681-A of providing a preference for LSEs, including such LSEs outside the transmission organization region, by placing a requirement that limits the preferential allocation of long-term rights to LSEs that have paid the embedded costs of the system used to support the load in question.

42. PJM's LTTR proposal gives priority to network service users and Qualifying Transmission Customers that took service during a historical reference year and have maintained that service continuously since the historical reference year.[37]

43. LIPA cannot receive a preferential allocation for LTTRs under PJM's LTTR proposal because it has not shown that it satisfies requirements to be a Qualifying Transmission Customer. LIPA is not a Qualifying Transmission Customer because it did not take service from PJM during the historical reference year, nor does it continue to pay the embedded costs of the PJM transmission system.

44. LIPA has not shown that it has taken transmission service during the relevant historical reference year for the zone in which a generation resource is located or maintained such service continuously. Consequently, LIPA cannot receive a preference for LTTRs under PJM's LTTR proposal. Contrary to LIPA's assertion, we find that the PJM LTTR provisions do not deny LTTRs to LIPA, or any LSE, simply because it is external to PJM. Therefore, we deny LIPA's rehearing on this matter.

> from a designated network resource located either outside or within the PJM Region to load located either outside or within the PJM Region, and that was confirmed and in effect during the historical reference year for the zone in which the resource is located. Such an agreement shall allow the Qualifying Transmission Customer to participate in the first stage of the allocation . . . . A Qualifying Transmission customer may request Auction Revenue Rights in either or both of the [*sic*] stage 1 or 2 of the allocation . . . .

[36] Section 7.4.2(b), Fourth Revised Sheet Nos. 408 and 408A, *Id*.

[37] The historical reference year for the zone is the year in which the zone was integrated into PJM. For the original PJM zones (including the zone from which LIPA holds firm withdrawal rights), that year is 1998; for Allegheny Power and Rockland Electric Zones it is 2002; for AEP East, The Dayton Power & Light Company and Commonwealth Edison Company Zones it is 2004; for Virginia Electric power Company and Duquesne Light Company Zones it is 2005. Section 7.4.2, Third Revised Sheet No. 408, PJM Tariff.

45. LIPA also claims it has met the criteria in Order Nos. 681 and 681-A for receiving LTTRs as an external LSE by claiming that it pays the embedded costs of the PJM system and that PJM plans and constructs its grid to support LIPA's firm transmission withdrawal rights. PJM has not planned and constructed its transmission system to support LIPA's load. LIPA appears to base its claim on the fact that it purchased the firm withdrawal rights on a merchant transmission project which entitles LIPA to withdraw power from the PJM system at a defined point.[38] While Neptune is subject to future reliability upgrade costs necessitated to support this merchant project (the costs of which will flow to LIPA as user of the facility), LIPA was not paying embedded costs in PJM during the historical reference year to serve load within or outside of a PJM zone.

46. It is true that the Neptune project is allocated costs for reliability upgrades pursuant to PJM's implementation of its Regional Transmission Expansion Plan (RTEP). According to the RTEP, PJM plans its system to ensure that the Neptune line operates reliably. However, these are future costs that were initially identified in the RTEP dated February 22, 2006 and have yet to be recovered.[39] These costs are not historical, they are in anticipation of future transmission system use (since the Neptune line is not yet operational), and in-fact have yet to be incurred. Therefore they do not support LIPA's claim that it has paid the embedded cost of the PJM system by taking historical service to serve specific load. LIPA's claim that it pays the embedded cost of the PJM system because it is assigned future transmission upgrade costs does not satisfy the criteria in Order No. 681-A for receiving a preference in the allocation of LTTRs.[40] However, to

[38] LIPA is a customer of the Neptune project, a merchant project which will allow for the delivery of 660 MW of capacity from New Jersey to Long Island via a high-voltage, direct-current (HVDC) underwater transmission cable. PJM has directly assigned approximately $6.5 million in reliability upgrades to Neptune in order for the project to be built. Neptune elected to receive firm withdrawal rights which entitle the holder to schedule energy on the associated merchant transmission facilities to be withdrawn from the PJM transmission system at the defined point between the Merchant DC or Fully Controllable AC transmission facilities and the PJM transmission system. Pursuant to a Firm Transmission Capacity Purchase Agreement between Neptune and Long Island Power Authority, LIPA is entitled to the firm withdrawal rights assigned or awarded to Neptune by PJM. *See PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,261 (2006).

[39] *See PJM Interconnection*, L.L.C. 115 FERC ¶61,261 (2006); *PJM Transmission Owners*, 115 FERC ¶61,345 (2006), *order on reh'g*, 119 FERC ¶61,067 (2007). See also Settlement filed between PJM Interconnection, L.L.C. and Neptune Regional Transmission System LLC on April 4, 2007 in Docket ER07-632-001 where the costs of transmission upgrades assigned to Neptune by PJM will be recovered from Neptune customers.

[40] LIPA also claims that it is precluded from ever obtaining LTTRs. The Commission notes that the PJM proposal does lack a provision whereby an LSE that is

the extent that LIPA funds the construction of new transmission capacity to support its new long-term use of the PJM grid, it should be eligible to receive incremental ARRs thus created, which would have a term longer than that of an LTTR.

Guideline (6)--Recall and Reallocation of ARRs

> A long-term transmission right held by a load-serving entity to support a service obligation should be re-assignable to another entity that acquires that service obligation.

PJM's Request for Clarification

47. PJM seeks clarification, or in the alternative, rehearing, that the recall provisions of its tariff to load that migrates among LSEs pertain to all allocated rights for historical load and not just to the long-term rights allocated in stage 1A and that the Commission did not intend to change this priority.[41] PJM states that section 7.4.2(c) of Attachment K of its existing Tariff requires reallocation of ARRs to follow migrating load. PJM adds that its LTTR proposal did not change this and asks that the Commission clarify that it did not intend to change this.[42]

48. PJM states that the requirement that these rights migrate with load as it moves between LSEs is necessary to ensure that such load has access to the rights to which it is entitled, and that this should apply to all allocated rights regardless of priority or term. PJM also states that limiting access only to stage 1A rights would adversely affect retail

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not currently a Qualifying Transmission Customer may obtain preferential long-term transmission rights in the future if it takes service for some period of time and meets certain thresholds (*i.e.*, the LSE begins paying the embedded costs of the system for some period of time). PJM stakeholders should develop market rules to address these circumstances in the future. For example, to the extent LIPA meets stage 1A eligibility requirements at some point in the future, PJM using the stakeholder process could develop a mechanism for entities like LIPA to obtain LTTRs that does not deviate from the Zonal Base Load limit.

[41] November 22 Order at P 95 citing Order No. 681 at P 358.

[42] PJM states that section 7.4.2(e) (previously section 7.4.2(c)) of Schedule 1 of its Operating Agreement and the corresponding section in the Appendix to Attachment K of its Tariff, provide that, on a daily basis within the annual Financial Transmission Rights auction period, "a proportionate share of Network Service User's Auction Revenue Rights for each Zone are reallocated as Network load changes from one Network Service User to another within that Zone."

competition because load would be hesitant to switch providers due to uncertainty over the level of congestion hedging.

Commission Decision

49. The November 22 Order found PJM's LTTR proposal consistent with guideline (6) because it permitted stage 1A ARRs to migrate with the load obligation to which they were assigned and still retain their priority.[43] It noted that Order No. 681 states that LTTR rights that an LSE receives preferentially through an allocation process are tradable, but with the proviso that they are subject to recall in secondary markets. The November 22 Order then stated that this recall provision governs the long-term rights allocated in stage 1A, but "does not apply to transmission rights awarded in the remainder of the PJM allocation process and thus such rights are not subject to this recall provision in the secondary market."[44]

50. The Commission clarifies the November 22 Order as PJM requests. In the November 22 Order, the Commission focused on the long-term product offered in stage 1A. It was not the Commission's intention in the November 22 Order to override previously accepted Tariff provisions regarding ARRs that are allocated preferentially; the existing recall provisions have been in effect since 2003 when the Commission accepted the current ARR allocation process and FTR auction[45] for historical load requirements of Network Service Users. The focus of the November 22 Order was on compliance with Order No. 681, and the Commission was concerned with the recall provisions as they pertain to the long-term transmission rights product (which for PJM is stage 1A). The PJM Tariff and Operating Agreement already provide protection to historical load by requiring preferentially allocated ARRs to be subject to recall so that they follow the load to which they were allocated. It was not the Commission's intent when approving the LTTR proposal to undo such provisions.

Ordering Paragraph (F)

51. Ordering Paragraph (F) of the November 22 Order provides:

PJM is directed to file with the Commission any proposed revisions to its

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[43] November 22 Order at P 95.

[44] *Id.*

[45] *See PJM Interconnection, L.L.C.*, 102 FERC ¶ 61,276 (2003). According to the PJM Tariff, certain ARRs are not subject to the recall provisions, specifically those allocated in stage 2 to other transmission customers and incremental ARRs related to participant-funded system upgrades.

market rules that may be necessary to ensure that all LSEs that serve load within PJM's market area are able to obtain a reasonable amount of LTTR to meet their service obligations when all ARR requests are not simultaneously feasible, as discussed in the body of this order.

52. The Maryland Municipalities ask the Commission to clarify that the filing under Ordering Paragraph (F) is to be made under section 205 so that the parties will be able to protest the filing and the Commission will retain its remedial authority. We find that the Settlement in ER06-1218-000, discussed later, addresses the Maryland Municipalities' concerns regarding the allocation of LTTRs to meet the reasonable needs of LSEs serving native loads, and therefore we find its request for clarification to be moot.

III. Compliance Filing – Docket No. ER06-1218-003

Background

53. Order No. 681 established seven guidelines that govern the structure of LTTRs in organized electricity markets. In the November 22 Order, the Commission held that PJM's LTTR proposal met the requirements of Order No. 681 and accepted the proposal, subject to modifications required to comply with guidelines (2), (3), and (5). Guideline (2), in particular, institutes a full funding requirement for LTTRs, which requires LTTRs to be stable in terms of quantity and value. The Commission found that PJM's LTTR proposal complied with the quantity requirement of guideline (2), but that it did not fully comply with the value requirement (*i.e.*, price certainty) because it did not include an uplift mechanism to ensure LTTRs will be fully funded. Accordingly, the Commission directed PJM to make a compliance filing modifying its proposal to include an uplift charge, or similar mechanism, to fund shortfalls in congestion revenues that would otherwise prevent the full funding of FTRs held by LTTR recipients.[46]

54. According to PJM, its compliance filing in Docket No. ER06-1218-003 provides for full funding of all ARRs and all FTRs. While the November 22 Order only required full funding of FTRs converted from stage 1A ARRs, PJM states that it believes it is prudent to fully fund all FTRs to prevent the creation of effectively different FTR products. To fully fund the revenue deficient transmission rights (*i.e.,* all ARRs and all FTRs), PJM proposes a full funding cost allocation mechanism that allocates costs to all FTR holders on a pro-rata basis according to the total target allocations for all FTRs held at any time during the relevant planning period.[47] In other words, PJM will allocate uplift charges based on the value of each FTR holder's total FTRs. PJM believes that this approach is consistent with Order No. 681, where PJM states, the Commission stated it

[46] *Id.* at P 38

[47] According to the PJM 2006 State of the Market Report Volume II (at page 308), "[t]he FTR target allocation is equal to the product of the FTR MW and the price differences between sink and source that occur in the Day-Ahead energy market."

was reasonable to distribute uplift charges over holders of both short-term and long-term rights.

55. PJM adds that it held two stakeholder working group meetings to discuss the full funding issue, but that the meetings did not result in a clear consensus on the uplift funding mechanism. To the contrary, the meetings highlighted that there were a number of ways to allocate uplift, and each raises different concerns and issues. Given the time constraints, PJM states that it only considered two options and no formal sector voting procedures were possible.

Notice of Filing and Responsive Pleadings

56. Notice of the compliance filing was published in the *Federal Register*, 72 Fed. Reg. 4,499 (2007), with protests and interventions due on or before February 12, 2007.

57. Timely comments or protests were filed by the Public Utilities Commission of Ohio (PUCO); Direct Energy Services, LLC (DES); [48] American Municipal Power–Ohio, Inc. (AMP-Ohio); Public Service Electric and Gas Company, PSEG Power LLC and PSEG Energy Resources and Trade, LLC (PSEG); American Electric Power Service Corporation (AEP); [49] Old Dominion Electric Cooperative (Old Dominion); FPL Energy Generators (FPL Generators); [50] Edison Mission Group; [51] DC Energy, LLC (DC Energy); NRG Companies (NRG); [52] and Sempra Energy Trading Corp. (Sempra) (collectively, the Commenting Parties); Allegheny Energy Companies (AEC);[53] and Reliant Energy, Inc. (Reliant). On February 20, 2007, Coral Power, LLC (Coral) filed a

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[48] On behalf of its affiliates, including Energy America, LLC.

[49] On behalf of certain operating companies of the American Electric Power system.

[50] FPL Energy Generators consist of FPL Energy Marcus Hook, L.P., North Jersey Energy Associates, L.P., Doswell Limited Partnership, Backbone Mountain Windpower LLC, Mill Run Windpower LLC, Somerset Windpower LLC, Meyersdale Windpower LLC, Waymart Wind Farm, LP, and Pennsylvania Windfarms, Inc.

[51] Edison Mission Group consists of Edison Mission Energy, Edison Mission Marketing & Trading, Inc., and Midwest Generation EME, LLC.

[52] NRG Companies consist of NRG Power Marketing Inc., Conemaugh Power LLC, Indian River Power LLC, Keystone Power LLC, NRG Energy Center Dover LLC, NRG Rockford LLC, NRG Rockford II LLC, and Vienna Power LLC.

[53] Allegheny Energy Companies consist of Allegheny Power (d/b/a Monongahela Power Company, The Potomac Edison Company, and West Penn Power Company) and Allegheny Energy Supply Company, LLC.

motion to intervene out-of-time. On March 13, 2007, the Joint Consumer Advocates [54] filed a motion to intervene out of time.

58. On February 28, 2007, PJM filed an answer to the comments and protests. On March 12, 2007, the Answering Parties,[55] the PJM Industrial Customer Coalition, and Coral filed replies to PJM's answer. On March 13, 2007, the Joint Consumer Advocates filed a reply to PJM's answer. On March 14, 2007, PSEG filed a reply to PJM's answer. On March 19, 2007, PJM filed a second answer.

Discussion

Procedural Matters

59. The Commission will grant the late-filed motions to intervene given the early stage of the proceeding, the parties' interests, and the absence of undue prejudice or delay. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2006), prohibits an answer to an answer or protest unless otherwise ordered by the decisional authority. We are not persuaded to accept the various answers and replies, and accordingly will reject them.

Parties' Comments

60. PUCO and DES support the proposed uplift methodology, which allocates the charge to all FTR holders on a pro-rata basis according to total target allocations. PUCO calls this a fair solution in assigning cost with causation as it is consistent with the general philosophy that those who benefit should pay. PUCO supports further stakeholder discussions to investigate other alternative uplift methodologies; however, PUCO urges the Commission to eliminate the consideration of an uplift mechanism that utilizes load ratio share across the entire PJM footprint because the benefits flow mostly

[54] The Pennsylvania Office of Consumer Advocate, the Office of the People's Counsel for the District of Columbia, Maryland Office of the People's Counsel, and the New Jersey Department of the Public Advocate, Division of the Rate Counsel.

[55] The Answering Parties consist of FPL Generators, Edison Mission Group, DC Energy, Exelon Corporation, Old Dominion, Southern Maryland Electric Cooperative, Inc., North Carolina Electric Membership Corporation, Strategic Energy, L.L.C., Williams Power Company, Inc., Pepco Holdings, Inc., The Dayton Power and Light Company, Blue Ridge Power Agency, Office of the Ohio Consumers' Counsel, Consolidated Edison Energy, Inc., and Constellation Energy Group Companies.

to the Eastern States while the costs would flow mostly to the Western States. PUCO states that this would be unjust and unreasonable and would violate general rate making principles. AMP-Ohio states that it does not object to PJM's proposal, based on PJM's pledge to bring the issue before the stakeholders once again.

61. AEP and others[56] state that they agree with PJM that full funding should be for all FTRs, not just those related to LTTRs, and also agree with PJM's assessment that there was no consensus reached in the stakeholder process during the 60 days provided for resolution of the issue. They state that a further discussion of full funding alternatives may lead to an approach that would be agreeable to more PJM stakeholders. Further, AEP and others allege that some of the participants favoring a load ratio share method of funding have no load responsibilities in the PJM area and are merely looking to improve their financial position at the expense of those LSEs with legitimate load hedging responsibilities. AEP and others request that the Commission give the stakeholders more time to reach consensus for the 2008/2009 planning year, while supporting the use of the proposed target allocation methodology in the interim period.[57]

62. Other parties state that the Commission should reject the proposed method for allocating uplift and advocate allocating FTR uplift costs based on load ratio share consistent with the alleged results in the PJM stakeholder process.[58] They state that the proposed method does not comply either with the Commission's directives in the November 22 Order or with the requirements of Order No. 681 for funding of LTTRs.

63. Several parties state that the proposed mechanism continues to internalize the under-funding risk to FTR holders, which results in transmission customers' realization of less revenue from the auction than if FTRs were truly fully funded.[59] They assert that FTR holders knowingly carrying the risk of under-funding will apply a risk premium in deciding how to bid. Consequently, they state, FTRs will clear the auction with lower prices, since bids in the FTR auctions will be lower. Lower clearing prices mean less revenue for transmission customers and overall a less efficient market. Allegheny adds that, under PJM's plan, LTTR holders face continuing price uncertainty over the term of their rights that significantly undercuts the value of the hedge. Reliant states that shortcomings will result in greater risks to FTR market participants which will, in turn, force market participants to reflect such risks in their FTR bids to the extent they continue to participate in the market.

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[56] *E.g.*, Dayton, Dominion, and Exelon.

[57] *E.g.*, AEP, DP&L, Dominion, and Exelon.

[58] *E.g.*, FPL, Edison Mission Group, DC Energy, NRG, and Sempra.

[59] *Id*.

64. Further, PSEG states that, under PJM's proposed method, holders of less valuable FTRs will make a smaller contribution to uplift, effectively reducing the set of LSEs over which to spread the costs. PSEG argues that, at the same time, the holders of FTRs with the largest targets can expect to incur the largest share of under-funded FTRs. PSEG contends that, because the allocation method is weighted toward them, they will pay a larger proportional share. Thus, PSEG finds that the companies that can be expected to incur the most under-funding (because they have the rights with the largest dollar outlays) will be allocated the largest share of uplift – exactly the Commission's concern in Order No. 681. Several parties assert that a better method for allocating uplift charges that would also satisfy the requirements of Order No. 681 would be to allocate the costs in the same manner that marginal losses over-collections are paid out – *i.e.*, to load serving entities on the basis of load ratio share.[60] They also state that a load ratio share method garnered the most support in the stakeholder process.

65. Old Dominion states that, if the Commission does not reject PJM's filing, it should approve PJM's filing for one year only with the instant uplift mechanism applied to the stage 1A ARR allocation and FTR auction for 2007/2008. In addition, Old Dominion asserts that the Commission direct PJM to file, by September 30, 2007, a revised proposal that reflects either a stakeholder consensus or majority stakeholder support, or the uplift mechanism that PJM believes is just and reasonable should such support not be achieved after PJM engages in a thorough stakeholder process. Old Dominion also requests that the Commission clarify that the compliance filing does not allocate full funding uplift to negative (or counter-flow) FTRs. Old Dominion states that these FTRs are fully funded and therefore do not contribute to the under-funding.

66. Several parties state that PJM's FTR proposal worsens an existing problem. They contend that PJM's proposal introduces increased risk which would again have a dampening effect on FTR clearing prices and result in even less revenue for transmission customers. They state that a transmission line outage that occurs during the planning year, but subsequent to a month in which FTRs are fully funded and which causes substantial under-funding, can cause an unpredictable liability for an FTR purchaser even after the term of the FTR has expired. They assert that this *ex post* adjustment also has the negative effect of preventing market participants from closing their books and handling credit issues in an efficient manner. They argue that if FTRs are under-funded, PJM believes that FTR holders should shoulder the burden. However, they explain that if there is a congestion rent surplus, PJM's Tariff dictates that network service transmission customers would reap the benefit. As a result, they contend, the same group of entities that bears the risk of under-funding should be eligible to reap the reward as well, should excess funds be realized at the end of the planning year. PJM's proposal does not match risk and reward in this manner, they argue.

[60] *Id*.

Commission Decision

67. In Order No. 681, the Commission determined that allocating the uplift for full-funding of LTTRs to load serving entities that hold LTTRs may be reasonable.[61] The same rationale would apply generally to an uplift allocation proposal that addresses full-funding for all transmission rights. In the instant proceeding, PJM's proposal fully funds all transmission rights, including LTTRs, on a pro-rata basis according to the total target allocations for all FTRs held throughout the planning year. In other words, PJM's proposal allocates the uplift to all FTR holders regardless of term. Therefore, the Commission finds that PJM's proposal is just, reasonable, and not unduly discriminatory.

68. In our November 22 Order, we required PJM to modify its proposal to include an uplift payment or similar mechanism to provide PJM with a source of revenue to make up for any shortfalls in congestion revenues that would otherwise prevent the full funding of FTRs held by the recipients of LTTRs. PJM has satisfactorily complied with this directive by proposing an uplift mechanism that not only funds LTTRs, but funds all transmission rights (both FTRs and LTTRs). No party objects to PJM's extension of its uplift mechanism to all transmission rights, and we find it to be consistent with Order No. 681, where we encouraged transmission organizations to evaluate whether the requirement to fully fund long-term rights should be paired with the full funding of short-term rights.[62] PJM, moreover, has concluded from its evaluation that creation of different FTR products may negatively impact liquidity in its FTR markets and be detrimental to market participants that depend on the auctions as a source of congestion hedging. Therefore, we will accept PJM's proposal to extend uplift to all transmission rights.

69. In Order No. 681, we allowed transmission organizations the discretion to propose a method for allocating uplift charges and provided some examples of reasonable allocation methods, recognizing that the concept of full funding of FTRs requires that shortfalls be socialized over a group larger than the group of holders of under-funded FTRs. We further determined that if transmission organizations decided to apply full funding to both short-term and long-term transmission rights, a potentially reasonable approach would be to distribute uplift charges over holders of both short-term and long-term rights.[63] That is the approach that PJM proposes here. PJM's proposal to allocate uplift to all FTR holders, which can reasonably be expected to be a group much larger than under-funded FTR holders, lessens the impact on the under-funded FTR holders and is reasonable.

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[61] Order No. 681 at P 177.

[62] Order No. 681 at *Id.* P 179.

[63] *Id.* P 178.

70. A number of market participants do not agree with PJM's proposed allocation method and instead favor an allocation of uplift based on a load ratio share method. While a load ratio share method may also have merit, PJM's proposal is just and reasonable and is consistent with Order No. 681. We find that the protestors have not supported their allegations that FTRs will clear the auction with lower prices, since bids in the FTR auctions will be lower, and that lower clearing prices will lead to less revenue for transmission customers.

71. Old Dominion requests that, if the Commission accepts PJM's filing, the Commission should clarify that the uplift allocation for each month must include only positive value FTRs and that such FTRs must not be reduced by negative value or counter-flow FTRs in that month. Old Dominion states that such negative or counter-flow FTRs are fully funded in and of themselves and, therefore, neither contribute to nor require an uplift mechanism in order to achieve full funding. We agree. Negative FTRs function to ensure that positive FTRs (target allocations) are fully funded. Therefore, reducing positive FTRs by negative value or counter-flow FTRs in the uplift allocation process would result in their holders paying twice (once through the negative FTR and again through uplift). Accordingly, the Commission directs PJM to revise its tariff as necessary to require that the monthly uplift allocation include only positive FTRs, with no reduction by negative or counter-flow FTRs.

72. Reliant argues that, by requesting a March 1, 2007 effective date, PJM's proposal has the effect of changing the rules for uplift in the middle of a planning year. To the extent that under-funding of FTRs occurs between March 1, 2007 and May 31, 2007, the cost of such under-funding will be retroactively applied to FTR holders who may otherwise have already booked revenues associated with an FTR earlier in the same planning year. These rule changes are being implemented to support the LTTR market which begins with the 2007/2008 planning year; therefore, the Commission agrees with Reliant that it may be less disruptive if the change in rules becomes effective coincident with the commencement of the 2007/2008 planning period, and so we will accept the changes effective on June 1, 2007, the beginning of the planning year.

73. Allegheny requests that the Commission clarify that LSEs with retail rate freezes may file to request regulatory asset treatment under the Commission's Uniform System of Accounts to the extent that they are unable to recover uplift costs through current rates due to retail rate freezes. The Commission finds that Allegheny's concerns are beyond the scope of this proceeding.

74. In addition, PJM has committed to revisit this issue in its stakeholder process to provide participants an opportunity to further explore all uplift funding alternatives. PJM provided some examples of allocating uplift based on the location of the transmission constraint that contributed to the under-funding that it will discuss.[64] We encourage PJM

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[64] *See* PJM Transmittal Letter, Docket No. ER06-1218-003 at 6-7 (January 22,

through its stakeholder process to consider the underlying zonal distribution of FTR holders, their revenues, and the parties paying congestion as part of its evaluation. We also encourage PJM and its stakeholder to review a hybrid methodology that would allocate short-falls to ARRs and load-ratio share obligations. To this end, we direct PJM to file by November 30, 2007, an informational report that describes the alternatives evaluated and the results of the stakeholder process. If, as a result of the stakeholder process, it is determined that revisions to the uplift mechanism may be appropriate, PJM should make a new FPA section 205 filing with the Commission.

IV. Settlement Agreement – Docket No. ER06-1218-000 and -001

Background

75. In the November 22 Order, the Commission found that PJM had not met its burden under FPA section 205 of showing that the stage 1A allocation process is consistent with the requirements contained in Order No. 681 and in FPA section 217 to ensure that LSEs receive sufficient priority for historical load, should requested ARRs not be feasible.[65] The Commission found PJM's proposed method may result in greater pro-rationing for LSEs in close proximity to constrained facilities.[66] Consequently, the Commission made available a settlement judge, and on January 22, 2007, PJM filed a Settlement concerning the pro-rationing of LTTRs in stage 1A of its allocation process.

2007 filing). There, PJM states, in relevant part:

> [P]JM will recommend to its stakeholders that the LTTR uplift issue be subject to comprehensive review. Consistent with this recommendation, PJM will conduct a thorough stakeholder process to consider the following issues:
>
> - The causes of FTR underfunding to determine if revenue shortfalls caused by different events should be allocated differently;
> - The feasibility of allocating uplift based on the location of the transmission constraint that contributed to underfunding;
> - The type of extraordinary circumstances under which the full funding requirement should be uplifted (*i.e.*, catastrophic events such as hurricanes or significant equipment failure); and
> - The alternative mechanisms for allocating uplift and associated impacts on the market (*e.g.*, utilizing the marginal loss surplus to fund FTR revenue deficiencies).

[65] November 22 Order at P 78 and 80.

[66] *Id.* P 80.

Settlement Provisions

76. The Settlement provides that there shall be no pro-rationing of ARRs or FTRs in stage 1A of the annual allocations of ARRs and FTRs, except in extraordinary circumstances.[67] The Settlement defines an extraordinary circumstance as an event of *force majeure* that reduces the capability of existing or planned transmission facilities with the reduction in capability, in turn, causing the infeasibility of ARRs or FTRs.

77. The Settlement also provides that each of the municipals that is located in the Allegheny Power Zone whose ARRs were prorated in the 2006/2007 planning period and that is executing the Settlement will have a one-time option to change its Energy Settlement Area definition from nodal to zonal settlement. These parties are Chambersburg, Front Royal, Hagerstown, Thurmont, and Williamsport. Zonal settlement means that the party's Energy Settlement Area, for purposes of all ARRs allocated to it and all energy settlements, shall be the aggregate set of load busses consisting of all of the load busses in the Allegheny Power Zone. Hagerstown, Thurmont, and Williamsport also agree not to convert back to nodal settlement before June 1, 2011, unless the municipality and Allegheny Energy Supply Company, LLC agree.

78. The Settlement further provides that, for the 2007/2008 planning period, PJM shall model the Bedington-Black Oak interface pursuant to the requirements of section 7.5 of Schedule 1 of the Operating Agreement such that the effect of loop flows does not decrease the capacity of the interface by more than ten percent of the capacity of the interface. For subsequent planning periods, PJM will model the Bedington-Black Oak interface pursuant to section 7.5 without a restriction on the effect of loop flows. However, if the loop flows decrease the capacity of this interface by more than ten percent, then PJM shall provide advance notice to PJM members at least 90 days prior to the annual ARR allocation for the planning period.

79. The Settlement prohibits parties from filing a complaint regarding the legality of the pro-rationing rule in section 7.4.2(h) of Schedule 1 of the Operating Agreement (which requires that all ARRs be feasible or be prorated) that seeks a change to be effective for a Planning Period prior to the 2012-2013 Planning Period. If, however, a Party other than Chambersburg and the Maryland Municipalities makes any other filing to change any aspect of the Settlement, this prohibition does not apply. The Settlement provides that the standard of review of the Settlement is the just and reasonable standard.[68]

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[67] Section 7.4.2(i), Second Revised Sheet No. 409.01, of the PJM Tariff, Sixth Revised Volume No. 1 (PJM Tariff). References to the PJM Tariff also refer to the corresponding provisions in Attachment K of the PJM Tariff and the PJM Operating Agreement.

[68] PJM January 22, 2007 Settlement, Explanatory Statement at 9.

Comments on the Settlement

Initial Comments

80. Trial Staff supports the Settlement as a fair and reasonable resolution of all the issues and in the public interest. It states that the Settlement confers several benefits on LSEs. Trial Staff states that, first, LSEs will receive all their nominated ARRs in stage 1A. It states that, second, the previously pro-rated municipal LSEs in the Allegheny Power Zone may elect to become zonal customers rather than nodal customers for purposes of ARR allocation (and energy settlement), and this option could allow them to receive more ARRs in stages 1B and 2.

81. The FPL Generators state that they are concerned about modifying the simultaneous feasibility test model in order to award ARRs that are not actually feasible, but that they are willing to accept the Settlement as a negotiated resolution of difficult issues. They state that their concern is mitigated by (1) PJM's representation that it does not expect that it will need to implement the Settlement in order to allocate otherwise infeasible ARRs in stage 1A of the allocation process;[69] (2) the fact that the Settlement states that no policy or precedent is being established; and (3) any simultaneous feasibility test modifications will not affect energy markets or capacity auctions.

82. LIPA does not object to the Settlement, but to the parties to whom it applies. LIPA contends that the Settlement should apply to LSEs outside PJM with firm transmission withdrawal rights, as well as to LSEs within PJM. LIPA repeats the arguments it made in its requests for rehearing of the November 22 Order that these external LSEs are entitled to LTTRs on an equal priority with internal LSEs based on the fact that they pay the embedded costs of the PJM system on a long-term basis, PJM plans and constructs its system to support the load of these external LSEs, and PJM allocates the costs of reliability upgrades needed for service to the external LSEs. LIPA asserts that, unless the Settlement is extended to external LSEs with firm transmission withdrawal rights, it is inconsistent with Order Nos. 681 and 681-A and with section 217 of the FPA.

83. DC Energy opposes the Settlement. DC Energy objects that the Settlement is contrary to the requirements for feasibility of LTTRs in Order No. 681.[70] It objects to the allocation of infeasible FTR or ARRs as contrary to a market efficient solution in several ways. DC Energy states that, first, such financial rights would be beyond the system's

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[69] PJM Explanatory Statement at 5.

[70] *Citing* Order No. 681 at P 14, 17, 20, and 453; Order No. 681-A at P 14, 16, 17, and 94.

capability and the costs of providing them would be shifted to market participants other than the LSEs receiving them. DC Energy first objects that the Settlement does not provide any information about the potential magnitude of the cost shift or how it will be funded. Second, DC Energy states that infeasible ARRs would insulate the LSEs from the true costs of serving their loads, thereby decreasing incentives to invest in local area generation on the constrained side of an interface or to support transmission expansion. DC Energy also asserts the infeasible FTRs or ARRs will depress the auction value of FTRs, especially if the resulting shortfall is to be paid for by all FTR holders. DC Energy would support the Settlement if the Commission were to condition approval of the Settlement on a requirement that PJM make a compliance filing within twelve months to modify the ARR allocation process to avoid knowingly infeasible allocations.

Reply Comments

84. PJM states that the eligibility of parties for the stage 1A pro-rationing protections is an issue outside the scope of the Settlement. PJM maintains that the Settlement addresses only the guideline (5) modification required in the November 22 Order. PJM argues that the modification required addresses the amount of the LTTRs guaranteed in the stage 1A allocation, not the entities eligible for that priority. PJM asserts that, consistent with Orders Nos. 681 and 681-A, external LSEs are not eligible for stage 1A priority since capacity on its system is limited.

85. PJM states that, contrary to the objections of DC Energy, the Settlement is necessary and reasonable. PJM notes that the Commission found PJM's market rules were not consistent with Order No. 681 because the PJM pro-rationing methodology may subject LSEs to pro-rationing below their Zonal Base Load.[71] PJM explains that the Commission required PJM to file revisions that enable LSEs to obtain LTTRs (*i.e.*, stage 1A ARRs) in an amount that meets their reasonable needs. PJM asserts that there are only limited options available to meet these requirements and that all of them would involve the award of rights that are not feasible and not strictly aligned with principles of market efficiency. PJM argues that any settlement or compliance filing would have to include such provisions, so that this aspect of the Settlement is consistent with the November 22 Order.

86. In addition, PJM states it does not believe it will be necessary to implement the stage 1A pro-rationing subsequent to the 2007/2008 planning period for the Bedington-Black Oak interface, which was the system constraint that resulted in a significant amount of pro-rationing in 2006/2007. PJM asserts that a static var compensator is included in its RTEP to be installed in 2008, and that after the installation of this device, there will be adequate capacity on the Bedington-Black Oak interface to accommodate all

[71] November 22 Order at P 87- 88, and Ordering Paragraph (F).

stage 1 ARR requests, even assuming the worst case scenario ARR request pattern of no counter-flow requests, through 2015.[72]

87. Finally, PJM opposes DC Energy's requested condition of a compliance filing within twelve months to eliminate the potential to allocate infeasible transmission rights. PJM argues that this approach would not meet the requirements of the November 22 Order because it would necessarily create the potential to pro-rate stage 1A rights in the future, even assuming the risk is small as anticipated.

Commission Decision

88. The Settlement revises provisions contained in the PJM Tariff and Operating Agreement to eliminate pro-rationing of ARRs and FTRs in stage 1A of the annual allocations of ARRs and FTRs, except in extraordinary circumstances. To accomplish this, the Settlement restricts the application of PJM's pro-rationing methodology, except in cases of *force majeure*, in stage 1A of the annual ARR allocation. The Settlement is consistent with requirements contained in the Final Rule to ensure that LSEs receive sufficient priority for historical load should ARRs not be feasible.[73] In addition, the Settlement resolves the loop flow issue among the settling parties by requiring PJM to assume in its ARR calculation that loop flow will not decrease by more than 10 percent the capacity of the Bedington-Black Oak line, and by requiring notice if PJM intends to decrease the capacity of the line by more than 10 percent. The settling parties also retain the rights to pursue other available remedies, including pursuant to section 206 of the FPA, regarding the effect of the loop flows on the Bedington-Black Oak interface.[74]

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[72] A table attached to PJM's Reply comments filed on February 21, 2007 indicates that the static var compensator will increase capacity by 250 MW. PJM concludes that after the static var compensator is installed, stage 1A and 1B ARR requests will not experience pro-rationing caused by the Bedington-Black Oak line through 2015.

[73] November 22 Order at P 78.

[74] PJM's market rules create a linkage between the planning process and with the allocation of LTTRs. The PJM RTEP system enhancement and expansion study process will be triggered if there is inadequate system capability to support stage 1A ARRs, or if incremental ARRs are requested pursuant to section 7.8. *See* sections 1.5.1 and 1.5.3 of Schedule 6 "Regional Transmission Expansion Planning Process" of the PJM Operating Agreement.

89. The Settlement also offers the Municipals whose ARRs were significantly pro-rated in the 2006-2007 planning year a one-time option to change their Energy Settlement area from nodal to zonal.[75] The option to change from nodal (*i.e.*, transmission bus) to zonal settlement areas permits these customers to submit load bids to PJM as a single aggregated amount for their zonal load rather than bus-by-bus. In other words, these customers are being provided the option to decide whether to use marginal prices at their nodes or the prices averaged over numerous nodes in the Allegheny Power Zone. This option may also allow these customers the ability to obtain additional ARRs in stages 1B and 2 of PJM's ARR allocation process (*i.e.*, above their Zonal Base Load). For example, Chambersburg and the Maryland Municipalities could request ARRs in stage 2 from non-historical resources and be awarded the ARRs they request.

90. The Settlement is just, reasonable, and not unduly discriminatory and is hereby approved. Only one party filed in opposition. However, as discussed below, DC Energy fails to persuade us to reject or modify the Settlement. Further, LIPA's request that the Commission modify the Settlement to extend the elimination of pro-rationing to LSEs with firm transmission withdrawal rights to serve load outside PJM is a matter beyond the scope of the issues addressed in the Settlement, because the November 22 Order addressed the amount of the LTTRs guaranteed in stage 1A, not the entities eligible for stage 1A priority. In any event, LIPA's position is addressed earlier in this order.

91. DC Energy argues that guaranteeing stage 1A ARR allocation is inconsistent with market principles and Order No. 681. This argument misses the point. PJM and the settling parties agreed to permit LTTRs in stage 1A of the allocation process that would otherwise have been infeasible so that the affected LSEs could obtain LTTRs up to their Zonal Base Loads. This is consistent with the intent of section 217 of the FPA and of Order No. 681: to ensure that LSEs can secure a reasonably sufficient amount of LTTRs

to meet their load obligations. Therefore, the Commission finds that permitting infeasible LTTRs to be funded through uplift is reasonable, as it is necessary to protect the transmission rights and the load service obligations of these entities.

92. DC Energy asserts that the allocation of infeasible rights will result in cost shifting and mute price signals, thereby undermining efficient investment in generation and transmission. We find this argument unpersuasive. First, DC Energy admits that it relies on PJM's representation that "[a]bsent unanticipated reductions in system capability, at this time PJM does not expect that it will need to implement these Settlement terms in order to allocate otherwise infeasible ARRs in stage 1A of the allocation process." The Commission concurs with this observation. Further, according to PJM, in 2008, a static

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[75] Section 1.11A.01 of the PJM Tariff defines Energy Settlement Area as "[t]he bus or distribution of buses that represents the physical location of Network Load and by which obligations of the Network Customers to PJM are settled."

var compensator should be installed at Bedington-Black Oak interface increasing the transfer capability of this interface by 250 MW. In fact, PJM predicts that, after this upgrade is installed, the stage 1A and 1B ARR requests should not experience pro-rationing due to the Bedington-Black Oak interface through 2015.[76] PJM will include this transmission upgrade in its planning process to allow requested ARRs to be feasible. As a result, absent reductions in system capability, PJM does not expect that it will need to allocate otherwise infeasible ARRs in stage 1A of the allocation process.

93. We also find that the Settlement adequately addresses the concerns raised regarding loop flows. Under the terms of the Settlement, for the 2007/2008 planning period, PJM will model the Bedington-Black Oak interface so the effect of loop flows does not decrease the capacity of the interface by more than 10 percent. For future years, if PJM models the Bedington-Black Oak interface so that loop flows decrease the capacity of the interface by more than 10 percent, it must provide notice to its members at least 90 days prior to the annual ARR allocation for the planning period.

94. As the Settlement provides that the standard of review of the Settlement is the just and reasonable standard, the Commission retains the right to investigate the rates, terms and conditions under the just and reasonable and not unduly discriminatory or preferential standard of section 206 of the Federal power Act, 16 U.S.C. § 824e (2000).

V. Compliance Filing – Docket No. ER06-1218-004

95. As we discussed above, in the November 22 Order, the Commission reserved making findings regarding the incremental ARRs associated with network upgrades.[77] Rather, the Commission directed PJM to file necessary Tariff changes to standardize processes at least 60 days prior to the beginning of the next planning year, *i.e.*, June 1, 2007.

96. Prior to the issuance of the November 22 Order, the Commission had noted that PJM needed to clarify its market rules related to queue priority rights between merchant transmission projects and projects funded for transmission service requests.[78] As a result, subsequent to the issuance of the November 22 Order, in Docket Nos. ER06-344-000 and

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[76] See the, PJM Regional Transmission Expansion Plan dated February 22, 2006, located at: http://www.pjm.com/planning/reg-trans-exp-plan.html, and additional information at: http://www.pjm.com/markets/ftr/downloads/20061220-ltftr-settlement.pdf.

[77] November 22 Order at P 46-47.

[78] *See Chesapeake Transmission, L.L.C. v. PJM Interconnection, L.L.C.*, 116 FERC ¶ 61,234 at P 37 (2006).

EL06-67-001, PJM filed provisions creating a process for coordinating transmission service requests, and generator and merchant project interconnection requests. On February 8, 2007, an order was issued under delegated authority accepting those revisions to the PJM Tariff.[79]

97. In the instant docket, PJM filed a compliance filing in Docket No. ER06-1218-004 requesting that the Commission confirm that the Tariff revisions accepted for filing on February 8, 2007 in Docket Nos. ER06-344-000 and EL06-67-001 complied with the Commission's directive in the November 22 Order. We find that the Tariff revisions accepted for filing on February 8, 2007, comply with our directive to establish standardized processes.

<u>The Commission orders:</u>

(A) The requests for rehearing are hereby denied, as discussed in the body of this order.

(B) PJM's request for clarification is hereby granted, as discussed in the body of this order.

(C) The Settlement in Docket Nos. ER06-1218-000 and ER06-1218-001 is hereby approved and Docket No. ER06-1218-001 is hereby terminated.

(D) The compliance filing in Docket No. ER06-1218-003 is hereby accepted to be effective June 1, 2007, subject to PJM's filing a status report on or before November 30, 2007 explaining alternatives to its uplift methodology that it has evaluated and the results of its stakeholder process concerning the uplift methodology.

(E) The compliance filing in Docket No. ER06-1218-004 is hereby accepted.

By the Commission.

(S E A L)

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[79] *See PJM Interconnection, L.L.C.*, (PJM), accepted in *PJM Interconnection, L.L.C.*, Docket Nos. ER07-344-000 and EL06-67-001 (February 8, 2007) (unpublished letter order) (PJM).

Philis J. Posey,
Deputy Secretary.