

122 FERC ¶ 61,279
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

PJM Interconnection, L.L.C.

Docket Nos. ER08-376-000
ER08-455-000
ER08-520-000
(Not consolidated)

ORDER ON TARIFF REVISIONS

(Issued March 25, 2008)

1. On December 26, 2007 (Docket No. ER08-376-000), January 18, 2008 (Docket No. ER08-455-000), and January 31, 2008 (Docket No. ER08-520-000), PJM Interconnection, L.L.C. (PJM) filed revisions to its credit policies with respect to its Financial Transmission Rights (FTR) markets.¹ The filings in Docket Nos. ER08-376-000 and ER08-520-000 primarily adjust PJM's collateral requirements for participants in the FTR markets in order to better account for the volatility and risk of certain positions. PJM requests an effective date of April 1, 2008 for the filings in Docket Nos. ER08-376-000 and ER08-520-000, with implementation applicable to FTRs that commence in the next Planning Period.²

2. The filing in Docket No. ER08-455-000 would allow PJM to set off a company's FTR default against FTR market revenues that PJM would otherwise have paid to the defaulting company's affiliates and to apply such affiliates' posted security to the default to the extent that the security relates to the company's FTR positions. In its application, PJM describes a set of circumstances involving the default of one company, Power Edge LLC (Power Edge), in its FTR markets and suggests that the Docket No. ER08-455-000 filing would apply to that default. PJM requests an effective date of January 19, 2008, one day after the submission of its filing in Docket No. ER08-455-000.

¹ See attached Appendix A for a listing of the filed tariff sheets.

² PJM's FTR Planning Period runs from June 1st to May 31st.

3. RTOs such as PJM are required by statute³ to make available long-term firm transmission rights, or equivalent tradable or financial transmission rights, that will allow load serving entities (LSEs) to deliver their output or purchased energy using the transmission grid to meet the LSEs' service obligations. Consistent with its pre-existing practice, PJM chose to continue using financial transmission rights, both Auction Revenue Rights (ARRs) and an FTR auction, to meet this statutory requirement. FTRs permit load to schedule delivery of energy from the source generator to the load without being responsible for paying congestion costs over the transmission line. FTRs therefore operate as a hedge against expected transmission congestion costs, and thereby provide load with the equivalent of firm transmission service. PJM chose to establish an ARR and FTR auction market that it believes enables load to both obtain and trade FTRs efficiently.

4. In this order, we accept PJM's revised collateral requirements as proposed in Docket Nos. ER08-376-000 and ER08-520-000, to become effective April 1, 2008, subject to conditions, because these collateral requirements will assist PJM in managing the risk and volatility of certain positions taken by FTR holders in the FTR auction markets PJM has established and help protect customers. With respect to the filing in Docket No. ER08-455-000, we note that the Commission's Office of Enforcement began a non-public investigation in January into the activities of Power Edge and its affiliates in PJM's FTR markets. That investigation is the appropriate context in which to examine whether the Commission's rules have been violated, and if so, whether a remedy is warranted. PJM's proposal to generically treat affiliated corporate structures differently than single companies participating in the FTR market will not address the perceived flaw in its credit policies, which may be present whether a company is or is not affiliated with other participants in the market. Accordingly, we reject PJM's proposal in Docket No. ER08-455-000.

I. Background

5. PJM's Credit Policy, Attachment Q of its Open Access Transmission Tariff (OATT) (Credit Policy), allows for two types of FTR positions: concurrent flow FTRs and counterflow FTRs.⁴ FTRs in PJM are valued based on the expected differences between the locational marginal prices (LMP) at the FTR's designated source and sink points over the life of the FTR. FTRs are financial commitments that are settled based

³ *Long-Term Firm Transmission Rights in Organized Electricity Markets*, Order No. 681, FERC Stats. & Regs. ¶ 31,226, *order on reh'g*, Order No. 681-A, 117 FERC ¶ 61,201 (2006).

⁴ PJM also refers to concurrent flow FTRs as "normal" flow and "prevailing" flow FTRs.

on prices in the Day-ahead market. A concurrent flow FTR occurs when the source price is lower than its sink price, an indication that the FTR consumes valuable transmission flow capability relative to projected transmission constraints. Concurrent flow FTRs have a positive purchase price that the purchaser commits to pay in the FTR auction⁵ and it is expected to yield a positive revenue stream to the FTR holder based on its economic value in PJM's Day-ahead energy market. Concurrent flow FTR positions are profitable when actual congestion charges in the Day-ahead energy market are higher than the expected congestion charges.

6. Counterflow FTRs occur when the source price is higher than the sink price, indicating that the FTR releases valuable transmission flow capability by providing flow in the opposite direction relative to a transmission constraint. Counterflow FTRs have a "negative" purchase price so the auction participant will be paid some amount to take on the costs and risks of holding a counterflow FTR.⁶ Counterflow FTRs are expected to result in negative revenue streams (i.e., payment obligations) to the FTR holder based on their economic value in the Day-ahead energy market. Counterflow FTR positions are profitable when actual congestion charges in the Day-ahead market are lower than the expected congestion charges.

7. Companies that purchase and sell FTRs solely to arbitrage the price differences between the FTR auction and the Day-ahead energy market tend to be financial participants (i.e., speculators). Most financial participants maintain a balanced portfolio of concurrent flow and counterflow FTRs to manage their risk. According to PJM, a net "short" FTR position, i.e., a net counterflow portfolio, is more risky than a balanced portfolio because it is exposed to the volatility of changing congestion without an offset from concurrent flow FTRs. While parties that choose to hold such positions serve a useful purpose by providing additional liquidity to the auction, they undertake above-average market risk.

II. Notice of Filings and Responsive Pleadings

8. Notice of PJM's filing in Docket No. ER08-376-000 was published in the *Federal Register*, 73 Fed. Reg. 2,336 (2008), with interventions, comments and protests due on or before January 16, 2008. On February 8, 2008, PJM filed an answer and on February 15, 2008, Citadel Energy Products LLC, Citadel Energy Strategies, LLC, and

⁵ A concurrent flow FTR holder pays for "annual" FTRs in approximately equal monthly payments over the 12-month Planning Period. The default risk for which PJM currently requires collateral is the result of the deferred payments.

⁶ Counterflow FTR holders receive monthly payments for over the 12-month Planning Period.

Citadel Energy Investments Ltd, (collectively Citadel) filed a reply. Notice of PJM's filing in Docket No. ER08-455-000 was published in the *Federal Register*, 73 Fed. Reg. 6,173 (2008), with interventions, comment, and protests due on or before February 1, 2008, which was extended to February 15, 2008. DTE Energy Trading, Inc. (DTE Energy) and PJM filed answers. Notice of PJM's filing in Docket No. ER08-520-000 was published in the *Federal Register*, 73 Fed. Reg. 10,021 (2008), with interventions, comments and protests due on or before February 21, 2008. On March 21, 2008, PJM filed an answer. Parties filing comments or protests regarding these PJM filings are listed in Appendix B of this order.

III. Discussion

A. Procedural Matters

9. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2007), all timely filed motions to intervene and any motions to intervene out-of-time filed before the issuance date of this order are granted. Granting late intervention at this stage of the proceeding will not disrupt this proceeding or place additional burden on the existing parties.⁷

10. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2007), prohibits an answer to an answer or protest unless otherwise ordered by the decisional authority. We will accept the answers filed by PJM, Citadel, and DTE Energy as they have assisted us in the decision-making process.

B. Docket No. ER08-376-000

1. FTR Collateral Requirement Revisions

a. PJM's Proposal

11. In its filing in Docket No. ER08-376-000, PJM asserts that the proposed revisions to its Credit Policy "right sizes" its FTR collateral requirements for both concurrent and counterflow FTR positions.

12. PJM explains that it currently calculates its FTR credit requirements using FTR cost and historical congestion values (referred to as Expected LMP Values) on each transmission path for a whole Planning Period. The credit requirement for each FTR is

⁷ Pursuant to Rule 214(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(a)(2) (2007), the Pennsylvania Office of Consumer Advocate was not required to file a motion to intervene, but only a timely notice of intervention.

the difference between the bid price and the Expected LMP Value. The current rules reduce the Expected LMP value by 30 percent for all concurrent flow FTRs, but do not adjust the Expected LMP value for counterflow FTRs.

13. PJM explains that a disproportionately large portion of the congestion value of FTRs is received by holders in the summer months at the beginning of each Planning Period. However, since credit requirements were based solely on total annual value and total annual cost, the timing difference between front-loaded congestion values and the evenly spread cost of the FTRs created a credit exposure because the FTR holder could receive a large amount of congestion revenues in the summer, but only pay a relatively small portion of the overall FTR cost during the summer months. With counterflow FTRs, a participant assumes the opposite exposure of the concurrent FTR position. A concurrent FTR offsets a volatile exposure to congestion against a fixed obligation to pay the purchase price of the concurrent flow FTR. Conversely a counterflow FTR holder accepts a stream of uncertain future monthly congestion obligations in exchange for receipt of fixed monthly payments for its counterflow FTRs. PJM's current credit rules require only that a counterflow FTR holder post the difference between the total annual cost of its counterflow FTRs and the total annual Expected LMP Value. PJM states that this requirement is inadequate because it does not recognize the potentially large up-front payments that are possible for the participant. Participants can acquire a large portfolio of counterflow FTRs, but post very little collateral because the FTR cost may be able to cover the Expected LMP value for the year, even if it cannot do so on a month-to-month basis during the year. A position that, on an annual basis, has been profitable during the past does not require much collateral, but a large portfolio of such positions poses significant risks. PJM states that its current Credit Policy may actually attract parties with a high risk tolerance to pursue a counterflow bidding strategy.

14. PJM proposes to remedy this problem by calculating the FTR Credit Requirement on a monthly rather than an annual basis. PJM argues that a monthly calculation provides better matching of collateral requirements with actual FTR risks while also removing the inequity that results from imposing a global average 30 percent discount on all concurrent flow Expected LMP Values, since the proposal's use of monthly congestion history automatically adjusts for individual FTR monthly congestion shapes and month-to-month volatility. PJM proposes to calculate the overall FTR Credit Requirement by summing the credit requirement subtotals for only those months when the subtotals are positive. PJM explains that the positive subtotal months are those in which the gross payments to PJM are expected to exceed the gross receipts from PJM, and capture both the counterflow exposure and concurrent flow exposure that arise from timing differences between congestion values and FTR auction payments throughout the year.

15. PJM also proposes a 10 percent adjustment to the Expected LMP Values to provide a buffer against uncertainty in congestion values without regard to intra-year

timing. PJM contends that this adjustment will mitigate exposure due to the risks inherent in relying on the accuracy of historical congestion values when formulating expectations about the future. PJM states that the 10 percent adjustment is either a reduction or an adder to Expected LMP Values depending upon whether the FTR reflects a concurrent flow or counterflow position.

16. PJM explains that the credit requirements under its proposal actually commence at a somewhat higher level than the current system, but can begin to drop immediately as PJM applies the actual monthly history to each FTR in a participant's portfolio. PJM also explains that the net result of its proposal is an approximately 25 percent reduction in collateral requirements when averaged over the twelve-month Planning Period relative to application of the current method.

17. PJM contends that its proposal also corrects a problem with application of ARR credits.⁸ PJM explains that it currently counts ARR credits on a Planning Year basis and allows offset to any FTR credit requirement for any month, which results in the possibility that ARR credits spread over many months may be used in the system to offset credit requirements of a single month of FTRs. PJM's proposal eliminates the problem by counting ARR credits on a monthly basis and allows offset to FTR credit requirements only for corresponding months.

18. To incorporate the proposed reforms, PJM establishes and revises some defined terms: (1) "FTR Historical Value" replaces the less self-explanatory terms Revenue Offset and Expected LMP Value; (2) "FTR Credit Requirement" is the amount of credit that a participant must provide in order to support the FTR positions that it holds and/or is bidding for; (3) "FTR Credit Limit" means only that credit specifically used for FTR activity; and (4) "FTR Monthly Credit Requirement Contribution" is the total FTR cost less the FTR Historical Value for each FTR for each month. PJM establishes the monthly credit exposure for each FTR and facilitates the monthly updating that permits an accelerated reduction of required credit and return of collateral. PJM explains that the term FTR Monthly Credit Requirement Contribution indicates that each FTR contributes on a monthly basis to the credit calculation for that month, which may be positive or negative.

19. Among PJM's other changes, section V.A obligates participants to maintain their FTR Credit Limit at a level equal to or greater than the FTR Credit Requirements. Section V.B sets forth the basic monthly calculation of FTR Credit Requirement as the future summation of expected monthly net FTR obligations of the participant to PJM, less the prorated value of any ARRs held. Section V.C clarifies that PJM will reject

⁸ ARRs entitle the ARR holder to receive the auction revenues that result from the sale of related FTRs.

bids that would cause the FTR Credit Requirement to exceed the FTR Credit Limit. Section V.E removes the reference to credit release schedule since it no longer applies, clarifies certain language, and clarifies the requirement that credit extend sufficiently past the last payment date for an FTR product for PJM to allow a cure period and to initiate recovery prior to expiration. Finally, PJM has made other minor housekeeping corrections.

20. In addition, PJM proposes to revise Sheet No. 523G of Attachment Q of its OATT relating to PJM's right to require additional Financial Security to state that "payment of additional Financial Security is due immediately upon notification of such modification and subject to the provisions of section VII below." Also, PJM proposes a revision to Sheet No. 523 K of Attachment Q that would provide PJM with the ability to retain "a defaulting Member's Financial Security for as long as such party's positions exist and for any residual period that PJM may deem appropriate and consistent with the PJM Credit Policy in this Attachment Q, in order to protect PJM's membership from default." However, PJM does not discuss or provide any justification for these two proposed changes in its transmittal letter.⁹

21. PJM asserts that additional protections will be necessary beyond its current proposal that will be specific to the risks posed by undiversified portfolios of counterflow positions. However, PJM states that the current proposed revisions significantly improve its ability to address the risks associated with counterflow positions and argues that there is no reason to delay moving forward with the instant filing. PJM states that it has initiated a stakeholder process to consider the additional reforms and will file those separately.

b. Comments and Protests

22. Regarding PJM's proposal as a whole, the commenters and protesters support the collateral requirement revisions and encourage the Commission to accept the proposal. Both Morgan Stanley Capital Group Inc. (MSCG) and Citadel strongly support PJM's instant filing and urge the Commission to accept the tariff changes proposed in the PJM filing. Citadel explains that PJM's proposed changes strike a reasonable balance between encouraging new entrants to the PJM markets and protecting PJM members against undue exposure from market participants holding undiversified counterflow FTR portfolios and lacking sufficient credit. DC Energy, LLC, and DC Energy Mid-Atlantic (collectively DC Energy) agrees that PJM's proposed change to the Credit Policy provides increased protection against net counterflow positions and thus supports

⁹ The Commission notes that these same proposed revisions were filed in Docket No. ER07-1036 and rejected. *PJM Interconnection, LLC*, 121 FERC ¶ 61,089 (2007) (October 26 Order).

the change. DC Energy believes that PJM's proposal provides a superior methodology of matching collateral requirements with actual FTR risks while also removing the inequity that results from imposing a global average 30 percent discount on all normal flow FTR congestion values, since the proposal's use of monthly congestion history automatically adjusts for individual FTR monthly congestion shapes as well as month-to-month volatility. DC Energy also believes that there is an additional benefit to allowing PJM to return posted collateral on the basis of path specific calculations much more promptly to participants whose positions become increasingly stabilized over the course of the Planning Period. Therefore, DC Energy requests that FERC approve the tariff changes and accept PJM's implementation timeframe.

23. Duke Energy Corporation (Duke) also believes that PJM's proposed revision to the Credit Policy will minimize the default exposure that is created when market participants enter into speculative, high risk FTR positions. Duke states that due to the inadequacy of PJM's credit requirements, a large amount of uplift charges have recently been assessed to PJM market participants as a result of several participants defaulting on their FTR obligations. Thus, Duke argues that PJM's proposal is a step in the right direction in terms of mitigating the risks of default associated with out-of-the-money counterflow FTR positions. Duke believes the end result of these proposed credit requirements is that PJM will be better collateralized, which will better protect the market in the event that there is a default.

24. The Joint Intervenors state that the PJM proposal is a significant improvement over the existing PJM Credit Policy. The Joint Intervenors explain that PJM's current FTR credit policies create an environment that allows market participants to speculate in the FTR markets using, in effect, the risk capital of non-defaulting PJM members to cover losses. The Joint Intervenors argue that PJM's proposed revisions constitute a significant and necessary improvement over its existing FTR credit policies with the benefit that it will eliminate the strong incentive contained in the current FTR credit policy for market participants to structure directional counterflow portfolios to avoid high collateral requirements. According to the Joint Intervenors, holders of concurrent flow FTRs will likely have less stringent collateral requirements because of the elimination of the 30 percent discount applied in the current method and the incentive to structure counterflow portfolios on a purely collateral requirement basis will be eliminated based on the requirements being calculated on a monthly basis. In addition, Joint Intervenors state that there is an additional benefit to allowing cleared FTRs with negative credit requirements to offset positive requirements, allowing market participants to more efficiently deploy collateral.

25. The EPIC Merchant Energy, LP (EPIC) and SESCO Enterprises, LLC (collectively Financial Marketers) also strongly support the modifications to the PJM FTR credit requirements proposed in the instant filing. Financial Marketers state that the proposal should be accepted because it more accurately reflects the variability and

seasonality in the value of the FTR purchases, without unduly penalizing those market participants with diversified and stable FTR portfolios. According to the Financial Marketers, PJM's proposal is consistent with the Commission's October 26 Order on PJM's Credit Policy because it takes into account seasonal variations and the risks posed by specific FTR purchases.

26. A number of parties filed comments asserting that the changes proposed by PJM do not go far enough to protect the PJM membership from substantial credit risk and losses resulting from undiversified counterflow FTR portfolios, citing the recent defaults by Exel Power Sources, LLC (Exel) and Power Edge.¹⁰ Public Service Electric and Gas Company (PSE&G) and PSEG Energy Resources & Trade LLC (PSEG ER&T) (collectively PSEG Companies) argue that PJM's proposed tariff changes leave non-defaulting members exposed to approximately 50 to 80 percent of default risk associated with undiversified portfolios. PSEG Companies urge the Commission to require PJM to close the credit loophole associated with FTR counterflow transactions.

27. A number of parties propose specific ways in which PJM could strengthen its credit requirements, including adoption of mechanisms paralleling those of futures exchanges, requiring participants to have a minimum of \$10,000,000 in assets, and allowing PJM to liquidate defaulted FTR positions to allow PJM to proceed against the defaulting party promptly in a legal proceeding.

28. Exelon Corporation (Exelon) and PSEG Companies object to PJM's proposal to delay the effective date of the instant revisions to April 1, 2008, asserting that the risk of further defaults exists on an ongoing basis. Some commenters urge the Commission to require PJM to implement the instant revisions immediately and make the to-be-filed revisions to address the risk of undiversified counterflow FTR holders effective February 1, 2008. Some commenters also assert that the tariff revisions should apply to current FTR positions, and that PJM should reevaluate the credit exposure associated with FTRs granted in the Summer 2007 FTR auction and immediately require participants whose open positions pose a greater credit risk to post additional collateral. The PPL Parties urge the Commission to consolidate the two proceedings as long as consolidation does not delay the issuance of an order.

¹⁰ PSEG Companies state that Exel was required to back its portfolio with only \$3,000 of credit, but then incurred a \$2.3 million loss on its FTR counterflow transactions, leading to a default on its payment obligations to PJM. PJM estimates Power Edge's payment defaults plus additional charges will be \$80 million by the end of May 2008.

29. Citadel argues that PJM should adopt changes that clarify when payment on demands for collateral will be due under applicable PJM tariff provisions, as PJM's proposed revision states that "payment of additional Financial Security is due immediately upon notification of such modification and subject to the provisions of section VII below."¹¹ Citadel suggests a one-day period is reasonable. Citadel also contends that PJM should promptly make the changes that the Commission directed PJM to make in the October 26 Order to section V.I.H of Attachment Q concerning the transfer of credit obligations.¹²

30. DC Energy asserts that PJM's proposed change exacerbates a mechanism contained in the Credit Policy that is not just and reasonable, namely a requirement that the collateral required to participate in the auction, i.e., bid collateral, can be significantly greater than the maximum possible collateral requirement of the awarded portfolio (i.e., hold collateral). DC Energy protests the unnecessary requirement for bid collateral because it serves no business purpose while causing an undue burden on participants.

31. DC Energy explains that if a member bids to buy multiple FTRs from point A to point B at different prices in the same auctions, PJM requires bid collateral equal to the sum of all the expected values in the calculation. According to DC Energy, this is unjust and unreasonable because if the lower-priced bid is awarded, then the higher-priced bid must also be awarded at the same lower clearing price. But, DC Energy continues, PJM currently evaluates and requires collateral based on the higher bid price. DC Energy recommends that to compute the maximum possible hold collateral, PJM should: (1) group each FTR bid in an auction by source, sink, class and period; (2) for each group, compute the maximum possible hold collateral by iterating through each bid; and (3) assign the bid collateral to a group of bids to the maximum possible hold collateral. While DC Energy has suggested this change to PJM, it filed the limited protest so the Commission can act quickly to correct this flaw in PJM's proposal. DC Energy notes that all of the other ISO/RTOs that operate FTR type markets currently use a methodology similar to the one proposed by DC Energy.

c. Answers

32. PJM states that its Credit Working Group is currently considering most of the proposals recommend by Citadel and others and anticipates that it will include some or all of them in an additional filing later this year. PJM explains that it has moved forward with the most urgent aspects of its credit reform with the instant filing.

¹¹ Attachment Q § II.B, Fourth Revised Sheet No. 523G.

¹² October 26 Order at P 35-36.

According to PJM, it is receptive to Citadel's proposals, but PJM does not believe it is necessary to circumvent the stakeholder process when the most significant reforms already have been put before the Commission.

33. PJM asserts in its answer that an effective date earlier than April 1, 2008 is not feasible. PJM explains that it cannot implement its proposal without the development of software capable of calculating collateral requirement in the manner that PJM proposes. However, the vendor working on the software informed PJM that they will have the new system completed and tested in time to meet the schedule that PJM proposed, but no earlier. PJM believes that attempting to force a more rapid implementation poses a risk of problems with implementation that does not offset the modest benefit of having the approach in place by April 2008, the last month of the current Planning Period during which this proposal could confer any benefit to participants in FTR markets. Accordingly, PJM encourages the Commission to refrain from ordering PJM to implement its proposal any earlier than requested by PJM.

34. In its answer, PJM explains that DC Energy identifies a defect with the proposed revisions and PJM agrees that if a participant submits multiple bids on the same line segment, at the same time and for the same directional flow, then for the reasons DC Energy provides, it is appropriate to establish the credit requirements on the basis of the bid combination that could produce the highest potential credit requirements rather than the sum of all bids, as now specified. PJM has no objection to the specific method that DC Energy proposes and is ready to craft a revision along these lines if directed to do so by the Commission. Otherwise, PJM states that it will include this item among additional revisions currently under consideration in the Credit Working Group.

35. In its response to PJM's answer, Citadel reiterates its support for PJM's proposal but again argues that there is need for further reforms to PJM's credit policy. Citadel believes there is urgent need to (1) clarify rights and obligations around collateral call and related default timing; (2) authorize PJM to suspend payments due to parties who have failed to perform on their financial obligation but are not yet in default; and (3) amend the tariff to allow PJM to terminate and liquidate FTRs upon a member's default. Citadel states that these reforms are critical and need to be implemented in connection with the annual FTR auction in April 2008. Citadel also urges the Commission to direct PJM to complete its review of various other credit policy changes applicable to the FTR markets, and to file them with the Commission in sufficient time so that the Commission may act upon the proposed changes prior to the FTR annual auction in April 2008. At a minimum, Citadel contends PJM should submit any additional proposals no later than April 1, 2008 so that the Commission can act and perhaps place them into effect by the start of the next FTR Planning Period. Citadel asserts that changing the Credit Policy rules in the middle of the auction process will inject uncertainty into the market and may raise the costs associated with participating in the auctions.

d. Commission Determination

36. We accept PJM's proposed tariff revisions, to become effective April 1, 2008, subject to conditions, as described below. PJM's revisions will better correlate its collateral requirements with the risk exposure in the FTR market by more precisely matching a participant's credit requirements with its actual FTR risks. For example, PJM's use of a monthly, rather than annual historical values for each FTR path in calculating its revised credit requirements, better reflects monthly congestion shapes and historical volatility, and allows PJM to return posted collateral more promptly to participants.

37. Protesters argue that PJM should make additional revisions to its collateral requirements. The Commission notes that PJM has already filed other revisions to its Credit Policy in Docket Nos. ER08-455-000 and ER08-520-000, and is still working with its stakeholders regarding collateral for FTR positions. We therefore do not see the need at this time to institute further procedures for additional revisions. Additionally, PJM stated in its answer that it will continue to consider the suggestions by participants to further enhance its credit requirements. The Commission, however, would like to be kept apprised of PJM's progress. We therefore direct PJM to file status reports on its progress of reviewing its Credit Policy every 90 days for a period of two years beginning on May 1, 2008. These reports, which will be for informational purposes only and will not be noticed or require Commission action, should include details of how the revisions accepted in this Order are working in the FTR market.

38. Some protesters request that we make these provisions effective earlier than the date proposed by PJM. PJM stated in its answer that it would not be able to implement the instant revisions sooner than April 1, 2008 due to the need to adequately test software implementation of the revisions. Under these circumstances, the Commission will make the filing effective April 1, 2008, as requested by PJM. With respect to PSEG Companies' request that the Commission require PJM to use the revised Credit Policy to reevaluate the credit exposure associated with FTRs granted in the summer 2007 FTR auction, we note that PJM's tariff provisions are effective on April 1, 2008. Therefore, we expect PJM to apply its revised credit policies as of this date.

39. With respect to Citadel's request that PJM comply with the Commission's October 26 Order concerning the transfer of credit,¹³ we note that on January 28, 2007, PJM filed to clarify the provision, and we addressed its clarification in an order in that

¹³ See October 26 Order at P 35-36.

proceeding.¹⁴ PJM, however, will have to file revised tariff sheets in this proceeding to reflect the outcome of its compliance filing in Docket No. ER07-1036-002.

40. The Commission will accept, subject to conditions, PJM's proposed revision to Attachment Q that requires payment of additional Financial Security "immediately." PJM does not define "immediately," and its meaning is ambiguous. As we stated in our October 26 Order,¹⁵ customers need to be given some reasonable time period in which to provide additional Financial Security. PJM seems to argue that the provision's time period set out in section VII, titled "Events of Default," would apply to the payment of additional Financial Security. PJM, though, has not shown the provision in section VII dealing with default is analogous, because an event in which PJM determines additional Financial Security is required by a party is not equivalent to an event of default. Customers need to be given some reasonable, specified time period in which to provide additional Financial Security. Therefore, the Commission finds that PJM needs to review this provision and determine the most reasonable time period for FTR participants to submit additional Financial Security. The Commission accepts the proposed revision, subject to PJM filing a specified time period in a compliance filing due within 30 days of the date of this Order.¹⁶

41. The Commission will accept, subject to condition, PJM's proposed revision to Attachment Q § VI that would provide PJM with the ability to retain a defaulting Member's Financial Security for as long as such party's positions exist and for any residual period that PJM may deem appropriate. As we found in our October 26 Order, PJM has not specified in the proposed tariff any situations that it "may deem appropriate" to use this provision. The phrase is ambiguous; PJM should only be allowed to keep collateral for as long as the positions exist and the customer has not paid. We will therefore accept this proposed revision subject to PJM removing the phrase "and for any residual period that PJM may deem appropriate" in its compliance filing due within 30 days of the date of this Order.

¹⁴ *PJM Interconnection, L.L.C.*, Docket No. ER07-1036-002 (February 25, 2008) (unpublished letter order).

¹⁵ *See* October 26 Order at P 32-33.

¹⁶ In Docket No. ER07-1036, PJM stated that it intended to require a party subject to a call for additional Financial Security to provide such security within the three-day cure period currently established for parties in default. In the instant filing Citadel suggested a one-day period. In its compliance filing, PJM must fully support the number of days it chooses.

42. The Commission agrees with PJM that its bidding credit requirements are more appropriately based on the bid combination that could produce the highest potential credit requirements rather than the sum of all bids. Therefore, the Commission accepts PJM's agreement to file a revised bidding requirement provision along the lines proposed by DC Energy, within 30 days of the date of this Order.

C. Docket No. ER08-455-000

1. PJM's proposal

43. PJM's default allocation proposal seeks to allow PJM to require affiliated companies trading in FTR markets to be each other's guarantors in defined circumstances. Under this proposal, when a market participant establishes multiple affiliates to trade FTRs and then isolates a particular type of high-risk FTR position in one of the affiliates (i.e., when an affiliate has a "net short portfolio" of FTR positions) PJM would then have the right to set off the default against FTR market revenues that PJM would otherwise have paid to the defaulting company's affiliates and to apply such affiliates' posted security to the default to the extent that the security relates to the company's FTR positions.

44. In support of its filing, PJM states that under current default allocation rules a market participant could establish one affiliate to make risky bets on future congestion levels through net short FTR positions and set up another affiliate to hold offsetting (long) FTR positions. In this scenario, the affiliate that took the risk could default and walk away leaving other PJM members to cover the default while the other affiliate would continue to earn revenues from its FTR position.¹⁷

45. PJM contends that just such a situation occurred this fall with Power Edge, which has six affiliated companies that are members of PJM and that trade in the PJM markets. Power Edge and each of its affiliates are controlled by Tower Research Capital Investment (collectively Tower Companies), which acts as the managing member of each company and one individual is designated for all seven affiliates as the representative authorized to conduct PJM marketing activity on their behalf. PJM states that, out of the four affiliates that trade in concurrent flow and counterflow FTRs, Power Edge holds only risky, undiversified counterflow FTRs and is the only affiliate with a significant net short position.

46. PJM states that, due to warmer weather and an extended transmission outage, congestion along the relevant path was greater than the market and Power Edge

¹⁷ Currently, when a PJM Member is in payment default, PJM spreads the amount in default across all Members.

anticipated. As a result, for the duration of the outage Power Edge now owes PJM for greater than anticipated congestion. Power Edge owed PJM \$1.5 million for the November 2007 billing period. In December, PJM sent Power Edge a bill for this amount, but Power Edge defaulted. Due to the prospective defaults, PJM recently billed Power Edge \$19.9 million for its December obligations. This amount was due on January 22, 2008, but as of the filing date (January 18, 2008) PJM assumed Power Edge would also default on this payment.

47. PJM states that it intends to impose the proposed revisions on Power Edge's affiliates after January 18, 2008. Since Power Edge holds the counterflow positions through May 31, 2008, PJM estimates that Power Edge will be liable for an additional \$60 million.¹⁸ However, during this same time period, PJM estimates that it will pay Power Edge's affiliates approximately \$19 to \$34 million on the concurrent flow FTRs they hold. In its filing, PJM proposes to cover a portion of Power Edge's losses by withholding the payments to Power Edge's affiliates. PJM would then make a default assessment on the remaining PJM members to cover any remaining default.

2. Comments and Protests

48. Several parties support PJM's proposal, requesting that the Commission approve PJM's proposal because the provisions are very limited in scope and will prevent some PJM members from shifting the risk of counterflow FTR positions to other non-affiliated PJM members. Several companies note that under the current rules they will be forced to cover Power Edge's default by paying out several million dollars while Power Edge's affiliates receive FTR revenues. Commenters state that PJM's proposal has been vetted through the stakeholder process and that the Commission should honor the decision. American Electric Power Service Corporation (AEP) contends that the proposed rule is prospective only since it applies to payments PJM owes the defaulting affiliate member as of January 19, 2008, the day following PJM's filing. Supporters also contend that this rule is necessary for the FTR market since it is an illiquid forward market.

¹⁸ Unless the Commission accepts PJM's proposal, under PJM's current default allocation rules, other PJM members will be forced to make up the entire approximately \$80 million short fall. Under PJM's proposal and its projections, Power Edge's affiliates will offset about \$40 million of that \$80 million and PJM members will be responsible only for the remainder. Several protesters, however, state that PJM has since reduced the total estimated losses to \$66 – 70 million.

49. The Tower Companies protest PJM's filing, and regarding the Power Edge default state that, in the May 2007 auction, Power Edge purchased a portfolio of both concurrent flow and counterflow FTRs with a collateral requirement of approximately \$6.4 million and that another market participant, Exel, acquired a portfolio, which required collateral of \$14.7 million. However, according to Tower Companies, Exel was unable to post the collateral and thus defaulted. Tower Companies state that it then spoke with PJM about possibly acquiring 20 to 50 percent of Exel's FTR portfolio, but PJM expressed technical concerns about transferring only a portion of Exel's portfolio. Tower Companies contend that PJM encouraged Power Edge to purchase the entire portfolio, knowing that such a purchase would leave Power Edge with a net short position, and permitted Power Edge to post only an additional \$3 million in collateral instead of the required \$14.7 million in collateral. Tower Companies state that PJM also permitted Power Edge to use that \$3 million collateral to bid in future auctions. Accordingly, Tower Companies state that it never gamed or manipulated PJM's credit policy rules to gain an unfair advantage.

50. Tower Companies argue that PJM's proposal is retroactive ratemaking and, thus, violates the filed rate doctrine. Tower Companies state that PJM's proposal retroactively alters the default allocation provisions after companies have acquired the FTRs and posted the associated collateral. Tower Companies assert that the new obligation of affiliate guarantees is a significant change and should only be applied to prospective FTR purchases. Tower Companies assert that they agreed to financial terms for a fixed period of time, and, thus, had the right to expect that the material terms applicable to the acquired FTRs would also be fixed for the term for the FTR absent an express provision otherwise. Tower Companies claim that contrary to PJM's assertions, the proposal is not prospective even though it is seizing future profits, since those future profits were based on pre-existing FTRs and are being seized to offset past losses.

51. Tower Companies assert that PJM's proposal violates the sanctity of contracts and that PJM has not shown that it is in the public interest to alter the contracts. Tower Companies also argues that the default allocation rule imposes alter ego liability without a proper basis. Tower Companies maintain that PJM's proposal does not fall within the zone of reasonableness, is discriminatory against Power Edge affiliates, was accepted prior to a meaningful stakeholder review process, and will undermine the Commission's efforts to promote competitive energy markets. Finally, Tower Companies oppose PJM's requested waiver of the Commission's 60-day prior notice requirement.

52. Numerous other parties protest PJM's filing, asserting that PJM's proposal violates retroactive ratemaking principles since it will apply to previously conducted FTR trades. Exelon argues that PJM's proposal fails to consider, for example, that an affiliate may only have a 10 percent common ownership with the defaulting party or may have no control over or derive no benefit from the positions held by the defaulting affiliate. Several protesters assert that by ignoring corporate structure, PJM's proposal

is contrary to corporate law principles, and could conflict with bankruptcy provisions. Protesters also contend that PJM's proposal is overly-broad.

53. Protesters argue for properly and consistently applied credit and collateral provisions, which would prevent such costly defaults and are less extreme than PJM's proposed default allocation provision. DTE Energy requests that the Commission investigate Power Edge to determine whether it manipulated the market. DTE Energy also suggests that the Commission initiate a rulemaking proceeding that focuses solely on the unique risks faced by market participants in organized markets such as PJM.

3. PJM's Answer

54. In response, PJM states that its proposal does not entail piercing the corporate veil since it is not holding Power Edge's parent responsible for its default and that common law corporate piercing principles do not apply to the Commission's regulatory actions. PJM states that corporate guarantees are commonly approved by the Commission. Furthermore, PJM states that PJM's Operating Agreement currently provides that affiliate companies together may only cast a single vote and that the Commission was not required to satisfy corporate piercing standards before approving that provision. PJM asserts that its proposal does not violate retroactive ratemaking principles since it only applies to future, not past, defaults. PJM asserts that the cost of defaults are current costs to PJM members that did not exist prior to the default.

55. PJM further argues that contrary to Tower Companies' assertion, it is not required to make a public interest showing prior to changing the Operating Agreement. PJM asserts that the Operating Agreement provides that it may be amended with approval by the PJM Members Committee and the Commission upon a showing that the change is just and reasonable. PJM contends that its default allocation proposal is necessary because credit policy changes can not sufficiently remedy all risks of members obtaining net short FTR portfolios. PJM states that its proposal does not unduly discriminate against Tower Companies but applies to all companies that hold net short FTR portfolios. PJM also contends that its proposal will not harm competitive markets and was approved by its Members Committee. PJM disagrees with Tower Companies' description of the Power Edge default and asserts that Power Edge engaged in price manipulation that exacerbated its default.

4. Commission Discussion

56. The Commission will reject the filing in Docket No. ER08-455-000, because we do not find it just and reasonable. PJM states in its filing that it intends to apply the proposal to recover losses previously incurred by the Tower Companies in PJM's markets since May 2007. But the Commission's Office of Enforcement has already

instituted a non-public investigation of the Tower Companies to determine whether remedies are appropriate in the circumstances described by PJM.¹⁹ That investigation, which began in January 2008, is the appropriate context in which to assess whether there has been a violation of the Commission's rules and if so, what remedy should be imposed.

57. Putting aside the circumstances surrounding the activities of the Tower Companies, we find that PJM's filing is too narrow to address the perceived flaw in its credit rules. PJM's filing treats affiliated companies participating in its FTR markets differently from companies without such affiliates. PJM asserts that companies with affiliates have motivations or incentives to create riskier investment strategies than non-affiliates. But the proper focus should be on establishing adequate credit requirements for all participants, regardless of their motivations. PJM has not established that its risks are limited to companies with affiliates. A company without an affiliate trading in PJM's FTR markets can take as risky or more risky positions than a company with such an affiliate, and PJM's proposal would not apply in this case. Indeed, two affiliated companies can each take risky positions that do not offset each other. PJM fails to explain why, if its proposed collateral requirements are sufficient in these situations, it should be entitled to an offset if it happens that an affiliate makes profits rather than incurs losses.

58. Companies have legitimate, non-manipulative reasons to establish affiliates, and we do not find it just and reasonable for PJM as a generic matter to impose a tariff provision that automatically takes the profits of one affiliate to offset against the losses of another separate corporate entity. Such cases must be analyzed on an individual basis, as we are doing with respect to the Tower Companies, rather than simply assuming that all uses of affiliates are suspect.²⁰ For instance, different investors may have different risk tolerances, and affiliated companies may acquire portfolios with differing risk characteristics commensurate with the risk profiles of their respective investors. For PJM automatically to offset earnings from one affiliate to cover the default of another would preclude investors from taking positions that reflect their level of risk tolerance. The appropriate protection in such cases is for PJM to ensure that its credit and other requirements provide sufficient protection depending on the risk profile of the individual company. In that case, investors in each affiliate would be required to

¹⁹ PJM also has recently filed a complaint regarding the activities of the Tower Companies in Docket No. EL08-44-000.

²⁰ As the Commission has found, "the parent company is not liable for the subsidiary's debts absent fraud or fundamental unfairness that warrant piercing the corporate veil." *SFPP, L.P.*, 121 FERC ¶ 61,240, at P 100 (2007). *See Conoco Inc. v. FERC*, 90 F.3d 536, 549 (D.C. Cir. 1996).

provide sufficient credit commensurate with the risk of their investment. PJM's filings in Docket Nos. ER08-376-000 and ER08-520-000 establish such collateral requirements, and we are accepting those filings. If PJM believes that the collateral requirements it has already filed are inadequate to the risks it faces, it should make appropriate additional filings.²¹ We find, however, that it is not just and reasonable to adopt a provision that will address only a subset of the entities likely to face the credit risks presented, and that discriminates against certain companies based on their corporate form.

59. PJM argues that the Commission permits corporate guarantees as a means of providing sufficient collateral, and maintains that its proposal is just another form of corporate guarantee. The Commission has in the past allowed pipelines and utilities to offer companies the *option* of using corporate guarantees in lieu of or to reduce collateral requirements. PJM can certainly propose to allow companies to use corporate guarantees in this way as well. But the use of a corporate guarantee is an option, rather than a mandatory requirement as in PJM's proposal. Moreover, a corporate guarantee is not a substitute for PJM establishing appropriate collateral requirements for companies that choose not to use the corporate guarantee.

D. Docket No. ER08-520-000

1. PJM's proposal

60. In its filing in Docket No. ER08-520-000, PJM proposes further revisions to its Credit Policy to protect its members from defaults related to counterflow positions. PJM asserts that speculative positions require additional credit safeguards even where historical experience suggests that such positions likely would be profitable. This is because when participants adopt lop-sided positions on counterflows, they assume, regardless of past experience, an uncertain return that is not clearly bounded up or down. PJM's concern is not the likelihood of losses, but rather the unbounded aspect of losses, should they occur. Therefore, PJM proposes to apply a substantial increase to the credit requirement associated with such undiversified portfolios. In addition, PJM explains that outages of transmission lines can cause usage patterns to significantly deviate from prior experience, which may lead to enhanced geographical risks to counterflow positions heavily reliant on the availability of key assets that warrant a further increase in the credit requirement.

²¹ PJM is under no obligation to offer risky counterflow positions in its auction and also is not obligated to act as a guarantor in these situations. PJM could, for example, facilitate bilateral transactions where counterflows are involved so that the parties themselves can arrange for sufficient collateral to justify the risks they are taking.

61. PJM proposes to address risks of undiversified portfolios of counterflow FTRs by raising the credit requirement for such portfolios in the course of clearing FTR auctions. PJM maintains that the new requirements will not affect the credit requirement for prevailing flow FTRs or for portfolios of holdings that include counterflow FTRs that are sufficiently diversified. According to PJM, speculative positions on counterflows do not need to be discouraged because participants engaging in this activity constitute a useful component of the market. However, PJM is attempting to set a credit requirement that is appropriate for the risks associated with those speculative positions.

62. PJM proposes to include Section V.G in Attachment Q to subject tentative FTR Portfolio Auction Values (the sum, on a monthly basis across all FTRs, of the FTR prices times the FTR volume (MW)) to two tests. PJM will determine if portfolios are: (i) "FTR Flow Undiversified," meaning net counterflow, and if so, (ii) whether they are "FTR Geographically Undiversified," meaning unduly threatened by the expected or unexpected unavailability of a transmission asset that has been historically available. If the portfolio fails the first test, an additional incremental amount of credit equal to two times the absolute value of the net FTR Portfolio Auction Value shall be required. In addition, if the portfolio is FTR Geographically Undiversified, then a factor of three rather than two applies.

63. PJM will apply the tests as they clear FTR auctions (or auction rounds) on the basis of the bids received, possibly through several iterations. PJM states that if after running a tentative solution to an FTR auction, it determines that a participant must establish additional credit, the participant must do so by 4 p.m. the following day or PJM will remove the bids from the auction and run another solution. However, the deadline does not apply to additional iterations because PJM expects to identify the most serious problems initially and the process cannot continue indeterminately.

2. Comments and Protests

64. Exelon and Duke support PJM's proposal as a step in addressing serious default issues that have recently occurred in PJM's FTR market. Exelon asserts that the proposal will impose collateral requirements on market participants commensurate with the risk presented by their participation in the market, and better protect other market participants from the cost of defaults resulting from undiversified portfolios. Duke believes that PJM's proposal will minimize the default exposure that is created when market participants hold undiversified FTR positions and that the increased credit requirements are just and reasonable because the increase is proportional to the size of the undiversified portfolio. Duke states that the proposed revisions received overwhelming stakeholder support. However, Duke encourages PJM to fully review its credit policies to ensure that its recent credit filings do not have any unintended detrimental consequences.

65. AEP and Constellation Energy Commodities Group, Inc. and Constellation New Energy (collectively CEG Companies) also support PJM's proposal. AEP contends that PJM's proposal would help protect innocent PJM members from the socialization of defaults on risky, undiversified portfolios of counterflow FTRs. AEP contends that the multiplication factors PJM proposes to apply to the credit obligation of participants with such portfolios are supported by PJM's empirical analysis of the 2007-2008 annual FTR auction results. CEG Companies state that, in light of recent defaults due to undiversified portfolios of counterflow FTRs, the proposed tariff revisions are necessary, timely and a positive step to protect PJM members from bearing unwarranted default risk. The CEG Companies encourage PJM to review all facets of its Credit Policy to assure proper assessment of credit risks and PJM member protections.

66. PPL Parties support PJM's proposed revisions to its Credit Policy. PPL Parties state that the filing appropriately seeks to reflect both the net size of positions held by a market participant and the geographic risk associated with such positions. PPL Parties assert that it is inappropriate to permit market participants to engage in trading activity if the market participant does not have the ability to handle financial settlement when payment becomes due. PPL Parties state that the changes are critical to ensure that participants in PJM's FTR market have posted adequate credit should their positions be unprofitable at the time payments on the positions are due. PPL Parties state that the changes will decrease the extent of defaults in the FTR market and decrease the reliance on other market participants to pay for losses associated with unprofitable positions. PPL Parties urge the Commission to require PJM to conduct a full-scale review of its credit, settlement and related collection policies, and to compare its policies to the best practices of other Independent System Operators. PPL Parties state the Commission should direct PJM to make a compliance filing within four months regarding its review, either proposing additional tariff changes or explaining why no additional changes are required.

67. PSEG Companies request that the Commission accept PJM's proposal. PSEG Companies contend that the filing addresses the actual risks presented by transactions in the FTR counterflow markets and seeks to impose meaningful collateral requirements reflecting that degree of risk. However, PSEG Companies also request that the Commission direct PJM to make an additional filing by April 30, 2008 to implement certain credit enhancements, since this proposal is limited. The enhancements include: (1) a rigorous, up-front credit evaluation; (2) the establishment of corporate trading limits; (3) restrictions on the use of collateral; (4) a better definition of the circumstances triggering a member default; and (5) enhanced capabilities to measure and monitor member credit exposure in real-time. PSEG Companies are concerned that reliance on a stakeholder group is inadequate to address PJM's credit issues. Therefore, PSEG Companies request that the Commission convene a technical conference no later than April 30, 2008 to address credit issues in all of PJM's markets.

68. Members of the Financial Institutions Energy Group (FIEG) support the steps PJM takes in its proposal to protect its members from defaults. However, FIEG urges PJM to take additional steps because the current rules and practices do not adequately protect PJM members from the risk of default by other members. FIEG recommends that PJM (1) ensure that each proposed member satisfies minimum credit standards; (2) improve the methodology for collecting margin in relation to FTRs, including both initial and variation margin; (3) adopt rules and a practice, subject to system requirements, of terminating and liquidating member positions promptly after a default has occurred and not been rectified within the applicable cure period; (4) procure insurance or some other form of third party protection to absorb member default losses; and (5) have annual audits of the application of revised credit policies by PJM's independent auditors. Bear Energy LP, BE Allegheny LLC, BE Ironwood LLC and BE Red Oak LLC (collectively Bear Subsidiaries) also urge PJM to take the additional steps recommended by FIEG. Bear Subsidiaries request that the Commission convene a technical conference to discuss the recommendations and any related issues.

69. Financial Marketers support PJM's efforts to revise its credit policies to require undiversified participants to post more collateral for cleared FTR bids. However, Financial Marketers argue that PJM's current proposal does not produce results that ensure a market participant's collateral requirements are proportionate to risk. Therefore, Financial Marketers urge the Commission to reject the filing.

70. Financial Marketers argue that PJM's reliance on the overall cleared value of the FTR portfolio does not accurately reflect flow diversification and produces unreasonable results. Financial Marketers state that the cleared value of an FTR portfolio has little relation to the relative risk that a participant has assumed and cannot reliably be used as the basis for imposing additional collateral requirements. Financial Marketers assert that even an FTR portfolio consisting of both concurrent flow and counterflow positions with a net positive price can pose a significant threat of default if the counterflow position becomes highly negative. Financial Marketers contend that PJM's proposal incorrectly assumes that a prevailing FTR can never lose money or become a counterflow FTR over the course of a year, since congestion on a transmission path can change between the time of an FTR auction and when the FTR is settled due to atypical weather, unplanned transmission or generation outages or other causes. Financial Marketers believe PJM should develop path-specific credit requirements based on the economic risk in a FTR holding.

71. Financial Marketers assert that the geographic diversity test proposed by PJM is overly vague, does not adequately protect the market, and would impose substantial new collateral requirements without a rational basis. Financial Marketers explain that the geographic diversity test also ignores market participants whose total net portfolios clear at a positive price although there is still a risk of a loss. Financial Marketers state that the test does not provide participants with a transparent method of determining or even

verifying their FTR credit requirements so they cannot estimate their collateral requirements prior to participating in the auction. Financial Marketers object that PJM does not even list the criteria it will use in simulation models, nor how it will determine which network changes “substantially” affect the network. According to Financial Marketers, PJM gives no indication of how soon it will post the required credit information prior to an auction.

72. According to Financial Marketers, PJM’s proposal requires, without rationale, market participants to post collateral far in excess of what is necessary to prevent a participant from defaulting and thus creates an unwarranted barrier to market entry, particularly for smaller participants, and could seriously decrease market liquidity by reducing the pool of FTR market participants. Financial Marketers state that the amount of collateral market participants must post is subject to large and unexpected changes if their portfolios are determined to be flow or geographically undiversified after the auction clears and market participants are given only a short period to obtain and post additional collateral after the auction closes. Financial Marketers contend that this is harmful to the market if a market participant does not satisfy the new credit obligation and the participant must forfeit its bid. After the participant’s bid is removed, PJM must re-run the auction which may substantially affect the cleared positions of other market participants and possibly cause a cascading effect on more market participants. Thus, Financial Marketers claim that PJM’s proposal creates harmful and unintended consequences that interfere with a well functioning market.

73. Financial Marketers argue that PJM’s proposal fails to adequately address the effect of its new policies on seasonal and monthly FTR markets. Financial Marketers assert that the Commission must consider the impacts of the PJM proposal on each of the FTR markets when developing new credit requirements, not just analyze the proposal’s effect on the annual FTR market. Financial Marketers urge the Commission to reject the proposed tariff revisions and also require PJM to conduct and report an impact analysis for both seasonal and monthly FTR markets to ensure that any proposed credit changes do not unduly impair trading in these markets.

74. DC Energy filed a protest stating that it agrees with the basic premise that PJM’s current Credit Policy applicable to FTRs is generally inadequate with respect to handling volatile positions, such as those associated with counterflow positions, but PJM’s proposed revisions are not just and reasonable and do not provide an adequate solution. DC Energy argues the proposed amendments are focused too narrowly on counterflow FTRs. DC Energy explains that PJM’s proposal deems an FTR portfolio to be FTR Flow Undiversified if the net auction investment is negative and therefore fails to address an underlying issue, that the value and risk of an FTR is based on the specific conditions on the transmission system during the duration of the specific FTR owned. DC Energy elaborates that by narrowly focusing on paths with a negative clearing price only, without regard to the inherent riskiness of the path, the proposal does not

recognize and address the fact that the same problems associated with counterflow FTR positions also exist with prevailing flow FTR positions, which by their nature are equally volatile. According to DC Energy, there are many potential scenarios in which a non-counterflow path could become a counterflow path due to unforeseen system condition changes that act to reverse the local direction of power flow. DC Energy believes that PJM's Credit Policy should be amended to address more fundamentally the risks associated with both prevailing flow and counterflow FTR positions.

75. DC Energy objects to FTR portfolios with net positive auction investment not being subjected to the geographically undiversified test. DC Energy argues that the use of a power flow model and an arbitrary set of outages is fundamentally flawed and is an inadequate and ill-supported basis to forecast risk. DC Energy states that such fundamentals of market collateral requirements should be specified in advance and filed with the Commission after appropriate vetting. DC Energy asserts that this provides PJM with unwarranted discretion and fails to address the risks related to nominally positive clearing FTRs, which are subject to large or significant counterflow risks based on system conditions.

76. DC Energy asserts that the multiplication factors for undiversified portfolios are arbitrary and unjustified. DC Energy argues that the values are not based on any analysis and only appear to be part of an attempt by PJM to secure additional collateral and the values will result in over-collateralizing part of the market. DC Energy explains that clearing the auction subsequent to removing an under-collateralized market participant can create new requirements for other market participants, leading to a potential cascade of auction clearing scenarios, which may lead to a decrease in competition and liquidity. In addition, DC Energy states that this procedure provides option value to the under-collateralized market participant since they can decide whether or not to proceed when additional collateral is required, but better collateralized market participants do not get this option or second chance.

77. DC Energy favors establishing appropriate collateral levels for all FTR portfolios based on a forward market view of the specific FTR paths in an FTR portfolio and applying the concept of discounting collateral requirements for diversified or offsetting positions. DC Energy recommends a robust, path-level collateral policy with a process for reducing collateral for well-diversified portfolios. DC Energy also makes other recommendations, which include: (1) addressing the illiquidity and lack of price discovery inherent in these securities by conducting more frequent auctions; (2) adopting a formal "initial margin" methodology related to the maximum change in market value that the FTRs can experience in between auctions; (3) conducting a "variance margin" methodology related to the change in the mark-to-market value of a held portfolio; (4) developing a portfolio risk methodology to account for obvious correlation effects of FTR paths; (5) granting more robust default authority to the ISO/RTO wherein they are authorized to manage and dispose of a defaulting portfolio in

the most expedited and efficient manner to maintain the integrity of the markets; (6) requiring that all participants provide a form of liquid collateral such as cash, letter of credit, or comparable security; and (7) adopting a provision that participants should meet similar requirements as those of an “Eligible Commercial Entity” as defined in § 1a of the Commodity Exchange Act. DC Energy encourages the Commission to convene a technical conference and to order PJM to amend its Credit Policy to conform to widely accepted methods and processes to more effectively manage the risk inherent in the PJM FTR market.

3. Commission Discussion

78. We accept PJM’s proposed tariff revisions in Docket No. ER08-520-000, to become effective April 1, 2008, as described below. As commenters requested in the proceeding in Docket No. ER08-376-000, PJM has given further consideration to credit in its FTR markets and the resultant instant filing provides added protection to PJM’s members by increasing collateral requirements for undiversified FTR portfolio participants, thereby reducing the risk of their default. The filing received overwhelming support from stakeholders, an indication of their desire for additional measures to protect members from exposure to defaults. PJM’s proposal only affects participants with net counterflow positions, and therefore will not affect the credit requirements of LSEs that hedge purchases to serve load. The proposal properly assesses higher collateral requirements against those that present additional risks. The proposal also should not prevent a robust FTR market, but it will help ensure that only participants who can financially handle the results of settlement will participate in trading.

79. The Commission also believes that this proposal, as well as PJM’s proposal in Docket No. ER08-376-000, has been adequately supported so as to not require a technical conference in order for the Commission to make a reasoned determination on the merits. While we will accept PJM’s instant proposal as a reasonable way to address the additional risks of undiversified portfolios, we expect PJM to continue to work on ways to further improve the assessment of risks that all FTR participants present and to provide appropriate credit requirements to protect against such risks. In its answer, PJM explains that it constituted a Credit Risk Management Steering Committee, open to all stakeholders, to consider all suggestions regarding credit that PJM’s stakeholders may wish to consider. Thus, PJM and its members should continue to use the stakeholder process to develop appropriate ways to protect its members from such risks. In this regard, and as stated earlier, we will require PJM to provide informational reports to the Commission reporting on its progress.

80. Contrary to the assertions by Financial Marketers and DC Energy that PJM’s proposal is too narrow, we find that PJM’s proposal is a reasonable measure to protect market participants from the risk of undiversified portfolios. PJM’s proposal focuses on

net counterflow portfolios because in PJM's view, as well as that of the overwhelming majority of affected market participants, such portfolios present the most risk to PJM's members, i.e., that of the unbounded aspect of losses that could result from counterflow FTR positions. Net counterflow FTR portfolios are more risky than a balanced portfolio because they are exposed to the volatility of changing congestion and the obligation is unknown and potentially unbounded; conversely, with concurrent flow FTRs, the obligation is known and fixed. For this reason, it is sensible to only apply the geographically undiversified test to FTR Flow Undiversified portfolios. Further, PJM's proposed use of a power flow model incorporating planned transmission outages in determining geographical diversification is also a reasonable way of assessing the potential changes that would affect the network and cause greater congestion and higher payment obligations for counterflow FTR holders. Additionally, PJM has committed to posting the planned outage information prior to the auctions, which should allow FTR participants to make advance preparations to deal with a possible increase to their FTR credit requirements based on their expected level of cleared trading activity. The need to adjust collateral positions is no different from requirements in other trading markets in which collateral requirements are adjusted depending on an assessment of value of the positions held.

81. The Commission agrees with PJM that its proposal should not create barriers for participants to enter the FTR market, as Financial Marketers claim. PJM's proposal establishes appropriate and reasonable collateral requirements, based on an assessment of risk that will enable all participants to trade so long as they have sufficient collateral to financially handle the consequent settlements without passing the costs of defaults onto all PJM members. While Financial Marketers argue that PJM's proposal is counterintuitive, it has not explained why participants receiving higher payments from PJM present a lower risk of default. It would appear that proportionately higher collateral requirements reflect the proportionately higher risk to the market that such counterflow positions present. Contrary to protestors' claim, re-runs of the auction should not harm the market, but instead should help because they will remove those participants that are unable to financially support their positions before settlement. PJM's proposal is not intended to discourage counterflow positions, but instead to act as a safeguard that allows financially qualified participants to make available more valuable flow for other participants. In addition, PJM's proposal is not only applicable to the annual FTR auctions as the tests are equally applicable to seasonal and monthly participants. Considering these factors, however, the Commission is interested in the effects of potential re-runs of the auction on the market. Therefore, to the extent that PJM is required to remove bids from the auction and run another solution, we direct PJM to include an analysis and discussion of such instances in the quarterly status reports required above.

82. DC Energy is incorrect that PJM's multiplication factors are unjustified and arbitrary. As both PJM and AEP explain, PJM's resultant multiplication factors are

based on the 2007/2008 annual FTR auction. The factor of two times the absolute value of the net FTR Portfolio Auction Value for undiversified portfolios was derived by analyzing the empirical results of the revenue performance of net counterflow portfolios that were obtained in the 2007/2008 annual FTR auction. The factor of three times the absolute value of the net FTR Portfolio Auction Value for Geographically Undiversified portfolios was derived by utilizing power flow analyses, which indicated that an average negative revenue impact related to potential transmission outage events on such undiversified portfolios was approximately three times the net FTR Portfolio Auction Value. Therefore, the Commission finds that PJM has adequately supported its use of its proposed factors.

83. Although DC Energy asserts that PJM's proposal will over-collateralize the market, it has not supported its assertion. Further, PJM explains that its bid collateral requirements are typically larger than cleared, so there will almost always be some available credit already in place by the time the undiversified calculation is made, so any collateral call will almost always be less than the full amount of the incremental adjustment.

The Commission orders:

(A) The tariff sheets submitted in Docket No. ER08-376-000 as listed in the Appendix A of this order are accepted, effective April 1, 2008, subject to conditions, and to PJM making a compliance filing within 30 days of the date of this order, as discussed in the body of this order.

(B) The tariff sheets submitted in Docket No. ER08-455-000 as listed in the Appendix A of this order are rejected, as discussed in the body of this order.

(C) The tariff sheets submitted in Docket No. ER08-520-000 as listed in the Appendix A of the order are accepted, effective April 1, 2008, and the requests for a technical conference are denied as discussed in the body of this order.

(D) Every 90 days, for a period of two years, beginning on May 1, 2008, PJM shall file a status report on its progress in further Credit Policy revisions, as discussed in the body of this order.

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

(S E A L)

Kimberly D. Bose,
Secretary.

Appendix A

PJM Interconnection, L.L.C.
FERC Electric Tariff
Sixth Revised Volume No. 1

Tariff Sheets Accepted Effective April 1, 2008

Second Revised Sheet No. 523I.05a
Third Revised Sheet No. 523I.05b
Original Sheet No. 523I.05c
Fifth Revised Sheet No. 523L.01

Tariff Sheets Conditionally Accepted Effective April 1, 2008

Fourth Revised Sheet No. 523G
Second Revised Sheet No. 523I.05
First Revised Sheet No. 523I.05a
Second Revised Sheet No. 523I.05b
Third Revised Sheet No. 523J
First Revised Sheet No. 523J.01
Sixth Revised Sheet No. 523K
First Revised Sheet No. 523K.01
Fourth Revised Sheet No. 523L
Fourth Revised Sheet No. 523L.01
Fourth Revised Sheet No. 523M

PJM Interconnection, L.L.C.
Third Revised Rate Schedule FERC No. 24

Tariff Sheets Rejected

Fourth Revised Sheet No. 50
Original Sheet No. 50A
Third Revised Sheet No. 51

Appendix B

In Docket No. ER08-376-000 comments or protests were filed by:

Public Service Electric and Gas Company (PSE&G) and
PSEG Energy Resources & Trade LLC (PSEG ER&T) (collectively PSEG Companies)
Exelon Corporation (Exelon)
PPL Parties
DC Energy, LLC, and DC Energy Mid-Atlantic LLC (collectively DC Energy)
Certain PJM Stakeholders: Virginia Electric and Power Company, American Electric
Power Service Corporation, Pepco Holdings, Inc., Old Dominion Electric
Cooperative, Baltimore Gas and Electric, Constellation Energy Commodities Group,
Inc., and Constellation NewEnergy, Inc. (collectively Joint Intervenors)
EPIC Merchant Energy, LP (EPIC) and SESCO Enterprises, LLC (collectively Financial
Marketers)
Citadel Energy Products LLC, Citadel Energy Strategies, LLC, and Citadel Energy
Investments Ltd (collectively Citadel)
Duke Energy Corporation (Duke)
Morgan Stanley Capital Group Inc. (MSCG)

In Docket No. ER08-455-000 comments or protests were filed by:

Accord Energy LLC, BJ Energy LLC, Franklin Power LLC, Ocean Power LLC,
Tower Research Capital LLC, and Tower Research Capital investments LLC
(collectively Tower Companies)
Citadel
DTE Energy Trading, Inc.
Exelon, PPL Parties, PSEG Companies and Consolidated Edison Companies (jointly)
Dynegy Power Marketing, Inc.
Dominion Resources Services, Inc.
American Electric Power Service Corporation and Dayton Light and Power (jointly)
Allegheny Energy Companies
Designated FirstEnergy Companies
PJM Industrial Customer Coalition
Constellation New Energy, Inc. and Constellation Energy Commodities Group (jointly)
Managed Funds Association
Tenaska Power Services Company, Tenaska Fund Parties, Mirant Parties, Calpine
Corporation and LS Power Associates, LP (jointly)

In Docket No. ER08-520-000 comments or protests were filed by:

Financial Marketers
DC Energy
PSEC Companies
Exelon
Duke

American Electric Power Service Corporation

Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc.

PPL Parties

Bear Energy LP, BE Allegheny LLC, BE Ironwood LLC, BE Red Oak LLC (collectively
Bear Subsidiaries)

Financial Institutions Energy Group (FIEG)

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

PJM Interconnection, L.L.C.

Docket Nos. ER08-376-000
ER08-455-000
ER08-520-000
(Not Consolidated)

(Issued March 25, 2008)

MOELLER, Commissioner dissenting, in part:

In Docket No. ER08-455-00, the Commission rejects PJM's proposal to amend the default allocation provisions in its Operating Agreement. I disagree with this decision.

PJM's proposal was narrowly tailored to address the very real situation of having a market participant use the existing default allocation rules to shift the risk of short FTR trades to other PJM market participants. Specifically, the proposal would have applied: (1) only in cases of actual defaults from net short portfolios of FTRs; (2) only to parties that have chose to separate their FTR trades among multiple entities; and (3) only to the extent of security posted and revenues owed to affiliates of the defaulting market participant. Notwithstanding the action that the Commission is taking today to strengthen PJM's credit policies in the two related dockets, I believe that revising the rules on the allocation of the costs of defaults would have provided a targeted solution to the specific problem where a market participant defaults after experiencing a substantial amount of unexpected congestion.

Additionally, PJM's tariff proposal would have prospectively allowed the grid operator to collect millions of dollars from a current defaulting market participant -- costs that will now largely, if not exclusively, be borne by all PJM members.

For these reasons, I respectfully dissent from the majority in Docket No. ER08-455-000.

Philip D. Moeller
Commissioner