

May 14, 2010

*Via Electronic Delivery*

PJM Board of Managers  
PJM Interconnection  
c/o Mr. Terry Boston  
955 Jefferson Avenue  
Norristown, PA 19403-2497

**RE: MLUG Proposed Marginal Losses Modeling Change**

Dear Board of Managers:

The undersigned PJM Members, representing multiple sectors and diverse business interests, contest the effective date of the recent request from the Marginal Loss User Group (MLUG) to modify the manner in which marginal losses are calculated. While the proposals submitted by the MLUG further reasonable public policy aims, they are not necessary for continued reliability or market operations. As a result, they need not be instituted immediately (or even at all). In examining the request, the Board should balance the equity of the benefits of the proposed change against the coincident market disruption it will cause. As further described below, the undersigned Members present a proposed solution that fairly balances the interests of all members over the short- and long-run. **In sum, we suggest that the Board direct PJM to implement the proposed marginal loss modeling changes effective June 1, 2012.**

**Background**

The Marginal Loss User Group (MLUG) requests two modifications to the manner in which PJM calculates the loss component of LMP: 1) change the model for calculating marginal losses from the State Estimator model (i.e., all State Estimator nodes, including those as low as 13kV) to the model PJM currently employs to monitor transmission facilities for markets and reliability (a smaller set of nodes with, generally, higher voltage ratings); and 2) move loss modeling at generation nodes to high side of the generator step up (GSU) transformer metering points. The MLUG requests that the Board direct PJM Management to implement the changes effective June 1, 2011.

The MLUG was chartered to examine a loss hedging mechanism, but was specifically barred from examining or proposing alterations to the allocation of the substantial surplus funds generated by marginal loss calculation. In the summer of 2009, the MLUG presented data to the Members purporting to evidence that changes to the State Estimator model were coincident with large increases in the surplus funds. The MLUG hypothesized that model changes at lower voltages exacerbated the loss surplus without congruent enhancement to dispatch efficiency. As a result, the MLUG proposed a new loss model arbitrarily truncating marginal loss calculation at 100 kV (and thereby pushing lower voltage level losses into the distribution losses assessment). Both the MLUG and PJM staff assisting the MLUG conceded at the time that they could not show a statistical correlation between the modeling results and the hypothesis. As a result, stakeholders challenged the hypothesis, requesting further information

and modeling. Such information and modeling results were presented to Members at the February 2010 Market Implementation Committee. Consequently, PJM staff suggested the means of modeling marginal losses that are presently before the Board. Members have acknowledged the primary benefits of the proposed model changes; namely a reduction in the loss surplus accompanied by very similar dispatch efficiency.

### **Description of Market Disruption Caused By Modeling Changes**

Imminent implementation of the proposed modeling changes will result in substantial disruption to the existing contracts between loads and load servers. The proposed modeling change will result in an approximately 20% reduction in the surplus generated by calculating losses on the margin. The surplus, which by Member agreement is returned to load, is a material component in the contracts between counterparties to both wholesale and retail supply contracts. Premature changes to the loss model will cause billions of dollars of unknown and unknowable risk at the time of contracting to be shifted to wholesale load servers and retail loads since term contracts were executed prior to any actual or constructive notice of any viable changes to the loss pricing model. Furthermore, retail load serving entities face the unenviable task of explaining to tens of thousands of retail customers why the negotiated expectations of their contracts have changed due to the change in the loss pricing model. Litigation over the contractual assignment of risk due to the proposed model change is likely.

Since the modeling changes are not necessary for reliability or market operations, the impact on such forward reliance should be respected to an extent that is reasonable and equitable. The repercussions of the implementation are as critical as the merits of the underlying proposal.

### **Magnitude of the Market Disruption Caused By Modeling Changes**

To put the matter in perspective, consider load service in New Jersey; a retail choice state with a default service auction that, in total, averages about 11% of total annual PJM consumption (approximately 75 million Mwh/year). Nearly the entire load is served, directly or indirectly, through a competitive supplier. Load that purchases from a competitive retail supplier is party to a bilateral contract that includes price terms considering the value of the marginal loss surplus allocation. Similarly, load that takes default service through a distribution company enjoys a competitive auction rate offered by a winning auction participant, also in consideration of the marginal loss surplus allocation.

BGS wholesale loads auctions run on a three year forward cycle, with each year fulfilling one-third of the total supply for the auction year and each of the two years hence. Recognizing that the historical loss surplus average equals approximately \$1.40/Mwh and that PJM has projected an approximately 20% reduction in the surplus allocation (approximately \$0.25/Mwh), the annual impact to New Jersey load, alone, is approximately \$15 million. Wholesale BGS suppliers are now supplying service from auction tranches awarded in 2008. Similarly, through June 1, 2012, at least a portion of the load will be served from auction tranches awarded prior to any senior committee votes on changing the marginal loss model. It cannot be fairly asserted that wholesale suppliers in the New Jersey BGS auctions (or the Maryland default service procurement, which runs on a similar cycle) had constructive notice of any

event that would lead such suppliers to reasonably anticipate the remote risk of elective changes to manner of marginal loss modeling.

Similarly, retail suppliers and their customers will be harmed by the proposed change. Any negotiated forward contracts will require the risk of the modeling change to be either absorbed by the supplier or passed through to the buyer. Although volumes of retail load under contract is typically not published due to its competitive nature, retail suppliers can attest that a large portion of those contracts will still be effective in the 2011-12 planning year, and a large portion will expire for the 2012-13 planning year. For the bulk of the contracts which have not specifically contemplated the risk of PJM marginal loss modeling changes, thousands of suppliers and buyers will be in the uncomfortable position of reexamining and potentially litigating their contracts to assign the new risk.

### **Recommendation**

Implementation of the proposed changes on June 1, 2011 is not in the best interest of the wholesale or retail marketplace due to the marketplace disruption that would ensue from such action. The proposed change meets a policy aim; it is not necessary to maintain reliability or market operations. There is nothing "incorrect" about the current loss pricing model that calls for haste in replacing it (In fact, a small stakeholder minority calls for extremely granular congestion and loss modeling, exacerbating the multi-billion dollar surplus). More appropriately, the Board is presented with a request to change to a new loss pricing model that results in a desirable reduction in the loss surplus while maintaining reasonable system dispatch efficiency. The benefits of this request must be weighed against the lack of notice and the substantial disruption to forward load contracts.

For those primary reasons the undersigned Members suggest that any market rule changes should only be implemented after a reasonable transition period; namely effective June 1, 2012. Implementation of the modeling change in 2012 permits the natural expiration of a bulk of the forward contracts negotiated prior to reasonable notice of a viable change to the loss modeling paradigm. However, this implementation date does not forestall the long term benefits expected from the proposed change.

Thank you for your time and consideration of this matter.

Regards,

/s/ Jason Barker  
Vice President, Energy Policy-PJM  
Constellation NewEnergy  
Constellation Energy Commodities Group

/s/ Ronald T. Carrier  
Director, Government and Regulatory Affairs  
Direct Energy Services

/s/ Gary A. Jack  
Assistant General Counsel  
Duquesne Light Company

/s/ J Kenneth MacMahon  
Senior Director Supply, PJM Region  
GDF Suez Energy Resources NA, Inc.

/s/ Dennis Sobieski  
Director ISO Services  
Hess Corporation

/s/ Melissa L. Lauderdale  
Director of Government & Regulatory Affairs  
Integrus Energy Services, Inc.

/s/ David Applebaum  
Director, Regulatory Affairs  
NextEra Energy Resources, LLC