

May 14, 2010

PJM Board of Managers
PJM Interconnection
955 Jefferson Avenue
Valley Forge Corporate Center
Norristown, PA 19403-2497

Marginal Loss User Group (MLUG) Request

Dear Board of Managers:

At the outset, the undersigned companies voice strong support for the PJM User Group process. Through a User Group, PJM members have a means to bring the views of a minority to a direct appeal to the PJM Board of Managers. At the same time, it is important to ensure that the views of the *majority* are well represented, and as such we write to you to explain our strong opposition to this proposal. We suggest the Board should not be unduly swayed by the supportive position taken by PJM staff in this regard. As shown below, the support by PJM staff appears to be contrary to market efficiency.

We request that the Board take no action on the MLUG request and to provide important clarity to statements made by PJM and the MLUG in their request to the board. At its face, the proposal acts to roll back the precision of the marginal loss calculation in the lower voltage areas of the network, generally to the benefit of a subset of generation owners at the expense of consumers.

Market participants have repeatedly vetted and voted against this proposal in a number of forums over the past several years, including the PJM Market Implementation Committee, Markets and Reliability Committee and the Members Committee (MC). The vote at the MC clearly demonstrates to the Board that this proposal lacks broad support (i.e., the MLUG proposal received only 42% in favor for a delayed 2012 implementation and 30% for a 2011 implementation). What is also compelling is the fact that a few of the companies who stand to benefit among the generation owners also voted against the proposal. The undersigned companies request the Board simply reject the request as PJM members have already discussed this proposal multiple times. This issue should not be brought back to the stakeholders as it would be an inefficient use of valuable PJM staff and member company resources.

As we stated above we would like to correct and clarify certain statements made in the MLUG request.

MLUG statement: "The system model used by PJM to calculate the marginal loss component of LMP is not the same one as PJM uses to calculate the congestion component of LMP."¹

Response: This is simply not the case. Both the loss and congestion calculations use the

¹ MLUG April 23, 2010 letter page 2.

entire network topology. The point of confusion here is that only certain lines in the system (Reliability and Markets) can become constraints and appear in the congestion component of LMP; however, when any of these lines is constrained, ALL lines in the system are affected in relation to the flow of the line with respect to the congested line; congestion is collected across all nodes in PJM. Those lines that never become congested do not have to be monitored, since the marginal cost of an uncongested line is zero. The same is not the case for marginal loss. All lines contribute to marginal losses. This issue has been brought forward repeatedly. The MLUG entities have repeatedly ignored this logic and continue to rely on this misleading statement as a justification for their request.

MLUG Statement: "Better meet the objective of ML dispatch of balancing the competing goals of decreasing physical system energy losses and decreasing the delivered price of energy."²

Response: This is misleading as the MLUG's proposal increases the delivered price of energy to load by hundreds of millions of dollars per year. Additionally the Board should be aware that FERC's initial ruling on the Marginal Loss issue clearly points to the overall efficiency objective: the magnitude of the loss over collection is moot as "market participants in the aggregate would benefit from the marginal loss method"³; the principal concern is efficient dispatch which is most efficient under the status quo. The undersigned believe that if any changes are to be made it should be towards greater precision; PJM should move to model more, not less, of the network to achieve greater efficiency benefits and ensure reliability.

MLUG Statement: "PJM also pointed out that any purported efficiency decrease was not significant and was outside PJM's ability to control flows in the physical system that it manages to that level of granularity."⁴

Response: 1) Unfortunately PJM staff has formed a strong opinion on the efficiency of this proposal, which has at its root a contradictory premise; on the one hand the proposal is very important to the User Group and is calculated to raise revenues by many hundreds of millions; on the other hand, PJM states its total effect on load is "de minimis." It can't be both. 2) PJM can't control flows. It can only control price and dispatch. Since the proposed loss calculation will impair the latter, the argument made by PJM seems at odds with reality. PJM will have better capability to promote more efficient flows when modeling the loss. 3) Further, the negative impact of the MLUG proposal would stretch beyond whatever degree of inefficiency it introduces today -- as it would result in incorrect / inefficient long-term investment signals for generators. If a generator were locating in a non-monitored area of the network, there would be little incentive for it to site at the end of a line with no losses vs. at the end of a line with huge losses as this decision would have no financial impact on it. This would tend to progressively worsen dispatch efficiency over time.

² MLUG April 23, 2010 letter page 3, recommendation.

³ Atlantic City Electric Company, et. al. v. PJM Interconnection, LLC. FERC Order on Complaint Requiring Compliance with Existing Tariff Provisions and Related Filings, May 1, 2006. Docket No. EL06-55-000. Page 11.

⁴ MLUG April 23, 2010 letter page 4.

Lastly if PJM believes that a change such as this proposal is necessary for "reliability reasons" (e.g., concerns that entities may choose to remove facilities from PJM management) this rationale is not something that has yet been shared or vetted with stakeholders in any form. Such an argument, if it has merit, raises further issues and logically deserves more complete public disclosure and discussion. We therefore urge the Board to reject this "last minute" rationale.

We thank PJM and the Board for the opportunity to provide this input and look forward to our continued mutual focus on ensuring reliability and enhancing the efficiency of PJM's markets.

Sincerely,

The Borough of Lavallette, NJ;
The Borough of Park Ridge, NJ;
The Borough of Seaside Heights, NJ
The Borough of South River, NJ
DC Energy
Long Island Power Authority
New York Power Authority
NYSEG/RG&E
Saracen
South Jersey Energy Company