

**BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

In Re: Credit and Capital Issues)
Affecting the Electric Power) **Docket No. AD09-2-000**
Industry)

**POST-TECHNICAL CONFERENCE COMMENTS
OF PJM INTERCONNECTION, L.L.C.**

PJM Interconnection, L.L.C. (“PJM”) appreciates the opportunity to provide comments to the Federal Energy Regulatory Commission (“Commission”) in response to its January 13, 2009, Technical Conference (“Technical Conference”) held in the matter of *In Re: Credit and Capital Issues Affecting the Electric Power Industry*.

I. COMMUNICATION

All pleadings, correspondence, and other communications related to this proceeding should be addressed to the following persons:

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II. BACKGROUND

On January 13, 2009, the Commission convened a Technical Conference to examine issues affecting the electric power industry that result from the current situation in the financial markets. Specifically, both short-term credit issues, such as a company's access to capital for normal business operations, including collateralizing exposures arising from its business in organized electricity markets, as well as access to credit of a longer tenure, to support the financing of infrastructure were addressed.

The Technical Conference's first panel discussed access to capital and cost of capital for operations and long-term investment. PJM's particular interest, and these comments, are directed to those issues addressed by the second panel: namely, the deployment of capital to support trading and transacting in organized electricity markets. PJM strongly supports comments made during this second panel advocating for shorter settlement periods and more limited and careful reliance on unsecured credit. We will not repeat here the merits of such actions, largely because PJM expects imminently to file proposed rule changes with the Commission addressing each subject in a manner consistent with comments made at the Technical Conference.¹

III. COMMENTS

PJM appreciates this opportunity to make short comments in three areas. These comments are broadly sketched at a high level to reflect what PJM believes is the appropriate policy dialogue that should take place at this stage in a potential rulemaking or policy articulation initiative.

¹ Generally, however, PJM would highlight that it supports the comments advocating shortened settlement periods and unsecured credit. *See, e.g.* Technical Conference, Transcript p. 92, line 10; p. 98, line 1; p. 107, line 3; p. 110, line 13, p. 112, line 1.

First, the Commission should acknowledge that certain products offered in some organized electricity markets contain forward elements that present risk of a different nature than the accounts receivable collection risk presented by most products and services provided in these markets. An illustration is found in the forward aspects of PJM's financial transmission rights product ("FTR"). The FTR market presents a different sort of credit risk with unique valuation challenges as compared to the credit risk associated with spot and day-ahead market transacting and the taking of transmission service.²

Keeping this risk in mind, PJM believes that credit rules and practices designed for accounts receivable risk require modification and enhancement before optimally addressing forward market risk. By way of example, providing some level of unsecured credit to a market participant may be reasonable when assessing the more predictable risk of accounts receivable exposure. But, the logic to support the provision of unsecured credit to that same market participant may no longer hold when the risk presented is volatile forward exposure in relatively illiquid FTR markets where quantification of price risk is challenging.

Second, when it comes to organized electricity markets, the Commission should examine the predicates upon which its public policy is grounded to verify that the grounding of such policy is sound. Past Commission precedent displays a strong policy disfavoring credit rules that might serve as a barrier to entry or set requirements

² PJM has improved its ability to manage the unique exposure presented by FTR positions. *See, PJM Interconnection, L.L.C.*, 122 FERC ¶61,279 (2008). This action represents improvement, but not a total solution to the vexing valuation challenges posed by FTRs.

that frustrate access or competition.³ These are indeed important objectives. They should be balanced, however, with an interest in minimizing the incidence and severity of default to the pool of market participants who share in the cost of an individual default in a mutualized manner. In striking this balance, the Commission should acknowledge distinctions that separate an independent system operator and a financially disinterested market administrator from affiliated transportation and transmission providers. While credit requirements can be used by affiliated providers as pretexts to limit open access and competition, there is no similar need to guard against this abuse in organized electricity markets.

Moreover, in organized electricity markets, many transactions that present credit risk to the pool are not the sorts of transactions core to the competitive purchase, sale and delivery of electricity. Rather, they are products offered with little or no transaction charge, by not-for-profit market administrators, as offerings to market participants to hedge or speculate around price movement or otherwise offer a scheduling or billing convenience. A credit philosophy too focused in its desire to prevent abusive barriers to entry is inapposite to the nature of organized markets and their products and services and can undervalue the need for appropriately rigorous rules to manage the very real credit exposure presented by some of these products and services.

Third, credit risk management rules in organized markets currently suffer from legal ambiguity or lack of definition as to the nature of the transacting and the legal

³ See, e.g., *Policy Statement on Credit-Related Issues for Electric OATT Transmission Providers, Independent System Operators and Regional Transmission Organizations*, 109 FERC ¶61,186 (2004)

relationship of the market administrator to the market participant. This ambiguity must be cured in order for the market administrator to both:

- (i) maximize tools, such as set-offs, bilateral matching, self-scheduling and clearing, to ensure the efficient use of capital by market participants to support their transacting in organized markets; and
- (ii) have requisite standing and commercially recognized rights to collect defaults and prosecute claims for payment in judicial contexts, including bankruptcy proceedings.

In this regard, PJM agrees with the point raised at the Technical Conference by the Chief Financial Officer of ISO-New England concerning the risk posed to the pool from bilateral transacting. While it appears ISO-New England permits such bilateral activity to be “settled through the ISO markets,”⁴ PJM is in the middle of an effort to clarify the relationship of PJM to such transactions and the legal significance of reporting such bilateral transactions to PJM for purposes of effecting physical delivery under those transactions.⁵ Suffice to note here, such changes will clarify that bilateral transactions remain purely bilateral, will *not* settle in the PJM market and thus will not expose PJM or the pool to risk of default under the bilateral.

The reporting of such transactions to PJM, through PJM’s eTools, allows PJM to coordinate for the parties the physical delivery necessary under their bilateral transaction. These voluntary tools can also be used to accommodate a bilateral

⁴ Technical Conference, Transcript p.92, line 5.

⁵ *PJM Interconnection, L.L.C.* Docket No. ER09-368-000. If these rule changes are accepted, PJM expects they will form a template to describe the nature and legal consequence of other bilateral transactions reported to PJM, which is to say, bilateral arrangements for products other than energy.

arrangement to replace what previously was a separate purchase out of the pool by a buyer and a sale into the pool by a seller. Taking this action will eliminate buyer's purchase out of the pool and any corresponding credit requirement owed to PJM as a result of this purchase. Going forward, the exposure presented by buyer's purchase now will be faced by seller, not PJM, who may elect to manage this exposure differently than would PJM. Particularly, where buyer and seller are related companies, the use of bilateral contracting, coupled with PJM's eTools, promises to provide very significant credit efficiencies to market participants.

While bilateral arrangements between market participants do not involve PJM in a transaction, PJM believes purchases out of, and sales into, the pool must be regarded legally as transactions between a market participant and the market administrator.⁶ A clear definition of this counterparty relationship is necessary for the efficiency and enforcement reasons set forth above. PJM expects to file requested rule changes with the Commission before June 1, 2009 to explain more fully the need for clarity in defining this counterparty relationship.

IV. CONCLUSION

PJM and its membership have been working for twelve months on a comprehensive examination and revision to PJM's credit risk management rules and practices. This effort has been successful and is coming to a close. In a pending December 2, 2008 filing before the Commission, PJM proposed certain key changes to its credit rules and indicated that it expected to make, in the ensuing months, one or two

⁶ In this regard, PJM does not agree with the apparent position of ISO-New England that in clearing the markets, the ISO "should not be considered a counterparty." Technical Conference, Transcript p.91 line 19-20.

additional filings to address complementary enhancements.⁷ PJM expects it will make one such filing in the first week of February, 2009 and the second before June 1, 2009. Together, these three filings represent the conclusion of a robust legal and analytical examination of, and a significant change and improvement to, PJM's credit risk management rules. This exercise has convinced PJM that the policy observations described above, and summarized below, should serve as important guiding principles in considering credit risk management rules in organized electricity markets, namely that:

- (1) credit tools to manage forward exposure must differ from those used to manage accounts receivable exposure,
- (2) the Commission should approach the setting of credit rules in organized markets with a very different perspective than that applied to affiliated transmission or transport providers; and
- (3) legal clarity, particularly in the area of counterparty definition, must be addressed in order to ensure the sound and efficient working of organized electricity markets.

We hope these ideas assist the Commission in considering the important questions raised by credit risk management rules and practices in organized electricity markets.

⁷ *PJM Interconnection, L.L.C.* Docket No. ER09-368-000.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that I have this day caused to be served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.



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