ARR/FTR Markets Task Force Q&A

January 21, 2021 4:13 PM EST

As discussed during our 12.22.2020 Task Force meeting, LEI consultants will be responding to stakeholder questions during the upcoming Task Force meeting on 1.26.2021.Please submit your questions in the text box below, no later than 1/18/2021.

Questions for LEI re their report: 1) Regarding revenue adequacy / underfunding: a. Does LEI agree that it is important that PJM continue to avoid overselling the system transfer capability in the form of allocated ARRs / FTRs? I.e. currently, PJM is conservative in its allocation of ARRs. This prevents the devaluation of FTR paths due to the risk of FTR revenue inadequacy, which in turn benefits the market in terms of having the FTR product be a dependable financial hedge and avoids discounting the ARRs (as market participants would pay less for FTRs that are not fully funded).

b. Given that ARR holders already receive excess congestion rents over the amount needed to fund FTRs, does LEI agree that increasing the quantity of ARRs allocated to LSEs should only be done as long as such an increase does not result in underfunding which would devalue the LSEs ARRs? 2) How to allocate congestion that is supply-side rather than load driven: LEI notes that the current allocated ARRs only account for 72% of PJM congestion charges (with the surpluses accounting for much of the remained). The PJM grid has evolved over time such that historical congestion into LSE load pockets has waned with transmission upgrades and new congestion has arisen due to the location of new remote generation (renewables and new CCs) causing generation pocket congestion. These new congested units are not associated with historical ARR

paths. This may in part explain why network capacity allocated to ARRs is not maximized. a. Given that both surplus FTR auction revenues (above ARR allocation) and the FTR surplus allocations (congestion rents that exceed ARR payouts) are rebated to ARR holders, why is there a concern that the amount of network capacity allocated to load in the ARR allocation process is not being maximized? b. If the new congestion on the system is not really associated with delivering congestion to load zones, on what basis can any LSE claim entitlement to the associated ARR paths? I.e. why isn't an allocation pro rata to ARR target allocations (assuming they are revised fairly), or pro rata to transmission service charges by zone, the fairest way to allocate such rights, rather than associate the ARRs with specific LSEs? 3) Regarding increasing the flexibility of LSEs to select ARR paths: a. ARR holders are already on equal footing with FTR holders to bid for valuable FTR paths. Any ARR holder can reconfigure its portfolio of congestion hedges by purchasing a different set of FTRs from its ARR entitlement in the FTR auction. If LSEs are given greater flexibility to select ARR paths: i. Would this not create rent-seeking opportunities associated with the ARR selection process? ii. Would this be counterproductive in creating a market opportunity for expert FTR trading firms to help select the ARRs for an LSE and get a share of the pie in return? iii. Would LSEs that have less expertise in congestion analysis be at a competitive disadvantage compared to LSEs with greater sophistication in understanding congestion, especially if the whole system is revised so that the ARR selection process is a source of commercial competition among LSEs? b. In Section 8.3.4, LEI suggests that PJM might base ARR allocations on bi-lateral contract information that LSEs might share with PJM. While it is enticing to seemingly better align ARR allocation with "actual system usage," such an approach may be counterproductive. If bi-lateral contracting with a supply resources in a congested area creates an entitlement to congestion rents, would this paradoxically create commercial value for the supply resource who will be able to command a significant share of the ARR rights? i. I.e. the constrained down supplier would require a share of the ARR entitlement in exchange for the bilateral arrangement. Historically, this happened in PJM, with respect to Stage 2 incremental FTRs. In fact, bi-lateral contracts regularly were entered between LSEs in high-priced locations and generation units in low priced locations with the sole objective of the trade to create incremental ARRs which were then split 50-50 between the generator and the LSE. c. Wouldn't ARR holders in aggregate be better off with a simple and fair process of allocating congestion rents to transmission customers (LSEs, etc.), rather than one where the ARR entitlees' relative commercial success depends on bi-lateral contracts with generators in congested locations or on their ability to make complex commercial judgements regarding future unknown congestion on the system? d. Is LEI concerned that increasing the flexibility of LSEs to pick ARR paths may lead to an increased risk of underfunding as more of the expected congestion on the system is picked up via allocation, leaving less cushion to off-set revenue inadequacy?

The recommendations in the LEI report do not include the creation of the monthly ARR allocation process, which is not explained. AEP-Regulated ComOps would like to offer the following reasons so that LEI could reconsider the idea of the monthly ARR allocation process. Why is the monthly ARR allocation needed? 1. Currently the frequency of the ARR allocation is inadequately commensurate with that of the FTR auction. On an annual basis, there are 18 auctions available for FTRs (long-term: 5x, annual: 1x, and monthly: 12x). In contrast, there is only one allocation for ARRs even though firm transmission customers pay for the transmission system. 2. ARR holders cannot respond to the changes in market congestion by adjusting their ARR portfolios over the course of a planning year. 3. New capacity resources, especially for rate-based ones, which come online in the middle of a planning year, do not have the associated ARRs/FTRs initially to hedge congestion risk. The unhedged period could be in terms of months to a year. 4. The FTR surplus was $180.8M for 2018/19 and $217.8M for 2019/20, which indicates that the transmission capability were withheld too much to be available to ARR holders. Once the withheld transmission capability becomes available over the course of a planning year, only FTR market participants benefit from it. ARR holders should be given additional opportunities as well to utilize the withheld transmission capability that PJM release. 5. Based on LEI's survey (Figure 19 at page 65 of the full report), it clearly shows that there is a strong support for the monthly ARR allocation.

Very benign question: Why were all members not shown on the charts? For example, [redacted] was not shown on the winners/losers chart. Would be nice to see on which side we fall. Thank you!

One of your conclusions/recommendations is that ARR allocations should be reformed to better hedge/match the delivery of supply arrangements made by load serving entities. You also acknowledge that the load paid for transmission through regulated rates. Should ARRs be allocated to hedge any deliveries the load wants, or should there be some consideration of what deliveries can actually be done with the transmission facilities that were actually paid for through regulated rates? For example, the original ARR allocation was based on a 1998 test year, because it was thought that the transmission lines hanging in the air at the time could accommodate all deliveries to load in 1998. This resulted in ARRs awarded from generation in a zone to load in a zone and some long-term transactions across zones. Should a load serving entity be granted ARRs to deliver supply from a remote location out of zone if the tranmission necessary to do that delivery was not completely paid for in regulated rates? Further, if the system has changed dramatically since 1998 -- should we consider just getting rid of ARRs and auctioning off the ENTIRE system? Load would get no hedges for paying for transmission through regulated rates, but a lot more of the system would be availble for purchase. Wouldn't a greater supply of FTRs drive down the price?