



955 Jefferson Ave.
Valley Forge Corporate Center
Norristown, PA 19403-2497

Jacquelyn B. Hugee
Senior Counsel
610 666.8208 Phone | 610 666.8211 Fax
hugeej@pjm.com

ORIGINAL

May 28, 2008

VIA HAND DELIVERY

Honorable Kimberly Bose, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E., Room 1A
Washington, D.C. 20426

Σ 08-1016-000

Re: PJM Interconnection, L.L.C., ER08-__-000

Dear Secretary Bose:

Pursuant to Section 205 of the Federal Power Act ("FPA"), 16 U.S.C. § 824d (2000) and Part 35 of the Commission's Rules and Regulations, 18 C.F.R. Part 35 (2007), PJM Interconnection, L.L.C. ("PJM") hereby submits revisions to the PJM Open Access Transmission Tariff ("Tariff") and the Amended and Restated Operating Agreement of PJM Interconnection, L.L.C. ("Operating Agreement").¹ The proposed revisions modify the Financial Transmission Rights ("FTR") auction rules in the PJM Interchange Energy Market ("PJM Market")² by establishing a long-term FTR auction process ("LTFTR Auction"). This LTFTR Auction will enable Market Participants to purchase and sell: 1) FTRs with terms longer than one Planning Period; and 2) single Planning Period FTRs effective for future Planning Periods that occur after the Planning Period in which the LTFTR Auction occurs. PJM's proposed revisions are consistent with the Commission's desire for RTOs to allow for the procurement of long-term

¹ Capitalized terms not otherwise defined herein have the meaning specified in the Operating Agreement and/or Tariff.

² The rules governing the PJM Interchange Energy Market are generally established in Schedule 1 of the Operating Agreement, which is reproduced as the Appendix to Attachment K of the Tariff. Accordingly, the proposed revisions to Schedule 1 are reproduced in that section of the Tariff.

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transmission rights, as well as flexibility in the design of their long-term firm transmission right processes.³

Description of the Proposed Revisions

a. Background

Transmission rights in PJM are allocated based on a dual rights system that allocates Auction Revenue Rights (“ARRs”) on a priority basis,⁴ and auctions FTRs to Market Participants without preference. This dual rights system maintains the ARR priority by allowing ARRs to be converted to FTRs.⁵ ARRs are available for single Planning Periods and certain long-term ARRs are available on a long-term basis for a term of 10-years. On the other hand, FTRs offer a greater variety of products, but are limited to a maximum term of a single Planning Period. Thus, at present the only long-term congestion hedge, i.e. a hedge of longer than one Planning Period, is the long-term ARR. Accordingly, Market Participants that are not eligible for long-term ARRs cannot obtain congestion hedges greater than one Planning Period. Given this limitation, PJM stakeholders requested that PJM develop a longer term FTR after the implementation of its long-term transmission rights product.⁶

Through its Long-Term FTR Working Group, PJM developed this proposal for a long-term FTR Auction (“Proposal”). These LTFTR auction rules were developed by the Long-Term FTR WG over the course of approximately twelve meetings held from September 2005 to June 2007. This

³ See Long-Term Firm Transmission Rights in Organized Electric Markets, Order No. 681, 116 FERC ¶ 61,077 (2006) at P 101.

⁴ The priority allocation is based on historical funding of the transmission system in the PJM Control Area.

⁵ Recipients of ARRs can keep the priority transmission rights as ARRs or convert the rights to FTRs. If an ARR is converted to an FTR, the associated capacity is not available for purchase by other parties.

⁶ See Footnote 39 in PJM's August 29, 2006 Answer filed in Docket No. ER06-1218.

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long-term FTR will enhance the total package of FTR products offered in PJM's Market in several ways. First, it will give participants greater flexibility in hedging their market positions. Second, it will give participants access to congestion hedges that better align with the requirements of retail access auctions that commit a load-serving entity to multi-year load serving obligations. Finally, the longer-term products also increase financial market participants' opportunities in the FTR Market by increasing the number of FTR products that can be traded in the market. The Proposal was vetted through the PJM committee process where it was endorsed by the Members Committee at its meeting held on November 15, 2007 without objection or abstention.

b. Proposal

i. LTFTR Auction Products

The Proposal revises the FTR auction process to establish a LTFTR Auction. In the LTFTR Auction, parties can purchase and/or sell FTRs covering three consecutive Planning Periods, beginning with the Planning Period that immediately follows the Planning Period in which the auction occurs.⁷ They may also purchase and/or sell FTRs covering any single Planning Period within the three Planning Period term. On-peak, Off-peak and 24-hour FTR obligation products will be offered in LTFTR Auctions, and eligible sources and sinks will include hubs, zones, aggregates, generators and interface buses.⁸ This is consistent with the existing rules for FTR products offered in the annual auction, except that FTR option products will not be offered.⁹ Because FTR options are

⁷ Again, the three year term is designed to align with retail access auctions.

⁸ An entity must be a PJM Member or Transmission Customer to participate in a LTFTR Auction.

⁹ FTR Option products are credited when the sink LMP is higher than the source LMP, but they are not charged when the LMP differential is reversed. This means an option does not incur charges for counterflow, and that counterflow congestion is ignored in the simultaneous feasibility analysis.

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not subject to charges, the analysis of such rights is more complicated than is the analysis for FTR obligations. Therefore, to ensure that the analysis required to conduct the LTFTR Auctions can be completed in a reasonable time period given reasonable system performance, options will not be offered.

ii. Capacity Available in LTFTR Auctions

The capacity offered in a LTFTR Auction is limited to the residual system capacity remaining after the annual ARR allocation and FTR auction. In determining this amount of residual system capacity, PJM will assume that all allocated ARRs effective at the time of the auction are self-scheduled as FTRs. This is necessary for PJM to ensure that FTR products sold in LTFTR Auctions, which are effective in future Planning Periods, do not affect the priority rights of ARR holders in those future Planning Periods. In other words, the amount of capacity offered in a LTFTR Auction must respect the capacity required to support all allocated ARRs going forward.¹⁰ It is possible that all ARRs may not be converted to FTRs in future years. Arguably, the underlying capacity could then be made available in a LTFTR Auction, assuming it was not sold in an annual FTR Auction. However, because ARRs are priority rights, and each ARR holder always has the option of converting its ARRs to FTRs, the LTFTR Auction rules have to account for the possibility that all ARRs will be converted to FTRs.

Because annual ARR nominations can vary,¹¹ to ensure that the rights of ARR holders are not compromised, the ARR conversion assumption used for the initial LTFTR Auction

¹⁰ This is necessary regardless of whether the ARRs are long-term (stage 1A) or annual (stage 1B), because an ARR holder has just as much right to its ARR entitlement on a year-to-year basis as it does if it elects to nominate long-term ARRs.

¹¹ For example, an entity entitled to 100 MWs of ARRs may nominate the full amount for one Planning Period, and then nominate only 75MW in a subsequent Planning Period. However, changes in nomination do not affect that entity's entitlement to the full 100 MW in any prospective Planning Period.

establishes a floor for subsequent ARR allocations. This guarantees the amount of capacity that, at a minimum, will be available for future ARR allocations.¹²

As between annual and LTFTR Auction products, each type of auction will respect the rights sold in the other. Consequently, annual FTR auctions will respect FTRs sold in LTFTR Auctions if they are effective in the Planning Period covered by the annual auction. To illustrate, if a 20 MW three-year LTFTR is sold in the LTFTR Auction that takes place in the 2008-2009 Planning Period, its effective term would be from the 2009-2010 Planning Period through the 2011-2012 Planning Period. The annual FTR auctions for each of those Planning Periods would have to respect the 20 MW of capacity required to support that FTR. Likewise, if a single Planning Period 20 MW FTR covering the second Planning Period was sold in the same LTFTR Auction, the annual auction for the 2010-2011 Planning Period would have to respect the capacity required to support that FTR.

iii. Timing and Structure of LTFTR Auctions

LTFTR Auctions will occur after annual FTR auctions and will consist of two rounds, each of which will offer 50 percent of the total capacity available for the LTFTR Auction. The first round will take place approximately eight to eleven months prior to the start of the first effective Planning Period for FTRs sold in the auction, with second round occurring approximately four months prior to the start of that Planning Period.¹³ Conducting the auction in multiple rounds facilitates price discovery for the auction products. Further, the use of two rounds is adequate given the limited capacity made available in LTFTR Auctions which is the result of the conservative assumption

¹² Because LTFTR products are locked in for the relevant future period, it does not matter what ARR holders do in future allocations, because basing the residual capability on this assumption in the first instance effectively means there will always be at least that amount of capacity available to support that amount of ARRs.

¹³ For example, if the first effective Planning Period is 2010-2011, the first round would occur between July and October 2009, which is approximately eight to eleven months prior to the start of the 2010-2011 Planning Period (i.e. June 1, 2010). The second round would occur around the beginning of February 2010, which is approximately four months prior to the start of the 2010-2011 Planning Period.

regarding the self-scheduling of ARR to FTRs. The timing of the auctions was selected to coincide with auctions for default service¹⁴ in retail access states, with one round occurring on either side of such auctions.¹⁵

iv. Allocation of LTFTR Auction Revenues

LTFTR Auction revenues from FTRs covering three Planning Periods will be distributed equally across each of the relevant Planning Periods. Revenues from FTRs covering a single Planning Period will be distributed in that Planning Period only. The revenues will be used to fund ARRs up to their economic value, as determined by the annual FTR auction clearing prices in each round of the relevant annual auction in the relevant Planning Period. The allocation shall consider annual FTR auction revenues, and the combination of annual and LTFTR Auction revenues shall not exceed the economic value of an ARR. If there are revenues remaining after this initial allocation, they will be distributed pursuant to Section 5.2.6 of Schedule 1 of the Operating Agreement, which establishes a priority allocation of excess congestion revenues in the same Planning Period.¹⁶ This distribution is reasonable because there is direct relationship between the revenues and the beneficiaries of the first allocation, ARR holders, and there is an indirect relationship between the revenues and the second allocation pursuant to Section 5.2.6: the revenues are derived from the transmission rights markets and are used to benefit participants in that market.

¹⁴ This is the competitively procured service provided for customers in retail access states that are not taking competitive supply. It has different names depending on the jurisdiction – e.g. provider of last resort, basic generation service.

¹⁵ The timing of the LTFTR Auction rounds was based on the timing of retail auctions typically seen in the PJM region, such as in MD and NJ.

¹⁶ PJM recently filed revisions to change the lowest priority allocation from Transmission Customers to FTR holders. That proposal is pending before the Commission. See PJM Transmittal Letter in Docket No. ER08-691.

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v. *Credit issues*

The credit requirements for LTFTRs are the same as the credit requirements that are applicable to annual FTRs. Indeed, LTFTRs and annual FTRs are indistinguishable in the calculation methodology for each since the calculation does not take into account the term of the FTR. Rather, the methodology considers each month of each FTR individually. Therefore, as with annual and shorter-term FTRs, LTFTRs will be subject to PJM's recently strengthened credit rules, including the rules governing undiversified FTR portfolios,¹⁷ in addition to all other credit requirements applicable to the FTR markets. Furthermore, as changes are made to FTR credit requirements, LTFTR credit requirements will be revised accordingly. Additionally, LTFTR credit requirements will be recalculated each year as a new set of historical data is prepared for the upcoming annual auction, and to the extent required, additional collateral requested from LTFTR holders. This annual recalibration will ensure that the most recent data is always being used for FTR credit calculations, whether long-term, annual or shorter term.

Proposed Revisions to Schedule 1 of the Operating Agreement

Schedule 1 of the Operating Agreement is reproduced in the Appendix to Attachment K in the Tariff. Accordingly, identical revisions are made to the corresponding sections of that part of the Tariff. These are itemized below:

- **Section 7.1** – This section is revised by adding the LTFTR Auction to the types of FTR auctions administered by PJM;
- **Section 7.1A** - This new section establishes the LTFTR Auction process and products generally;
- **Section 7.1A.1** – This new section establishes the LTFTR Auction and describes the total amount of capacity that will be made available in such auctions;
- **Section 7.1A.2** – This new section establishes the structure and timing of the LTFTR Auctions;

¹⁷ See PJM Interconnection, L.L.C., Order on Tariff Revisions, 122 FERC ¶ 61,279 (2008).

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- **Section 7.1A.3** – This new section establishes the types of products that will be offered in LTFTR Auctions;
- **Section 7.1A.4** – This new section establishes the eligibility requirements to participate in LTFTR Auctions;
- **Section 7.1A.5** – This new section establishes the eligible sources and sinks for LTFTR Auction products;
- **Section 7.4** – This section is revised to establish the allocation process for LTFTR Auction revenues.

Stakeholder Support

On November 15, 2007, the Members Committee unanimously endorsed the proposed revisions, with no objections or abstentions.

Effective Date

Consistent with the Commission's 60-day notice requirement, PJM requests an effective date of July 28, 2008.

Documents Enclosed

PJM encloses with this transmittal letter 6 copies of each of the following:

1. This transmittal letter;
2. Attachment 1: Revised Tariff and Operating Agreement sheets; and
3. Attachment 2: Redlined versions of the revised Tariff and Operating Agreement sheets.

Correspondence and Communications

Correspondences and communications with respect to this filing should be sent to, and PJM respectfully requests the Secretary to include on the official service list, the following:

Jacquelyn B. Huges
Senior Counsel
PJM Interconnection, L.L.C.
955 Jefferson Avenue
Norristown, PA 19403
(610) 666-8208

Craig Glazer
VP, Federal Government Policy
PJM Interconnection, L.L.C.
Suite 600, 1200 G Street, N.W.
Washington, DC 20005
(202) 423-4743

Filed at Kimberly Stone
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Service and Request for Waiver

PJM has served a copy of this filing on all PJM Members and on all state utility regulatory commissions in the PJM Region by posting this filing electronically, and requests waiver of the requirement to post by mailing paper copies. Waiver of paper service is consistent with the Commission's decision to establish electronic service as the default method of service on service lists maintained by the Commission Secretary for Commission proceedings.¹⁸ While Order No. 653 did not amend the posting requirements, application of its rules to initial tariff filings would be consistent with the Commission's "efforts to reduce the use of paper in compliance with the Government Paperwork Elimination Act."¹⁹ Applying amended section 385.2010(f) to this filing, PJM will post this filing today to the FERC filings section of its internet site, <http://www.pjm.com/documents/ferc.html>, and send an e-mail to all PJM members and all state utility regulatory commissions in the PJM Region²⁰ notifying them that the filing is available by following such link.

Respectfully submitted,

Jacquelynn B. Huges

Craig Glazer
 Vice President, Federal Government Policy
 PJM Interconnection, L.L.C.
 1200 G Street, N.W., Suite 600
 Washington D.C. 20005
 (202) 423-4743 (phone)
 (202) 393-7741 (fax)
glazec@pjm.com

Jacquelynn B. Huges
 Senior Counsel
 PJM Interconnection, L.L.C.
 955 Jefferson Ave.
 Norristown, PA 19403
 (610) 666-8208 (phone)
 (610) 666-8211 (fax)
hugeej@pjm.com

¹⁸ See Electronic Notification of Commission Issuances, Order No. 653, 110 FERC ¶ 61,110 (2005).

¹⁹ *Id.* at P 2, citing 44 U.S.C. § 3504.

²⁰ PJM already maintains, updates, and regularly uses e-mail lists for all Members and affected commissions.

Attachment 1

REVISIONS TO PJM OPERATING AGREEMENT

Schedule 1

Clean Version

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7. FINANCIAL TRANSMISSION RIGHTS AUCTIONS

7.1 Auctions of Financial Transmission Rights.

Annual, periodic and long-term auctions to allow Market Participants to acquire or sell Financial Transmission Rights shall be conducted by the Office of the Interconnection in accordance with the provisions of this Section.

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Vice President, Federal Government Policy
Issued On: May 28, 2008

Effective: July 28, 2008

Each Financial Transmission Right acquired in a Financial Transmission Rights auction shall entitle the holder to credits of Transmission Congestion Charges for the period that was specified in the corresponding auction.

7.1A Long-Term Financial Transmission Rights Auctions.

7.1A.1 Auctions.

(i) Subsequent to each annual FTR auction conducted pursuant to Section 7.1 of Schedule 1 of this Agreement, the Office of the Interconnection shall conduct a long-term FTR auction for the three consecutive Planning Periods immediately subsequent to the Planning Period during which the long-term FTR auction is conducted.

(ii) The capacity offered for sale in long-term FTR auctions shall be the residual system capability after the Annual Auction Revenue Rights allocations and annual FTR auction. In determining the residual capability the Office of the Interconnection shall assume that all Auction Revenue Rights allocated in the immediately prior annual Auction Revenue Rights allocation process are self-scheduled into FTRs, which shall be modeled as fixed injections and withdrawals in the long-term FTR auction.

7.1A.2 Frequency and Timing.

Long-term FTR auctions shall consist of two rounds. The first round shall be conducted by the Office of the Interconnection approximately 11 months prior to the start of the three Planning Period term covered by the relevant long-term FTR auction and the second round shall be conducted approximately 4 months after the first round. In each round 50% of total capacity available in the long-term FTR auction shall be offered for sale. Eligible entities may submit bids to purchase and offers to sell FTRs at the start of the bidding period in each round. The bidding period shall be three business days ending at 1700 on the last day. PJM performs the FTR auction clearing analysis for each round and posts the auction results on the MUI within five business days after the close of the bidding period for each round.

7.1A.3 Products.

(i) The periods covered by long-term FTR auctions shall be: (1) any single Planning Period within the three Planning Period term covered by the relevant auction; and (2) the three Planning Period term covered by the relevant auction.

(ii) On-Peak, off-peak and 24-hour FTR obligations, as defined in Section 7.3.4 of Schedule 1 of this Agreement, shall be offered in long-term FTR auctions; FTR options shall not be offered.

7.1A.4 Participation Eligibility.

(i) To participate in long-term FTR auctions an entity shall be a PJM Member or a PJM Transmission Customer. Eligible entities may submit bids or offers in long-term FTR auctions, provided they own FTRs offered for sale.

7.1A.5 Specified Receipt and Delivery Points.

Eligible sources and sinks in long-term FTR auctions shall be limited to hubs, zones, aggregates, generators, and interface buses.

7.2 Financial Transmission Rights Characteristics.**7.2.1 Reconfiguration of Financial Transmission Rights.**

Through an appropriate linear programming model, the Office of the Interconnection shall reconfigure the Financial Transmission Rights offered or otherwise available for sale in any auction to maximize the value to the bidders of the Financial Transmission Rights sold, provided that any Financial Transmission Rights acquired at auction shall be simultaneously feasible in combination with those Financial Transmission Rights outstanding at the time of the auction and not sold in the auction. The linear programming model shall, while respecting transmission constraints and the maximum MW quantities of the bids and offers, select the set of simultaneously feasible Financial Transmission Rights with the highest net total auction value as determined by the bids of buyers and taking into account the reservation prices of the sellers.

7.2.2 Specified Receipt and Delivery Points.

Auction bids for annual Financial Transmission Rights Obligations may specify as receipt and delivery points any combination of hubs, Zones, aggregates, generators, and interface buses. Auction bids for annual Financial Transmission Rights Options may specify as receipt and delivery points such combination of hubs, Zones, aggregates, generators, and interface buses as the Office of the Interconnection shall allow from time to time as set forth in its FTR business manual. Auction bids for Financial Transmission Rights submitted in the monthly auctions may specify as receipt and delivery points any combination of hubs, Zones, aggregates, generators, and interface buses for bids that cover any month beyond the next month, including bids that cover Planning Period Quarters or the Planning Period Balance. Auction bids for Financial Transmission Rights submitted in the monthly auctions that cover the single calendar month period immediately following the month in which the monthly auction is conducted may specify any combination of receipt and delivery buses represented in the State Estimator model for which the Office of the Interconnection calculates and posts Locational Marginal Prices. Auction bids may specify receipt and delivery points from locations outside of the PJM Region to locations inside such region, from locations within the PJM Region to locations outside such region, or to and from locations within the PJM Region.

7.2.3 Transmission Congestion Charges.

Financial Transmission Rights shall entitle holders thereof to credits only for Transmission Congestion Charges, and shall not confer a right to credits for payments arising from or relating to transmission congestion made to any entity other than the Office of the Interconnection.

7.3 Auction Procedures.**7.3.1 Role of the Office of the Interconnection.**

Financial Transmission Rights auctions shall be conducted by the Office of the Interconnection in accordance with standards and procedures set forth in the PJM Manuals, such standards and procedures to be consistent with the requirements of this Schedule.

(d) Long-term FTR auction revenues associated with FTRs that cover individual Planning Periods shall be distributed in the Planning Period for which the FTR is effective. Long-term FTR auction revenues associated with FTRs that cover multiple Planning Years shall be distributed equally across each Planning Period in the effective term of the FTR. Long-term FTR auction revenue distributions within a Planning Period shall be in accordance with the following provisions:

(i) Long-term FTR Auction revenues shall be distributed to Auction Revenue Rights holders in the effective Planning Period for the FTR. The distribution shall be in proportion to the economic value of the ARRs when compared to the annual FTR auction clearing prices from each round proportionately. The distribution shall not exceed, when added to the distribution of revenues from the prompt-year annual FTR auction itself, the economic value of the ARRs when compared to the annual FTR auction clearing prices from each round proportionately.

(ii) Long-term FTR auction revenues remaining after distributions made pursuant to Section 7.4.1(d)(ii) of Schedule 1 of this Agreement shall be distributed pursuant to Section 5.2.6 of Schedule 1 of this Agreement.

7.4.2 Auction Revenue Rights.

(a) Prior to the end of each PJM Planning Period an annual allocation of Auction Revenue Rights for the next PJM Planning Period shall be performed using a two stage allocation process. Stage 1 shall consist of stages 1A and 1B, which shall allocate ten year and annual Auction Revenue Rights, respectively, and stage 2 shall allocate annual Auction Revenue Rights. The Auction Revenue Rights allocation process shall be performed in accordance with Sections 7.4 and 7.5 hereof and the PJM Manuals.

(b) In stage 1A of the allocation process, each Network Service User may request Auction Revenue Rights for a term covering ten consecutive PJM Planning Periods beginning with the immediately ensuing PJM Planning Period from a subset of the historical generation resources that were designated to be delivered to load based on the historical reference year for the Zone, and each Qualifying Transmission Customer (as defined in paragraph (f) of this section) may request Auction Revenue Rights based on the megawatts of firm service provided

REVISIONS TO PJM TARIFF

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PJM Interconnection, L.L.C.
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Sixth Revised Volume No. 1

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7. FINANCIAL TRANSMISSION RIGHTS AUCTIONS

7.1 Auctions of Financial Transmission Rights.

Annual, periodic and long-term auctions to allow Market Participants to acquire or sell Financial Transmission Rights shall be conducted by the Office of the Interconnection in accordance with the provisions of this Section.

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An Auction Revenue Rights holder that converts its Auction Revenue Rights may not designate a price bid for its converted Financial Transmission Rights and will receive a price equal to the clearing price set by other bids in the annual Financial Transmission Right auction. To the extent a market participant seeks to obtain FTRs in the annual auction through such conversion, the FTRs sought will not be included in the calculation of such market participant's credit requirement for such annual FTR auction.

7.1.2 Frequency and Time of Auctions.

Subject to section 7.1.1 of this Schedule, annual Financial Transmission Rights auctions shall offer the entire FTR capability of the PJM system in four rounds with 25 percent of the capability offered in each round. All four rounds of the annual Financial Transmission Rights auction shall occur within the two-month period (April – May) preceding the start of the PJM Planning Period. Each round shall occur over five business days and shall be conducted sequentially. Each round shall begin with the bid and offer period. The bid and offer period for annual Financial Transmission Rights auctions shall be open for three consecutive business days, opening the first day at 12:00 midnight (Eastern Prevailing Time) and closing the third day at 5:00 p.m. (Eastern Prevailing Time). Monthly, Financial Transmission Rights auctions shall be held each month. The bid and offer period for monthly Financial Transmission Rights auctions shall be open for three consecutive business days in the month preceding the first month for which Financial Transmission Rights are being auctioned, opening the first day at 12:00 midnight (Eastern Prevailing Time) and closing the third day at 5:00 PM (Eastern Prevailing Time).

7.1.3 Duration of Financial Transmission Rights.

Each Financial Transmission Right acquired in a Financial Transmission Rights auction shall entitle the holder to credits of Transmission Congestion Charges for the period that was specified in the corresponding auction.

7.1A Long-Term Financial Transmission Rights Auctions.

7.1A.1 Auctions.

(i) Subsequent to each annual FTR auction conducted pursuant to Section 7.1 of Schedule 1 of this Agreement, the Office of the Interconnection shall conduct a long-term FTR auction for the three consecutive Planning Periods immediately subsequent to the Planning Period during which the long-term FTR auction is conducted.

(ii) The capacity offered for sale in long-term FTR auctions shall be the residual system capability after the Annual Auction Revenue Rights allocations and annual FTR auction. In determining the residual capability the Office of the Interconnection shall assume that all Auction Revenue Rights allocated in the immediately prior annual Auction Revenue Rights allocation process are self-scheduled into FTRs, which shall be modeled as fixed injections and withdrawals in the long-term FTR auction.

7.1A.2 Frequency and Timing.

Long-term FTR auctions shall consist of two rounds. The first round shall be conducted by the Office of the Interconnection approximately 11 months prior to the start of the three Planning Period term covered by the relevant long-term FTR auction and the second round shall be conducted approximately 4 months after the first round. In each round 50% of total capacity available in the long-term FTR auction shall be offered for sale. Eligible entities may submit bids to purchase and offers to sell FTRs at the start of the bidding period in each round. The bidding period shall be three business days ending at 1700 on the last day. PJM performs the FTR auction clearing analysis for each round and posts the auction results on the MUI within five business days after the close of the bidding period for each round.

7.1A.3 Products.

(i) The periods covered by long-term FTR auctions shall be: (1) any single Planning Period within the three Planning Period term covered by the relevant auction; and (2) the three Planning Period term covered by the relevant auction.

(ii) On-Peak, off-peak and 24-hour FTR obligations, as defined in Section 7.3.4 of Schedule 1 of this Agreement, shall be offered in long-term FTR auctions; FTR options shall not be offered.

7.1A.4 Participation Eligibility.

(i) To participate in long-term FTR auctions an entity shall be a PJM Member or a PJM Transmission Customer. Eligible entities may submit bids or offers in long-term FTR auctions, provided they own FTRs offered for sale.

7.1A.5 Specified Receipt and Delivery Points.

Eligible sources and sinks in long-term FTR auctions shall be limited to hubs, zones, aggregates, generators, and interface buses.

(b) Auction Revenue Rights Credits will be calculated based upon the clearing price results of the applicable Annual Financial Transmission Rights auction.

(c) Monthly and Balance of Planning Period FTR auction revenues, net of payments to entities selling Financial Transmission Rights into the auction, shall be allocated according to the following priority schedule:

(i) To stage 1 and 2 Auction Revenue Rights holders in accordance with section 7.4.4 of Schedule 1 of this Agreement. If there are excess revenues remaining after a distribution made pursuant to this subsection, such revenues shall be distributed in accordance with subsection (c)(ii) of this section;

(ii) To the Residual Auction Revenue Rights holders in proportion to, but not more than their target allocation as determined pursuant to section 7.4.3(b) of Schedule 1 of this Agreement. If there are excess revenues remaining after a distribution made pursuant to this subsection, such revenues shall be distributed in accordance with subsection (c)(iii) of this section;

(iii) To FTR Holders in accordance with section 5.2.6 of Schedule 1 of this Agreement.

(d) Long-term FTR auction revenues associated with FTRs that cover individual Planning Periods shall be distributed in the Planning Period for which the FTR is effective. Long-term FTR auction revenues associated with FTRs that cover multiple Planning Years shall be distributed equally across each Planning Period in the effective term of the FTR. Long-term FTR auction revenue distributions within a Planning Period shall be in accordance with the following provisions:

(i) Long-term FTR Auction revenues shall be distributed to Auction Revenue Rights holders in the effective Planning Period for the FTR. The distribution shall be in proportion to the economic value of the ARR when compared to the annual FTR auction clearing prices from each round proportionately. The distribution shall not exceed, when added to the distribution of revenues from the prompt-year annual FTR auction itself, the economic value of the ARRs when compared to the annual FTR auction clearing prices from each round proportionately.

(ii) Long-term FTR auction revenues remaining after distributions made pursuant to Section 7.4.1(d)(ii) of Schedule 1 of this Agreement shall be distributed pursuant to Section 5.2.6 of Schedule 1 of this Agreement.

7.4.2 Auction Revenue Rights.

(a) Prior to the end of each PJM Planning Period an annual allocation of Auction Revenue Rights for the next PJM Planning Period shall be performed using a two stage allocation process. Stage 1 shall consist of stages 1A and 1B, which shall allocate ten year and annual Auction Revenue Rights, respectively, and stage 2 shall allocate annual Auction Revenue Rights. The Auction Revenue Rights allocation process shall be performed in accordance with Sections 7.4 and 7.5 hereof and the PJM Manuals.

(b) In stage 1A of the allocation process, each Network Service User may request Auction Revenue Rights for a term covering ten consecutive PJM Planning Periods beginning with the immediately ensuing PJM Planning Period from a subset of the historical generation resources that were designated to be delivered to load based on the historical reference year for the Zone, and each Qualifying Transmission Customer (as defined in paragraph (f) of this section) may request Auction Revenue Rights based on the megawatts of firm service provided between the receipt and delivery points as to which the Transmission Customer had Point-to-Point Transmission Service during the historical reference year. The historical reference year for all Zones shall be 1998, except that the historical reference year shall be: 2002 for the Allegheny Power and Rockland Electric Zones; 2004 for the AEP East, The Dayton Power & Light Company and Commonwealth Edison Company Zones; 2005 for the Virginia Electric and Power Company and Duquesne Light Company Zones; and the Office of the Interconnection shall specify a historical reference year for a new PJM zone corresponding to the year that the zone is integrated into the PJM Interchange Energy Market. For stage 1, the Office of the Interconnection shall determine a set of eligible historical generation resources for each Zone based on the historical reference year and assign a pro rata amount of megawatt capability from each historical generation resource to each Network Service User in the Zone based on its proportion of peak load in the Zone. Auction Revenue Rights shall be allocated to each Network Service User in a Zone from each historical generation resource in a number of megawatts equal to or less than the amount of the historical generation resource that has been assigned to the Network Service User. Each Auction Revenue Right allocated to a Network Service User shall be to the aggregate load buses of such Network Service User in a Zone or, with respect to Non-Zone Network Load, to the border of the PJM Region. In stage 1A of the allocation process, the sum of each Network Service User's allocated Auction Revenue Rights for a Zone must be equal to or less than the Network Service User's pro-rata share of the Zonal Base Load for that Zone.

Attachment 2

REVISIONS TO PJM OPERATING AGREEMENT

Schedule 1

Redline Version

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First Revised Sheet No. 132f
Superseding Original Sheet No. 132f

7. FINANCIAL TRANSMISSION RIGHTS AUCTIONS

7.1 Auctions of Financial Transmission Rights.

Annual, ~~and periodic~~ and long-term auctions to allow Market Participants to acquire or sell Financial Transmission Rights shall be conducted by the Office of the Interconnection in accordance with the provisions of this Section.

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Each Financial Transmission Right acquired in a Financial Transmission Rights auction shall entitle the holder to credits of Transmission Congestion Charges for the period that was specified in the corresponding auction.

7.1A Long-Term Financial Transmission Rights Auctions.

7.1A.1 Auctions.

(i) Subsequent to each annual FTR auction conducted pursuant to Section 7.1 of Schedule 1 of this Agreement, the Office of the Interconnection shall conduct a long-term FTR auction for the three consecutive Planning Periods immediately subsequent to the Planning Period during which the long-term FTR auction is conducted.

(ii) The capacity offered for sale in long-term FTR auctions shall be the residual system capability after the Annual Auction Revenue Rights allocations and annual FTR auction. In determining the residual capability the Office of the Interconnection shall assume that all Auction Revenue Rights allocated in the immediately prior annual Auction Revenue Rights allocation process are self-scheduled into FTRs, which shall be modeled as fixed injections and withdrawals in the long-term FTR auction.

7.1A.2 Frequency and Timing.

Long-term FTR auctions shall consist of two rounds. The first round shall be conducted by the Office of the Interconnection approximately 11 months prior to the start of the three Planning Period term covered by the relevant long-term FTR auction and the second round shall be conducted approximately 4 months after the first round. In each round 50% of total capacity available in the long-term FTR auction shall be offered for sale. Eligible entities may submit bids to purchase and offers to sell FTRs at the start of the bidding period in each round. The bidding period shall be three business days ending at 1700 on the last day. PJM performs the FTR auction clearing analysis for each round and posts the auction results on the MUI within five business days after the close of the bidding period for each round.

7.1A.3 Products.

(i) The periods covered by long-term FTR auctions shall be: (1) any single Planning Period within the three Planning Period term covered by the relevant auction; and (2) the three Planning Period term covered by the relevant auction.

(ii) On-Peak, off-peak and 24-hour FTR obligations, as defined in Section 7.3.4 of Schedule 1 of this Agreement, shall be offered in long-term FTR auctions; FTR options shall not be offered.

7.1A.4 Participation Eligibility.

(i) To participate in long-term FTR auctions an entity shall be a PJM Member or a PJM Transmission Customer. Eligible entities may submit bids or offers in long-term FTR auctions, provided they own FTRs offered for sale.

7.1A.5 Specified Receipt and Delivery Points.

Eligible sources and sinks in long-term FTR auctions shall be limited to hubs, zones, aggregates, generators, and interface buses.

7.2 Financial Transmission Rights Characteristics.**7.2.1 Reconfiguration of Financial Transmission Rights.**

Through an appropriate linear programming model, the Office of the Interconnection shall reconfigure the Financial Transmission Rights offered or otherwise available for sale in any auction to maximize the value to the bidders of the Financial Transmission Rights sold, provided that any Financial Transmission Rights acquired at auction shall be simultaneously feasible in combination with those Financial Transmission Rights outstanding at the time of the auction and not sold in the auction. The linear programming model shall, while respecting transmission constraints and the maximum MW quantities of the bids and offers, select the set of simultaneously feasible Financial Transmission Rights with the highest net total auction value as determined by the bids of buyers and taking into account the reservation prices of the sellers.

7.2.2 Specified Receipt and Delivery Points.

Auction bids for annual Financial Transmission Rights Obligations may specify as receipt and delivery points any combination of hubs, Zones, aggregates, generators, and interface buses. Auction bids for annual Financial Transmission Rights Options may specify as receipt and delivery points such combination of hubs, Zones, aggregates, generators, and interface buses as the Office of the Interconnection shall allow from time to time as set forth in its FTR business manual. Auction bids for Financial Transmission Rights submitted in the monthly auctions may specify as receipt and delivery points any combination of hubs, Zones, aggregates, generators, and interface buses for bids that cover any month beyond the next month, including bids that cover Planning Period Quarters or the Planning Period Balance. Auction bids for Financial Transmission Rights submitted in the monthly auctions that cover the single calendar month period immediately following the month in which the monthly auction is conducted may specify any combination of receipt and delivery buses represented in the State Estimator model for which the Office of the Interconnection calculates and posts Locational Marginal Prices. Auction bids may specify receipt and delivery points from locations outside of the PJM Region to locations inside such region, from locations within the PJM Region to locations outside such region, or to and from locations within the PJM Region.

7.2.3 Transmission Congestion Charges.

Financial Transmission Rights shall entitle holders thereof to credits only for Transmission Congestion Charges, and shall not confer a right to credits for payments arising from or relating to transmission congestion made to any entity other than the Office of the Interconnection.

7.3 Auction Procedures.**7.3.1 Role of the Office of the Interconnection.**

Financial Transmission Rights auctions shall be conducted by the Office of the Interconnection in accordance with standards and procedures set forth in the PJM Manuals, such standards and procedures to be consistent with the requirements of this Schedule.

(d) Long-term FTR auction revenues associated with FTRs that cover individual Planning Periods shall be distributed in the Planning Period for which the FTR is effective. Long-term FTR auction revenues associated with FTRs that cover multiple Planning Years shall be distributed equally across each Planning Period in the effective term of the FTR. Long-term FTR auction revenue distributions within a Planning Period shall be in accordance with the following provisions:

(i) Long-term FTR Auction revenues shall be distributed to Auction Revenue Rights holders in the effective Planning Period for the FTR. The distribution shall be in proportion to the economic value of the ARRs when compared to the annual FTR auction clearing prices from each round proportionately. The distribution shall not exceed, when added to the distribution of revenues from the prompt-year annual FTR auction itself, the economic value of the ARRs when compared to the annual FTR auction clearing prices from each round proportionately.

(ii) Long-term FTR auction revenues remaining after distributions made pursuant to Section 7.4.1(d)(ii) of Schedule 1 of this Agreement shall be distributed pursuant to Section 5.2.6 of Schedule 1 of this Agreement.

7.4.2 Auction Revenue Rights.

(a) Prior to the end of each PJM Planning Period an annual allocation of Auction Revenue Rights for the next PJM Planning Period shall be performed using a two stage allocation process. Stage 1 shall consist of stages 1A and 1B, which shall allocate ten year and annual Auction Revenue Rights, respectively, and stage 2 shall allocate annual Auction Revenue Rights. The Auction Revenue Rights allocation process shall be performed in accordance with Sections 7.4 and 7.5 hereof and the PJM Manuals.

(b) In stage 1A of the allocation process, each Network Service User may request Auction Revenue Rights for a term covering ten consecutive PJM Planning Periods beginning with the immediately ensuing PJM Planning Period from a subset of the historical generation resources that were designated to be delivered to load based on the historical reference year for the Zone, and each Qualifying Transmission Customer (as defined in paragraph (f) of this section) may request Auction Revenue Rights based on the megawatts of firm service provided.

REVISIONS TO PJM TARIFF

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Redline Version

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7. FINANCIAL TRANSMISSION RIGHTS AUCTIONS

7.1 Auctions of Financial Transmission Rights.

Annual, ~~and periodic~~ and long-term auctions to allow Market Participants to acquire or sell Financial Transmission Rights shall be conducted by the Office of the Interconnection in accordance with the provisions of this Section.

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An Auction Revenue Rights holder that converts its Auction Revenue Rights may not designate a price bid for its converted Financial Transmission Rights and will receive a price equal to the clearing price set by other bids in the annual Financial Transmission Right auction. To the extent a market participant seeks to obtain FTRs in the annual auction through such conversion, the FTRs sought will not be included in the calculation of such market participant's credit requirement for such annual FTR auction.

7.1.2 Frequency and Time of Auctions.

Subject to section 7.1.1 of this Schedule, annual Financial Transmission Rights auctions shall offer the entire FTR capability of the PJM system in four rounds with 25 percent of the capability offered in each round. All four rounds of the annual Financial Transmission Rights auction shall occur within the two-month period (April – May) preceding the start of the PJM Planning Period. Each round shall occur over five business days and shall be conducted sequentially. Each round shall begin with the bid and offer period. The bid and offer period for annual Financial Transmission Rights auctions shall be open for three consecutive business days, opening the first day at 12:00 midnight (Eastern Prevailing Time) and closing the third day at 5:00 p.m. (Eastern Prevailing Time). Monthly Financial Transmission Rights auctions shall be held each month. The bid and offer period for monthly Financial Transmission Rights auctions shall be open for three consecutive business days in the month preceding the first month for which Financial Transmission Rights are being auctioned, opening the first day at 12:00 midnight (Eastern Prevailing Time) and closing the third day at 5:00 PM (Eastern Prevailing Time).

7.1.3 Duration of Financial Transmission Rights.

Each Financial Transmission Right acquired in a Financial Transmission Rights auction shall entitle the holder to credits of Transmission Congestion Charges for the period that was specified in the corresponding auction.

7.1A Long-Term Financial Transmission Rights Auctions.

7.1A.1 Auctions.

(i) Subsequent to each annual FTR auction conducted pursuant to Section 7.1 of Schedule 1 of this Agreement, the Office of the Interconnection shall conduct a long-term FTR auction for the three consecutive Planning Periods immediately subsequent to the Planning Period during which the long-term FTR auction is conducted.

(ii) The capacity offered for sale in long-term FTR auctions shall be the residual system capability after the Annual Auction Revenue Rights allocations and annual FTR auction. In determining the residual capability the Office of the Interconnection shall assume that all Auction Revenue Rights allocated in the immediately prior annual Auction Revenue Rights allocation process are self-scheduled into FTRs, which shall be modeled as fixed injections and withdrawals in the long-term FTR auction.

7.1A.2 Frequency and Timing.

Long-term FTR auctions shall consist of two rounds. The first round shall be conducted by the Office of the Interconnection approximately 11 months prior to the start of the three Planning Period term covered by the relevant long-term FTR auction and the second round shall be conducted approximately 4 months after the first round. In each round 50% of total capacity available in the long-term FTR auction shall be offered for sale. Eligible entities may submit bids to purchase and offers to sell FTRs at the start of the bidding period in each round. The bidding period shall be three business days ending at 1700 on the last day. PJM performs the FTR auction clearing analysis for each round and posts the auction results on the MUI within five business days after the close of the bidding period for each round.

7.1A.3 Products.

(i) The periods covered by long-term FTR auctions shall be: (1) any single Planning Period within the three Planning Period term covered by the relevant auction; and (2) the three Planning Period term covered by the relevant auction.

(ii) On-Peak, off-peak and 24-hour FTR obligations, as defined in Section 7.3.4 of Schedule 1 of this Agreement, shall be offered in long-term FTR auctions; FTR options shall not be offered.

7.1A.4 Participation Eligibility.

(i) To participate in long-term FTR auctions an entity shall be a PJM Member or a PJM Transmission Customer. Eligible entities may submit bids or offers in long-term FTR auctions, provided they own FTRs offered for sale.

7.1A.5 Specified Receipt and Delivery Points.

Eligible sources and sinks in long-term FTR auctions shall be limited to hubs, zones, aggregates, generators, and interface buses.

(b) Auction Revenue Rights Credits will be calculated based upon the clearing price results of the applicable Annual Financial Transmission Rights auction.

(c) Monthly and Balance of Planning Period FTR auction revenues, net of payments to entities selling Financial Transmission Rights into the auction, shall be allocated according to the following priority schedule:

(i) To stage 1 and 2 Auction Revenue Rights holders in accordance with section 7.4.4 of Schedule 1 of this Agreement. If there are excess revenues remaining after a distribution made pursuant to this subsection, such revenues shall be distributed in accordance with subsection (c)(ii) of this section;

(ii) To the Residual Auction Revenue Rights holders in proportion to, but not more than their target allocation as determined pursuant to section 7.4.3(b) of Schedule 1 of this Agreement. If there are excess revenues remaining after a distribution made pursuant to this subsection, such revenues shall be distributed in accordance with subsection (c)(iii) of this section;

(iii) To FTR Holders in accordance with section 5.2.6 of Schedule 1 of this Agreement.

(d) Long-term FTR auction revenues associated with FTRs that cover individual Planning Periods shall be distributed in the Planning Period for which the FTR is effective. Long-term FTR auction revenues associated with FTRs that cover multiple Planning Years shall be distributed equally across each Planning Period in the effective term of the FTR. Long-term FTR auction revenue distributions within a Planning Period shall be in accordance with the following provisions:

(i) Long-term FTR Auction revenues shall be distributed to Auction Revenue Rights holders in the effective Planning Period for the FTR. The distribution shall be in proportion to the economic value of the ARRs when compared to the annual FTR auction clearing prices from each round proportionately. The distribution shall not exceed, when added to the distribution of revenues from the prompt-year annual FTR auction itself, the economic value of the ARRs when compared to the annual FTR auction clearing prices from each round proportionately.

(ii) Long-term FTR auction revenues remaining after distributions made pursuant to Section 7.4.1(d)(ii) of Schedule 1 of this Agreement shall be distributed pursuant to Section 5.2.6 of Schedule 1 of this Agreement.

7.4.2 Auction Revenue Rights.

(a) Prior to the end of each PJM Planning Period an annual allocation of Auction Revenue Rights for the next PJM Planning Period shall be performed using a two stage allocation process. Stage 1 shall consist of stages 1A and 1B, which shall allocate ten year and annual Auction Revenue Rights, respectively, and stage 2 shall allocate annual Auction Revenue Rights. The Auction Revenue Rights allocation process shall be performed in accordance with Sections 7.4 and 7.5 hereof and the PJM Manuals.

(b) In stage 1A of the allocation process, each Network Service User may request Auction Revenue Rights for a term covering ten consecutive PJM Planning Periods beginning with the immediately ensuing PJM Planning Period from a subset of the historical generation resources that were designated to be delivered to load based on the historical reference year for the Zone, and each Qualifying Transmission Customer (as defined in paragraph (f) of this section) may request Auction Revenue Rights based on the megawatts of firm service provided between the receipt and delivery points as to which the Transmission Customer had Point-to-Point Transmission Service during the historical reference year. The historical reference year for all Zones shall be 1998, except that the historical reference year shall be: 2002 for the Allegheny Power and Rockland Electric Zones; 2004 for the AEP East, The Dayton Power & Light Company and Commonwealth Edison Company Zones; 2005 for the Virginia Electric and Power Company and Duquesne Light Company Zones; and the Office of the Interconnection shall specify a historical reference year for a new PJM zone corresponding to the year that the zone is integrated into the PJM Interchange Energy Market. For stage 1, the Office of the Interconnection shall determine a set of eligible historical generation resources for each Zone based on the historical reference year and assign a pro rata amount of megawatt capability from each historical generation resource to each Network Service User in the Zone based on its proportion of peak load in the Zone. Auction Revenue Rights shall be allocated to each Network Service User in a Zone from each historical generation resource in a number of megawatts equal to or less than the amount of the historical generation resource that has been assigned to the Network Service User. Each Auction Revenue Right allocated to a Network Service User shall be to the aggregate load buses of such Network Service User in a Zone or, with respect to Non-Zone Network Load, to the border of the PJM Region. In stage 1A of the allocation process, the sum of each Network Service User's allocated Auction Revenue Rights for a Zone must be equal to or less than the Network Service User's pro-rata share of the Zonal Base Load for that Zone.