

customers on an annual basis. The ARRs will entitle these customers to an allocation of revenues from an annual mandatory FTR auction. See PJM Transmittal Letter at 3.

PJM’s proposal to restructure its FTR allocation process is of central concern to ELCON member companies in PJM and throughout the rest of the country. In many ways, PJM has served as a model for the Commission’s Standard Market Design (SMD) initiative and ELCON supports efforts by PJM and other RTO stakeholder processes to refine the basic SMD model to ensure properly functioning markets. In that regard, ELCON takes note of, and is very supportive of the comments filed by the PJM Industrial Customer Coalition (PJMICC) – the industrial group that participated in the PJM stakeholder process – in response to the PJM auction proposal.

The timing of PJM’s filing to revamp its FTR allocation procedures, however, may be premature and should not be considered a model for the industry at this time without consideration of the concerns ELCON addresses below. Specifically, the proposed changes are insufficient to address the problems that they are attempting to solve. While PJM’s effort is laudable, the proposal does not go far enough. Until the Commission has established its broader policy objectives through the finalization of the SMD NOPR, changes to the FTR allocation procedure in PJM should be the minimum necessary to meet the Commission’s objectives in Occidental Chemical Corp. v. PJM Interconnection, L.L.C., Docket No. EL02-121, 101 FERC ¶ 61,005 (Oct. 10, 2002), reh’g pending (“Occidental”).

PJM contends in its filing that its proposal is “consistent with the Commission’s SMD NOPR.” PJM Transmittal Letter at 2. ELCON urges the Commission to insist on less extensive reforms to the FTR allocation process until a clear direction is established through finalization of the SMD NOPR. First, the amendments to the FTR allocation process do not

solve the problem of FTR allocation when load switches suppliers, i.e., FTRs do not “follow the load” as required in FERC’s Occidental Order. The process proposed by PJM is extremely cumbersome and puts a retail customer at a disadvantage against the resources of large LSEs and generators. Second, the new auction procedures – which would be mandatory – do not ensure that the auction of FTRs will not be subject to the exercise of market power and undue discrimination. This possibility is particularly a problem where local market power can be exercised by generators (e.g., in load pockets).

In short, ELCON believes the auction proposal is premature and poorly designed. These potential pitfalls to the Congestion Revenue Rights (CRR)/FTR auction and allocation methods were raised by ELCON in its November 15, 2002 and January 10, 2003 SMD NOPR Comments.¹ Charging ahead with revisions to PJM’s FTR allocation procedures when important issues such as vulnerability of CRR/FTR allocation procedures to market power and manipulation have yet to be addressed is ill-advised. In the alternative, and in light of the Commission’s requirement that PJM revise its FTR allocation procedure in Occidental, ELCON urges the Commission to adopt the minimal changes endorsed by Occidental Chemical Corporation in its January 31, 2003 filing in this docket. The bigger changes can wait until the Commission has an opportunity to carefully consider the appropriate structure for CRRs/FTRs in the SMD. That approach would also allow the PJM stakeholder process to revisit the FTR auction and ARR allocation procedure and modify it – by a date certain – to address the concerns raised by our comments and the comments of other intervenors.

¹ ELCON filed joint SMD NOPR comments with the American Iron and Steel Institute (AISI) and American Chemistry Council (ACC) (together, Industrial Consumers). ELCON also joined the Transmission Dependent Utility Systems, Great River Energy, Buckeye Power Inc., Wolverine Power Supply Cooperative Inc., and the East Texas Cooperatives in a joint filing that stressed the importance of properly allocating CRRs to avoid the exercise of market power. See Joint Comments on Market Power Mitigation Issues, Nov. 15, 2002, Docket No. RM01-12, at 19-25.

COMMENTS

PJM's Transmittal Letter states that the amendments to the FTR allocation procedures are motivated by a desire to evolve the "maturing energy and transmission markets in the PJM region" by providing market participants with "more flexible transmission congestion hedging alternatives" and "markets for FTRs." PJM Transmittal Letter at 2. The amendments have been under consideration by various PJM stakeholder groups and member committees for approximately one year.

This effort acquired new urgency in October 2002, when the Commission issued its October 10, 2002 Order in Occidental. Occidental Chemical Corporation filed a complaint against PJM and Delmarva, requesting that a portion of Delmarva's existing FTRs attributable to Delmarva's service to Occidental be assigned to Occidental at such time as Occidental acquired a third party supplier or became its own LSE. The October 10 Order denied Occidental's complaint, but ordered PJM to modify its existing procedures for allocating FTRs no later than April 1, 2003, stating:

We agree that to maximize the benefits of retail competition, FTR allocations should reflect load shifts. We also recognize that PJM's existing FTR allocation procedures fail to provide this necessary flexibility....

Accordingly, we will deny Occidental's request for an immediate reallocation of Delmarva's FTRs. However, given the important role that such reallocations will play as retail competition programs continue to evolve, we direct PJM to modify its existing procedures and to make a filing reflecting these modifications by no later than April 1, 2003.

Occidental, slip op. at 6.

Industrial consumers play a critical role in exerting downward pressure on rates through effective self-supply, supplier switching and demand response. ELCON believes a flaw in the FTR or ARR allocation or auction process will jeopardize the benefits industrial consumers provide to competitive energy markets.

I. FTRs Fail To “Follow The Load” In Violation of FERC’s Order in Occidental Chemical Corp. v. PJM, et al. (Docket No. EL02-121)

PJM contends its ARR proposal is consistent with the Commission’s directive in Occidental, requiring that PJM modify its procedures to allow rights to follow load. PJM purports to achieve this objective in the following way:

ARR entitlements will be reassigned on a pro-rata basis within a transmission zone as load shifts between suppliers in that zone. This change will allow all customers that are paying for transmission to receive the benefit of congestion hedges and should facilitate retail market entry. Specifically, as load changes from one load serving entity (“LSE”) to another within a transmission zone, a proportional share of the ARRs defined to sink in the zone would be reassigned automatically to the new LSE.

PJM Transmittal Letter at 5.

While the FTRs – or more specifically their proxy, ARRs – appear to follow the load in the new proposal, they actually still reside only with LSEs, leaving consumers to fend for themselves in attempting to secure the value obtained by their LSEs with the ARR revenues associated with the consumer’s load. Additionally, the allocation process is unnecessarily complex to achieve FERC’s objective in Occidental. This complexity is demonstrated by the following description of the process through which loads (LSEs, not consumers) would have to reconfigure their ARRs:

[I]n the annual FTR auction, ARR holders will have the option to convert their ARRs into FTRs by “self-scheduling” the FTRs on the exact same source

and sink points as the ARR that have been allocated to the customer. Alternatively, customers can reconfigure their ARRs by bidding to acquire FTRs on alternative paths. Of course, the holders of ARRs also simply may retain the ARRs that have been allocated and receive the associated allocation of revenues from the auction.

Id. at 3. PJM's proposed FTR auction and ARR allocation process is too ill-defined at this stage for ELCON to conclude that FTRs will truly follow the consumer load through the untested ARR allocation and reassignment process, especially if only point-to-point customers have the ability to self-schedule and convert all of their ARRs into FTRs. Additionally, granting LSEs the right to convert their ARRs into FTRs by "self scheduling" potentially allows the same type of FTR hoarding by LSEs that has plagued PJM's existing FTR markets.

Rather than insist on a new mandatory FTR/ARR auction and allocation procedure, PJM should simply reassign FTRs monthly to follow the underlying consumer load as requested by Occidental. As noted in Occidental's January 31, 2003 Intervention and Protest in this docket, the proposed reassignment of ARRs to follow load demonstrates that FTRs could simply be reallocated by PJM in the same way. See Occidental Protest at 6. ELCON regards this approach as preferable until the Commission can adequately address the optimal CRR allocation method in the context of the SMD NOPR proceeding. Unfortunately, rather than simply address Occidental's complaint and the Commission's directive by reallocating FTRs, PJM has chosen to impose an untested regime of ARRs and a mandatory FTR auction. With a proposed effective date of March 12, 2003, PJM's proposed FTR auction and ARR allocation procedures will be implemented under the old Order No. 888 tariff regime, and not under the new Network Access Service (NAS) proposed in the SMD NOPR. This approach is unwarranted before the finalization of the SMD.

Not only is the FTR/ARR auction proposal premature in light of the ongoing SMD proceedings, the proposal is flawed and unworkable, as highlighted by the filings of PJMICC, Old Dominion Electric Cooperative, and Occidental. First, by insisting on a one-year transition period during which ARR source points must be unit-specific capacity resources, PJM unnecessarily benefits incumbent LSEs and generators. Second, PJM's proposal discriminates against customers in the new areas of PJM that seek competitive supply options by relying on the existing FTR allocation process in these new areas until June 1, 2004. Third, and most importantly from ELCON's perspective, end-use customers will not be able to fully protect themselves from transmission congestion unless FTRs/ARRs are allocated directly to the end-use customers in states with retail access, to LSEs in the states where retail access is not available, and to Market-Participating Loads (MPLs).² Unless the ARR is directly allocated to end-use customers, there is no guarantee that the LSEs will provide customers the full or any benefit of the FTR auction revenues. See PJMICC January 31, 2003 Protest at 8. While ELCON would prefer the development of a CRR/FTR auction and allocation process in the context of the SMD NOPR proceedings, the flaws in PJM's proposal, as pointed out by various PJM market participants, further caution against implementation of the current proposal.

II. The New, Mandatory Auction Procedures Are Potentially Vulnerable to the Exercise of Market Power and Undue Discrimination

ELCON stressed the importance of developing a CRR auction/allocation mechanism that will not be vulnerable to the exercise of market power in its November 15, 2002

² ELCON, AISI and ACC (together, Industrial Consumers) coined the term "Market-Participating Loads" in our Nov. 15, 2002 SMD NOPR Comments. MPLs can be end-use customers in retail access states or end-use customers that are otherwise allowed to participate in markets to provide demand response, sell excess generation or buy backup services.

and January 10, 2003 SMD NOPR Comments.³ ELCON believes the PJM FTR auction/ARR allocation proposal has the potential to invite market manipulation to the detriment of industrial and other end-use consumers, despite PJM's claim to the contrary:

Establishing FTR auctions for PJM's system capability in place of FTR allocations will not facilitate the exercise of market power, either generally or in load pockets. The PJM Market Monitoring Unit reviewed the proposed FTR auctions and reported that they should not result in the ability to exercise additional market power. In any event, auctions merely are mechanisms to make FTRs more available in an open and transparent manner. An entity improperly seeking to achieve a dominant market position could acquire financial rights bilaterally as readily as it can acquire them through auctions. No special considerations or rules are needed for the allocation of ARR to entities inside load pockets. PJM's market monitor will continue to monitor for all abuses of market power in load pockets, whether through FTRs/ARRs or otherwise.

PJM Transmittal Letter at 9, n. 7. ELCON supports the role of market monitors in ferreting out the exercise of market power by market participants. The Commission, however, must focus on structural safeguards that prevent the exercise of market power in the first place. PJM's belief, as stated above, that the auction will not result in "the ability to exercise additional market power" does nothing to address any existing exertion of market power in PJM. ELCON also cannot summarily agree with PJM that the auction format for FTR allocation will be no more likely to face market manipulation than bilateral trading of FTRs. Among other reasons, the proposed auction would be mandatory and bilateral trades, by definition, are voluntary.

Consider the following scenario: PJM will allocate the ARRs to LSEs and those ARRs are supposed to be reallocated among the affected LSEs proportionately as a customer moves from one supplier to another. The compensation for LSEs will come from the annual FTR auction process. An industrial consumer that wants to self-supply, however, will have to

³ See Industrial Consumers November 15, 2002 SMD NOPR Comments at 90-95; Industrial Consumers January 10, 2003 SMD NOPR Comments at 32-35.

figure out which source to use in order to be able to even apply for the ARRs. This method is proposed to change next year. However, even after this feature is changed, and FTRs/ARRs can be designated from a source zone to an industrial's load zone, the industrial still must secure its supply in that source zone in order to complete a zonal source to zonal sink request. The self-supplying industrial will only get the benefit of PJM's self-schedule option that converts ARRs into FTRs if it has specified and reserved a particular transmission path. As a result, the self-supplying industrial that is not a point-to-point customer and is relying on network service must then bid for additional FTRs to cover its actual load. PJM's proposal to automatically reassign ARRs on a proportional basis when a load changes suppliers does not go far enough because it reassigns the ARRs to the suppliers and not the load. An industrial planning to self-supply will have to match wits with the generation owners or their affiliated electricity distribution companies (EDCs) in its attempt to value the FTRs. As noted in Occidental's January 31, 2003 Protest, entities such as EDCs will always be at an informational advantage compared to a self-supplying industrial because the EDC will have both historical and real-time bus bar specific load information. Occidental Protest at 14-16. The generation owners and affiliated EDCs are the very parties who can potentially manipulate the value of the FTRs down the road, and therefore control whether the self-supplying industrial's offer is a losing or winning bet.

ELCON generally addressed this issue in its January 10, 2003 SMD NOPR comments. While ELCON supports the eventual transition to a system of auctioned CRRs/FTRs coupled with ARRs, the January 10 comments stressed the importance of a transition period to prevent the potential exercise of market power. ELCON is concerned that if the market value of the transmission system – as represented by CRRs/FTRs – is separated from end-use customers who ultimately pay for the transmission system, some market participants will unduly profit at

the expense of consumers by using CRRs/FTRs to game their bids and generation scheduling or dispatch and not for their intended purpose which is to hedge.⁴

ELCON is also concerned that if there is not a sufficient amount of CRRs/FTRs available in the market, end-use customers (or their suppliers) may not be able to hedge their transactions against congestion, and power markets will remain unnecessarily unstable and potentially face future reliability problems. These concerns form the basis for our position on the allocation of CRRs/FTRs by either direct assignment or auction. However, auctions should be delayed until end-use customers, LSEs and MPLs have some experience with the new market mechanics and some understanding of the innate value of the CRRs/FTRs that they hold. The Commission should not permit any entities other than end-use customers, LSEs and MPLs to hold CRRs/FTRs or participate in auctions until the Commission determines that other entities – e.g., generators or ITCs – lack market power such that they cannot abuse the congestion management system through the ownership or hoarding of CRRs/FTRs. CRRs/FTRs will be scarce even under the best of circumstances. Therefore, FERC should not conclude that it is sound public policy at this stage in PJM's and the general electricity market's development to allow CRR/FTR ownership for the purpose of gaming the dispatch process, especially when PJM

⁴ Old Dominion illustrated this potential:

Vertically-integrated utilities with generation in load pockets stand to profit from the FTR auction mechanism in a manner that creates a dis-incentive to investments in congestion-relieving alternatives. Where the utility holds valuable FTRs, the profits from FTRs could easily outweigh the burden and potential profit of investment in new transmission facilities that would ease congestion. If the utility owns generation in the constrained area, congestion creates an opportunity to reap profits through the sale of that generation. Under either scenario, an auction mechanism would allow entities with market power (and sufficient resources) to out-bid other market participants in obtaining valuable FTRs, then use those FTRs to their competitive advantage, all at the expense of load. Rather than allow valuable FTRs to simply go to the highest bidder, customers that have traditionally relied on the transmission system and paid the costs therefore should be allocated FTRs directly.

Jan. 31, 2003 Protest of Old Dominion Electric Cooperative, Docket No. ER03-406, at 18-19.

intends to implement the FTR/ARR auction and allocation process under the Order No. 888 tariff regime.

Mandatory FTR or CRR auctions will be highly vulnerable to the exercise of market power in congested load pockets until effective demand response and transmission expansion alleviates the congestion. In the short run, PJM's untested proposal will decrease competition by discouraging loads from self-supplying or seeking new supply options if they must supplement their allocation of ARR or must reconfigure their ARRs by participating in the FTR auction process in order to change from one source to another.

CONCLUSION

PJM's implementation of a new, untested mandatory FTR auction and ARR allocation procedure is unnecessary to meet its obligations under the Occidental Order and premature in light of the pending SMD NOPR. In the interim, FTRs should be reassigned to follow end-use consumer load until the potential for market power in mandatory CRR/FTR auctions has been addressed and resolved by FERC on a generic basis in the SMD proceedings. ELCON urges FERC to direct the PJM stakeholder process to revisit the FTR auction and ARR allocation procedure and modify it – by a date certain – to address the concerns raised in our comments, as well as in the comments of the PJMICC, Occidental and Old Dominion.

MOTION FOR LATE INTERVENTION SHOULD BE GRANTED

Pursuant to 18 C.F.R. § 385.214(d), ELCON's motion for late intervention should be granted. ELCON represents a number of substantial industrial facilities in PJM, and also represents the general interests of industrial consumers throughout the country seeking the

implementation of standardized markets that promote effective competition on the wholesale and retail level. ELCON's ability to respond to the PJM filing in this docket has been delayed by the occurrence of its annual meeting during the first week in February. ELCON believes that its late intervention, filed shortly after the deadline, will not be disruptive or prejudice any parties, as the proceeding is in its earliest stages.

DESCRIPTION OF INTERVENOR

ELCON is an association of industrial consumers of electricity organized to promote the development of coordinated and rational federal and state policies that will assure an adequate, reliable, and efficient electricity supply for all users at competitive rates. ELCON member companies produce a wide range of products from virtually every segment of the manufacturing community. The member companies of ELCON consume approximately five percent of all electricity in the United States. ELCON is an intervenor in the related Occidental/PJM proceeding, Docket No. EL02-121.

NOTICES AND COMMUNICATIONS

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Dated: February 14, 2003

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing Motion for Late Intervention and Comments of the Electricity Consumers Resource Council were today mailed to parties on the service list of this proceeding by U.S. mail, postage prepaid.

Dated at Washington, D.C., this 14th day of February, 2003.

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