

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Provider of Last Resort Roundtable  
Docket No. M-00041792**

**Comments of PJM Interconnection**

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## **Introduction**

PJM appreciates this opportunity to offer the following comments for the Pennsylvania Public Utility Commission to consider as it contemplates what additional regulatory actions may be necessary to address post-transition Provider of Last Resort (POLR) obligations. PJM's comments address (1) wholesale level technical or legal issues relative to how an Electric Distribution Company (EDC) or other default provider would need to interact with PJM in order to satisfy load requirements, (2) POLR design considerations, and (3) broader policy issues regarding demand response.

## **Technical/Legal Issues**

As PJM noted in its comments during the Commission's Roundtable discussion on April 8, 2004, PJM has worked with the states of New Jersey and Maryland in implementing the default service rules that the respective state commissions have adopted at the conclusion of their respective transition phases. New Jersey, for example, adopted a wholesale, competitive auction structure to allocate slices of retail load obligation to suppliers based on bids for such load obligation. Maryland, on the other hand, adopted a Request for Proposal process that affords suppliers the opportunity to bid to become a full-requirements supplier for a slice of retail load that will continue to be served by the EDC. PJM's focus on such rules is what is required at the PJM/wholesale level to accommodate the retail rules. Based on PJM's experiences with the New Jersey and Maryland rules, PJM offers the following items for the Commission's consideration.

1. PJM Planning Period Considerations

PJM recommends that the Pennsylvania Commission give consideration to the interplay of any proposed POLR rules with the processes in PJM that key off the PJM Planning Period. PJM's capacity adequacy and transmission adequacy constructs are based on a Planning Period (June 1 through May 31) concept. The period begins June 1 because that is the beginning of PJM's peak period, and the period spans twelve months because the planning constructs that trigger off of it are annual constructs. PJM, for example, worked through the stakeholder process to accommodate the fact that the first year of the New Jersey Basic Generation Service program commenced on August 1 by (a) adding additional capacity market auctions, and (2) offering a carve-out to New Jersey load in the FTR allocation process to accommodate the June 1-July 31 time frame and then the August 1 through to May 31 timeframe.<sup>1</sup>

The rules regarding FTRs have since changed to provide an automatic assignment of a pro rata share of Auction Revenue Rights (ARRs) when load shifts to another supplier, so an accommodation like what was done to facilitate the first year of the NJ Basic Generation Service program would not be needed in the future. However, the entities responsible for serving the POLR load may wish to enter the PJM FTR auction directly and not merely receive an assignment of an allocated share. The Commission, therefore, may wish to consider how the retail rules that are developed impact the

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<sup>1</sup> The FTR allocation process was based on which entity had the load obligation on June 1. Because the first year of NJ BGS began on August 1, the entity with the load obligation on June 1 was not the same as the entity with the load obligation on August 1. Additionally, since the majority of the load within the state of New Jersey was affected since that load was still taking Basic Generation Service and not otherwise with a competitive, third-party supplier, the stakeholders in PJM entertained the concept of allowing a two phase allocation of FTRs for the transmission zones in New Jersey. The stakeholders endorsed, and the Federal Energy Regulatory Commission approved, a two-phase allocation of FTRs for the load within the transmission zones in New Jersey in 2002 to accommodate this nuance of New Jersey law. In subsequent years, however, New Jersey was able to synch its BGS rules with the PJM Planning Period.

suppliers' ability to enter the FTR auction directly. Since PJM is not able to speak to what suppliers may prefer, PJM offers no specific guidance for how the Commission should resolve this. PJM merely raises this so that the Commission is aware that there may be implications related to FTRs associated with the timing of retail POLR programs.

Additionally, the Commission may consider whether there are any implications for other POLR program rules that may be proposed which may not coincide with the PJM Planning Period. PJM has not considered the universe of proposals that may come before the Commission that have an interplay with the PJM Planning Period; therefore, PJM would be happy to provide additional commentary on these matters as specific retail rules are proposed.

## 2. Qualifications for POLR Providers

The states within the PJM region that have either already adopted post-transition default service rules, or are in the process of adopting such rules, have considered the interplay of the eligibility and qualifications PJM imposes on wholesale energy buyers, transmission customers and load serving entities (which could be one and the same entity) with their retail rules. PJM, therefore, requests that Pennsylvania similarly consider and explicitly make clear in its POLR rules that the entity (or entities, depending on how the obligations may be parsed) that must interface with PJM to satisfy the load obligations under POLR must also satisfy PJM standards and obligations for such services as outlined in the PJM Operating Agreement, PJM Open Access Transmission Tariff, and PJM Reliability Assurance Agreement/PJM West Reliability Assurance Agreement. While PJM's rules would apply to the entity with the wholesale interface even in the absence of such explicit retail rules, such explicit treatment in the retail rules

may eliminate confusion on the part of the POLR suppliers. Explicit treatment would also provide clarity to PJM in ensuring that the correct entities are signatories to the PJM Agreements and assume the corresponding wholesale obligations.

Since several parties during the course of the POLR Roundtable discussions referenced the PJM Credit Policy and questioned its applicability, PJM also offers a few comments regarding that policy to clarify any misperceptions about the applicability and purpose of that policy that may exist in this docket. The PJM Credit Policy applies to those entities that obtain services from PJM (such as transmission service) or who participate in the PJM markets (such as the energy market, capacity market, FTR market, etc). A copy of the policy is attached to these comments as **Appendix A**. The purpose of the PJM Credit Policy is to minimize the possibility of failure of payment for services rendered pursuant to the PJM Agreements and does not address any additional retail obligations that these entities may have.

### 3. EDC/Supplier Defaults of PJM Obligations

Wholesale customer defaults in PJM are defined as (1) failure, for reason other than a billing dispute, to make payment to PJM on or before the date due, or (2) failure at any time to meet PJM's creditworthiness requirements, and such failure is not corrected within three business days after PJM notifies the customer and requests the customer to cure that failure. PJM Operating Agreement Section 7.3. Upon the occurrence of a default, PJM may initiate a proceeding with the Federal Energy Regulatory Commission (FERC) to terminate service to that customer and may not terminate service until the FERC approves the request. There is one exception to this rule that the Pennsylvania Commission should consider as it defines rules for POLR service beyond the transition

period. The exception provides that “in the event that a state required retail access program provides for continuation of retail service to affected end-use customers by another supplier that is a Transmission Customer, then the Transmission Provider [PJM] may, upon default by a Transmission Customer, immediately terminate Transmission Service to the defaulting Transmission Customer for the load of such end-use customers.” Id. Thus, PJM recommends that the Pennsylvania Commission clearly designate which entity has this ultimate responsibility for POLR load in order to avoid confusion in the event of a supplier default.

4. Legal Relationship Between EDC and POLR Supplier Vis-a-Vie PJM

To the extent that the Pennsylvania Commission may consider separating responsibility for aspects of the POLR obligation between the current EDC and a POLR supplier, PJM would like to offer the following comments regarding the implications for PJM’s market settlements system as well as the implication for who has the rights to FTRs per the PJM Tariff. With regard to the current PJM market settlements system, the billing determinant associated with transmission service cannot be separately assigned to more than one entity. In other words, to the extent that the financial responsibility for the various PJM charges related to transmission service are split between an EDC and a supplier per retail agreements, PJM’s settlements system currently is not equipped to automatically divide the payment responsibility between those parties as per their retail agreement. The PJM market settlements system was based on the premise that the entity with the load obligation also would be the Transmission Customer of PJM.

Other jurisdiction's retail default rules have not have changed that premise, but they have shifted payment responsibility for certain aspects of the transmission obligation to the entity that is not the Transmission Customer. (See PJM's Power Point presentation from the April 8, 2004 POLR Roundtable for additional detail about "PJM Relationship with POLR Service Providers.) While the payment responsibility could be addressed between the EDC and the default supplier completely outside of PJM's market settlements system, under the Maryland Standard Offer Service agreements, and now under discussion for Duquesne and the District of Columbia, both the EDCs and the default suppliers wish for this to be accommodated in the PJM market settlements system. The rationale underlying this desire is administrative ease and alignment of PJM creditworthiness obligations. Since this is still a relatively small portion of the overall PJM load, PJM has agreed to manually adjust the PJM market settlements accounts to shift cost responsibility for certain transmission related charges to be in alignment with the retail agreements.<sup>2</sup> However, extensive manual adjustments to the PJM bill is not a preferred method of ensuring accuracy in and timeliness of the PJM bill.

PJM, therefore, has engaged the PJM stakeholders in the PJM Retail Access Working Group to consider whether there should be any modifications to the PJM market settlements system to better accommodate retail choice programs. PJM encourages parties that have an interest in this matter to participate in the discussions of that group. The group, among other things, will be discussing whether it is possible to identify a "menu" of EDC/Supplier relationships that then the PJM market settlements system may

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<sup>2</sup> PJM also required the EDC and the default supplier to execute a Declaration of Authorities form to indicate to PJM which entity is responsible for what PJM obligations and charges so that PJM would have a legal basis for delineating the obligations and for manually adjusting the market settlements account.

need to be revamped in order to support. The group also would consider the cost implication for any market settlement system redesign.

### **POLR Design Considerations**

#### 1. Timing of RFP/Auction

As PJM stated in its remarks during the April 8, 2004 POLR Roundtable, whether the Pennsylvania Commission were to consider an RFP process or Auction process to assign responsibility for POLR load – if such a construct were to be adopted in Pennsylvania, the Commission should consider coordinating the timing of the assignment process with the other states in the PJM region to avoid potential market disruption. For example, were a potential POLR supplier to wish to participate in multiple of the state processes that occur concurrently, that supplier might allocate risk premiums to the fact that it does not know with certainty which load obligation it will obtain. The general concern is that there may be a less efficient result for the various state programs if the programs are not coordinated than there might otherwise be if the timing of the programs were coordinated.

This timing, as stated above, also should recognize the importance of PJM's Planning Period so that suppliers can appropriately procure the resources they need and hedges they desire to meet the POLR obligation. Additionally, the timing is important to the suppliers who must obtain services from PJM with respect to any PJM market settlements account reconfiguration that may be required for the POLR load obligation. Any adjustments in PJM market settlements accounts to reflect the load obligation must



be completed before the entity is able to enter the FTR Auction or the Capacity Credit Market.

2. Three RTO Footprints in Pennsylvania

During the discussion throughout the POLR Roundtables, comments were made regarding the fact that Pennsylvania is split between PJM, the Midwest ISO, the New York ISO and even a portion of the state currently not within any RTO. While various nuances between RTO rules may require the details of POLR design to be different in those EDC service territories, the presence of a wholesale energy market in PJM, the NY ISO, and soon in the Midwest ISO -- as well as the development of the Joint and Common Market between PJM and the Midwest ISO —will provide benefits via options in supply procurement and the transparency in energy prices within those wholesale energy markets to Pennsylvania that can be transferred from the suppliers to the retail customers. PJM, however, will not in these comments address the region of Pennsylvania currently not within any RTO – Duquesne – as that matter is pending before this Commission in another docket. PJM participated in Docket No. P-00032071, including the submission of the Direct Testimony of Steven R. Herling and a Main Brief that outlays PJM’s position regarding Duquesne’s integration into PJM.

**Policy Issues**

During the April 8, 2004 POLR Roundtable PJM offered comments about the importance of ensuring a sufficient link between the wholesale load service obligation and the retail end user in sending proper signals to incent and encourage demand

response. Typically, within the PJM region, the entity with the relationship with the end user is the entity that offers demand response programs to retail customers. To the extent that the entity that has the tie to the retail end user does not have the associated obligation to purchase at wholesale the supply to satisfy the retail load, there may be less incentive for that entity to develop new or encourage expansion of existing demand response programs. (There may be an incentive for other entities to specialize in DSR, however.) The Commission should consider the implications for existing utility demand response programs once post-transition phase POLR programs are implemented and whether the current price responsive load will remain active in the market. Additionally, the Commission may wish to consider phased implementation of advanced metering to additional customers and classes of customers well as retail default rate designs that provide a market based, dynamic pricing options to those customers that have the metering infrastructure and the ability to respond to price.

## **Conclusion**

PJM appreciates the opportunity to participate in the Pennsylvania Commission's POLR Roundtable discussions and to offer these comments for the Commission's consideration. PJM welcomes further dialog on any of the comments offered by PJM. PJM notes too that while some of PJM's comments focus on limitations in the PJM rules or systems, accommodations for a default service rules in Pennsylvania that may require rule changes in PJM may be considered in the PJM stakeholder process. For any such accommodations, it will be important to take into account the time required to work

through the PJM stakeholder process and to receive approval from the Federal Energy Regulatory Commission for any changes to the PJM Agreements or Tariff.

Respectfully submitted,

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PJM Interconnection

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## **APPENDIX A**

## ATTACHMENT Q

### PJM CREDIT POLICY

#### POLICY STATEMENT:

It is the policy of PJM Interconnection, LLC (“PJM”) that prior to an entity (**Applicant**) participating in the PJM Markets, or in order to take **Transmission Service**, the Applicant must demonstrate its ability to meet PJM’s credit requirements.

Prior to becoming a **Participant/Member** of PJM, each Applicant must have an approved Credit Application (including Credit Agreement) and an established **Working Credit Limit** with PJM. In addition to completing a PJM Credit Application, each Applicant and/or Participant/Member will be subject to a complete credit evaluation that will include, but not be limited to, a review of financial statements, rating agency reports, and other pertinent indicators of credit strength.

#### POLICY INTENT:

This Credit Policy describes requirements for: (1) the establishment and maintenance of credit by **Market Participants, Transmission Customers**, (together “Participants”), Applicants seeking membership to be Market Participants and/or Transmission Customers, and/or Members pursuant to one or more of the **Agreements**, and (2) forms of security that will be deemed acceptable (hereinafter the “**Financial Security**”) in the event the Applicant or Participant/Member does not satisfy the financial requirements to establish unsecured credit.

This policy also sets forth the credit limitations that will be imposed on Applicants, Participants, and Members in order to minimize the possibility of failure of payment for services rendered pursuant to the Agreements, and conditions that will be considered an event of default pursuant to this policy and the Agreements.

The Office of PJM Interconnection, LLC shall administer and implement the terms of this Credit Policy.

#### APPLICABILITY:

This policy applies to all new Applicants, Members, Market Participants, and Transmission Customers who utilize services or participate in the PJM Markets.

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Vice President, Governmental Policy  
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**IMPLEMENTATION:**

**I. CREDIT EVALUATION**

Each Applicant/Participant/Member will be subject to a complete credit evaluation in order for PJM to determine creditworthiness and to establish an **Unsecured Credit Allowance**, if applicable. PJM will identify any necessary Financial Security requirements and establish a Working Credit Limit for each Applicant/Participant/Member. In addition, PJM will perform follow-up credit evaluations on at least an annual basis.

If a **Corporate Guaranty** is being utilized to establish credit for an Applicant/Participant/Member, the guarantor will be evaluated and the Unsecured Credit Allowance or Financial Security requirement will be based on the financial strength of the Guarantor.

**A. Initial Credit Evaluation**

In completing the initial credit evaluation, PJM will consider:

**1) Rating Agency Reports**

In evaluating credit strength, PJM will review rating agency reports from Standard & Poor's, Moody's Investors Service, Fitch Ratings, or other nationally known rating agencies. The focus of the review will be on senior unsecured debt ratings; however, PJM will consider other ratings if senior unsecured debt ratings are not available.

**2) Financial Statements and Related Information**

Each Applicant must submit audited financial statements for the most recent fiscal quarter, as well as the most recent three fiscal years, or the period of existence of the Applicant, if shorter. If audited financial statements are not available, financial statements as described in §A.2.b.iii below must be submitted, signed and attested to as a fair presentation of the financial condition of the Applicant in accordance with generally accepted accounting principles by an officer of the Applicant.

The information should include, but not be limited to, the following:

- a.** If publicly traded:
  - i.** Annual and quarterly reports on Form 10-K and Form 10-Q, respectively.
  - ii.** Form 8-K reports, if any.
  
- b.** If privately held:
  - i.** Management's Discussion & Analysis
  - ii.** Report of Independent Accountants
  - iii.** Financial Statements, including:

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- Balance Sheet
  - Income Statement
  - Statement of Cash Flows
  - Statement of Stockholder's Equity
- iv. Notes to Financial Statements

If the above information is available on the Internet, the Applicant may provide a letter stating where such statements may be located and retrieved by PJM. For certain Applicants, some of the above financial submittals may not be applicable, and alternate requirements may be specified by PJM.

In the credit evaluation of Cooperatives and Municipalities, PJM may request additional information as part of the overall financial review process and will consider other alternative measures in determining financial strength and creditworthiness.

### 3) References

Each Applicant is to provide at least one (1) bank and three (3) utility credit references. In the case where an Applicant does not have the required utility references, trade payable vendor references may be substituted.

### 4) Litigation, Commitments and Contingencies

Each Applicant is also required to provide information as to any known **Material** litigation, commitments or contingencies as well as any prior bankruptcy declarations or Material defalcations by the Applicant or its predecessors, subsidiaries or **Affiliates**, if any. These disclosures shall be made upon application, upon initiation or change, and at least annually thereafter, or as requested by PJM.

### 5) Other Disclosures

Each Applicant is required to disclose any Affiliates that are currently Members of PJM or are applying for membership within PJM. Each Applicant is also required to disclose the existence of any ongoing investigations by the Securities and Exchange Commission ("SEC"), Federal Energy Regulatory Commission ("FERC"), or any other governing, regulatory, or standards body. These disclosures shall be made upon application, upon initiation or change, and at least annually thereafter, or as requested by PJM.

## B. Ongoing Credit Evaluation

On at least an annual basis, PJM will perform follow-up credit evaluations on all Participants/Members. In completing the credit evaluation, PJM will consider:

**1) Rating Agency Reports**

In evaluating credit strength, PJM will review rating agency reports from Standard & Poor's, Moody's Investors Service, Fitch Ratings, or other nationally known rating agencies. The focus of the review will be on senior unsecured debt ratings; however, PJM will consider other ratings if senior unsecured debt ratings are not available.

**2) Financial Statements and Related Information**

Each Participant/Member must submit audited annual financial statements as soon as they become available and no later than 120 days after fiscal year end. Each Participant/Member is also required to provide PJM with quarterly financial statements promptly upon their issuance, but no later than 60 days after the end of each quarter. If audited financial statements are not available, financial statements as described in §B.2.b.iii below must be submitted, signed and attested to as a fair presentation of the financial condition of the Participant/Member in accordance with generally accepted accounting principles by an officer of the Member/Participant. If financial statements are not provided within the timeframe required, the Participant/Member may not be granted an Unsecured Credit Allowance.

The information should include, but not be limited to, the following:

- a. If publicly traded:
  - i. Annual and quarterly reports on Form 10-K and Form 10-Q, respectively.
  - ii. Form 8-K reports, if any, immediately upon issuance.
  
- b. If privately held:
  - i. Management's Discussion & Analysis
  - ii. Report of Independent Accountants
  - iii. Financial Statements, including:
    - Balance Sheet
    - Income Statement
    - Statement of Cash Flows
    - Statement of Stockholder's Equity
  - iv. Notes to Financial Statements

If the above information is available on the Internet, the Participant/Member may provide a letter stating where such statements may be located and retrieved by PJM. For certain Participants/Members, some of the above financial submittals may not be applicable, and alternate requirements may be specified by PJM.

In the credit evaluation of Cooperatives and Municipalities, PJM may request additional information as part of the overall financial review process and will consider other alternative measures in determining financial strength and creditworthiness.



**3) Material Changes**

Each Participant/Member is responsible for informing PJM immediately, in writing, of any Material change in its financial condition.

For the purpose of this policy, a Material change in financial condition may include, but not be limited to, any of the following:

- a. A downgrade of any debt rating by any rating agency;
- b. Being placed on a credit watch with negative implications by any rating agency;
- c. A bankruptcy filing;
- d. Any action requiring filing of a Form 8-K;
- e. Insolvency;
- f. A report of a quarterly or annual loss or a decline in earnings of ten percent or more compared to the prior period;
- g. Restatement of prior financial statements;
- h. The resignation of key officer(s); or
- i. The filing of a lawsuit that could adversely impact any current or future financial results by ten percent or more.

If there is a Material change in the financial condition of the Participant/Member, PJM may require the Participant/Member to provide Financial Security within three (3) **Business Days**, in an amount and form approved by PJM. If the Participant/Member fails to provide the required Financial Security, the Participant/Member shall be in default under this Credit Policy.

**4) Litigation, Commitments, and Contingencies**

Each Participant/Member is also required to provide information as to any known Material litigation, commitments or contingencies as well as any prior bankruptcy declarations or Material defalcations by the Participant/Member or its predecessors, subsidiaries or Affiliates, if any. These disclosures shall be made upon initiation or change or as requested by PJM.

**5) Other Disclosures**

Each Participant/Member is required to disclose any Affiliates that are currently Members of PJM or are applying for membership within PJM. Each Participant/Member is also required to disclose the existence of any ongoing investigations by the Securities and Exchange Commission (“SEC”), Federal Energy Regulatory Commission (“FERC”), or any other governing, regulatory, or standards body. These disclosures shall be made upon initiation or change, or as requested by PJM.

### **C. Corporate Guaranty**

If a Corporate Guaranty is being utilized to establish credit for an Applicant/Participant/Member, the Guarantor will be evaluated and the Unsecured Credit Allowance or Financial Security requirement will be based on the financial strength of the Guarantor.

An irrevocable and unconditional Corporate Guaranty obtained from a parent or an Affiliate of the Applicant/Participant/Member ("Guarantor") may be utilized as part of the credit evaluation process, but will not be considered a form of Financial Security. The Corporate Guaranty will be considered a transfer of credit from the Guarantor to the Applicant/Participant/Member. The Corporate Guaranty must guarantee the (i) full and prompt payment of all amounts payable by Applicant/Participant/Member under the Agreements, and (ii) performance by the Applicant/Participant/Member under this policy.

The Corporate Guaranty should clearly state the identities of the "Guarantor," "Beneficiary" (PJM) and "Obligor" (Applicant/Participant/Member) and the relationship between the Guarantor and the Applicant/Participant/Member Obligor. The Corporate Guaranty must be duly authorized by the Guarantor, must be signed by an officer of the Guarantor, and must be accompanied by an executed and sealed Secretary's Certificate noting that the Guarantor was duly authorized to provide such Corporate Guaranty and that the person signing the Corporate Guaranty is duly authorized.

An Applicant/Participant/Member supplying a Corporate Guaranty must provide the same information regarding the Guarantor as is required in the "Initial Credit Evaluation" §I.A. and the "Ongoing Evaluation" §I.B. of this policy, including providing the Rating Agency Reports, Financial Statements and Related Information, References, Litigation Commitments and Contingencies, and Other Disclosures.

If there is a Material change in the financial condition of the Guarantor or if the Corporate Guaranty comes within 30 days of expiring without renewal, the Participant/Member will be required to provide Financial Security either in the form of a cash deposit or a letter of credit. Failure to provide the required Financial Security will constitute an event of default under this Credit Policy. A Participant/Member may request PJM to perform a credit evaluation in order to determine creditworthiness and to establish an unsecured credit allowance, if applicable. If PJM determines that a Participant/Member does qualify for a sufficient Unsecured Credit Allowance, then Financial Security will not be required.

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The PJM Credit Application contains an acceptable form of Corporate Guaranty that should be utilized by an Applicant/Participant/Member choosing to establish its credit with a Corporate Guaranty. If the Corporate Guaranty varies in any way from the PJM format, it must first be reviewed and approved by PJM. All costs associated with obtaining and maintaining a Corporate Guaranty and meeting the policy provisions are the responsibility of the Applicant/Participant/Member.

## **II. CREDIT ALLOWANCE AND WORKING CREDIT LIMIT**

PJM's credit evaluation process will include calculating a **Credit Score** for each Applicant/Participant/Member. The credit score will be utilized to determine an Applicant/Participant/Member's Unsecured Credit Allowance.

Applicants/Participants/Members who do not qualify for unsecured credit will be required to provide Financial Security based on their Peak Market Activity, as provided below.

A corresponding Working Credit Limit will be established based on the Unsecured Credit Allowance and/or the Financial Security provided.

Where Applicant/Participant/Member of PJM are considered Affiliates, Unsecured Credit Allowances and Working Credit Limits will be established for each individual Applicant/Participant/Member, subject to an aggregate maximum amount for all Affiliates as provided for in §II.E of this policy.

In the credit evaluation of Cooperatives and Municipalities, PJM may request additional information as part of the overall financial review process and will consider other alternative measures in determining financial strength and creditworthiness.

### **A. Credit Score**

A Credit Score will be generated from PJM's review and analysis of various factors that are predictors of financial strength and creditworthiness. Key factors in the scoring process include, but are not limited to, ratings from credit rating agencies, financial ratios, and years in business. PJM will consistently apply the measures it uses in determining Credit Scores.

### **B. Unsecured Credit Allowance**

PJM will determine an Applicant/Participant/Member's Unsecured Credit Allowance based on its Credit Score and the parameters in the table below. The maximum Unsecured Credit Allowance is the lower of:

- 1) A percentage of the Applicant/Participant/Member's **Tangible Net Worth**, as stated in the table below, with the percentage based on the Applicant/Participant/Member's credit score; and
- 2) A dollar cap based on the credit score, as stated in the table below:

Credit Score	Tangible Net Worth Factor	Maximum Unsecured Credit Allowance (\$ Million)
91-100	6.375-7.50%	\$150
81-90	5.125-6.25%	\$125
71-80	3.875-5.00%	\$100
61-70	2.625-3.75%	\$20
51-60	1.375-2.50%	\$0-\$5
41-50	0.125-1.25%	\$0-\$2
40 and Under	0%	\$0

If a Corporate Guaranty is utilized to establish an Unsecured Credit Allowance for an Applicant/Participant/Member, the value of a Corporate Guaranty will be the lesser of:

- The limit imposed in the Corporate Guaranty;
- The Unsecured Credit Allowance calculated for the Guarantor; and
- A portion of the Unsecured Credit Allowance calculated for the Guarantor in the case of Affiliated Applicants/Participants/Members.

PJM has the right at any time to modify any Unsecured Credit Allowance and/or require additional Financial Security as may be deemed reasonably necessary to support current market activity.

### C. Peak Market Activity and Financial Security Requirement

If PJM determines that an Applicant/Participant/Member does not qualify for an Unsecured Credit Allowance, that Applicant/Participant/Member will be required to provide Financial Security equal to its Peak Market Activity to support its activity in the PJM market. Peak Market Activity will be determined as follows:

- 1) Applicants shall provide PJM's Treasury Department with an estimate of their transaction activity for all PJM markets and services over the next twelve months. PJM will determine the two consecutive months for which the total invoiced amount (to be determined before any reduction for prepayments) is expected to be highest to determine an Applicant's Peak Market Activity.

- 2) PJM will review the transaction activity of Participants/Members for all PJM markets and services in order to determine the two consecutive months for which the total invoiced amount was highest. PJM may review a Participant/Member's market activity at its discretion but will review such activity at least annually.

#### **D. Working Credit Limit**

PJM will establish a Working Credit Limit for each Applicant/Participant/Member against which its **Total Net Obligation** will be monitored. The Working Credit Limit is defined as 85% of the Financial Security provided to PJM and/or 85% of the Unsecured Credit Allowance determined by PJM based on a credit evaluation. An Applicant/Participant/Member's Total Net Obligation should not exceed its Working Credit Limit.

Example: After a credit evaluation by PJM, a Participant/Member is deemed able to support an Unsecured Credit Allowance of \$10.0 million. The Participant/Member will be assigned a Working Credit Limit of \$8.5 million. PJM will monitor the Participant/Member's activity against the Working Credit Limit.

An Applicant/Participant/Member with an Unsecured Credit Allowance may choose to provide Financial Security in order to increase its Working Credit Limit. An Applicant/Participant/Member with no Unsecured Credit Allowance may also choose to increase its Working Credit Limit by providing Financial Security in an amount greater than its Peak Market Activity.

If a Participant/Member's Total Net Obligation approaches its Working Credit Limit, PJM may require the Participant/Member to make an advance payment or increase its Financial Security in order to maintain its Total Net Obligation below its Working Credit Limit.

Example: After 30 days, and with 20 days remaining in the current billing cycle, a Participant/Member approaches its \$3.0 million Working Credit Limit. PJM may require a prepayment of \$2.0 million in order that the expected final bill will not exceed the Working Credit Limit.

If a Participant/Member exceeds its Working Credit Limit or is required to make advance payments four or more times during a twelve-month period, PJM may require Financial Security in an amount as may be deemed reasonably necessary to support its Total Net Obligation.

## **E. Credit Limit Setting For Affiliates**

If two or more Applicants/Participants/Members are Affiliates and each is being granted an Unsecured Credit Allowance and a corresponding Working Credit Limit, PJM will consider the overall creditworthiness of the Affiliated Applicants/Participants/Members when determining the Unsecured Credit Allowances and Working Credit Limits in order not to grant more unsecured credit than the overall corporation could support.

**Example:** Participants A and B each have a \$10.0 million Corporate Guaranty from their common parent, a holding company with an Unsecured Credit Allowance calculation of \$12.0 million. PJM may limit the Unsecured Credit Allowance for each Participant to \$6.0 million, so the total Unsecured Credit Allowance does not exceed the corporate total of \$12.0 million.

PJM will work with Affiliated Participants/Members to allocate the total Unsecured Credit Allowance among the Affiliates while assuring that no individual Participant/Member exceeds the Unsecured Credit Allowance appropriate for its credit strength.

## **F. Working Credit Limit Violations**

### **1) Notification**

A Participant/Member is subject to notification when its Total Net Obligation to PJM approaches the Participant/Member's established Working Credit Limit.

### **2) Suspension**

A Participant/Member that exceeds its Working Credit Limit is subject to suspension from participation in the PJM markets and from scheduling any future Transmission Service unless and until Participant/Member's credit standing is brought within acceptable limits. A Participant/Member will have three (3) Business Days from notification to remedy the situation in a manner deemed acceptable by PJM. Additionally, PJM will take such actions as may be required or permitted under the Agreements, including but not limited to the termination of Participant/Member's ongoing Transmission Service and participation in PJM Markets. Failure to comply with this policy will be considered an event of default under this Credit Policy.

## **III. VIRTUAL BID SCREENING**

### **A. Credit and Financial Security**

PJM does not require a Participant/Member to establish separate or additional credit for virtual bidding. A Participant/Member's ability to submit virtual bids into the spot market will be governed, however, by the terms of this section, so a Participant/Member

may choose to establish such additional credit in order to expand its ability to undertake virtual bidding in the PJM spot market.

If a Participant/Member chooses to provide additional Financial Security in order to increase its **Credit Available for Virtual Bidding**, then that Financial Security must be maintained for a minimum of three months.

A Member/Participant wishing to increase its Credit Available for Virtual Bidding by providing additional Financial Security may make the appropriate arrangements with the PJM Treasury Department. PJM will make a good faith effort to make new Financial Security available as Credit Available for Virtual Bidding as soon as practicable after confirmation of receipt. In any event, however, Financial Security received and confirmed by noon on a business day will be applied (as provided under this policy) to Credit Available for Virtual Bidding no later than 10:00 am on the following business day. Receipt and acceptance of wired funds for cash deposit shall mean actual receipt by PJM's bank, deposit into PJM's customer deposit account, and confirmation by PJM Treasury that such wire has been received and deposited. Receipt and acceptance of letters of credit shall mean receipt of the original letter of credit or amendment thereto, and confirmation from PJM's credit and legal staffs that such letter of credit or amendment thereto conforms to PJM's requirements, which confirmation shall be made in a reasonable and practicable timeframe. To facilitate this process, bidders wiring funds for the purpose of increasing their Credit Available for Virtual Bidding are advised to specifically notify PJM Treasury that a wire is being sent for such purpose.

## **B. Market Activity Review**

Each month, PJM will update the **Nodal Reference Price** for each node and each aggregated price point based on a rank ordering of historical price differentials. The Nodal Reference Price at each location will be the 97th percentile price differential between hourly Day-ahead and Real-time prices experienced over the corresponding two-month reference period in the prior calendar year. In order to capture seasonality effects and maintain a two-month reference period, reference months will be grouped by two, starting with January (e.g., Jan-Feb, Mar-Apr, ... , Jul-Aug, ... Nov-Dec). For any given current-year month, the reference period months will be the set of two months in the prior calendar year that include the month corresponding to the current month. For example, July and August 2003 would each use July-August 2002 as their reference period.

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On a daily basis, PJM will perform an analysis for each market participant to determine if **Virtual Bid Screening** is required for bidding in the Day-ahead market. This analysis will be performed as follows:

1. For each participant account, PJM will calculate an **Uncleared Bid Exposure**.  
Uncleared Bid Exposure = sum of (not-cleared bids and offers x the Nodal Reference Price) summed over all nodes for the prior two days of actual bids. If a participant submits uncleared bids and uncleared offers at the same node or aggregated price point, only the higher of the two megawatt quantities (i.e., either the sum of all of the participant's bids at such node or the sum of all of the participant's offers at such node) shall be considered for purposes of this calculation.
2. If the Uncleared Bid Exposure exceeds the Member's Working Credit Limit, then Virtual Bid Screening will be required.
3. PJM will initially look at historical activity beginning May 1, 2003 to determine which participants will require Virtual Bid Screening upon implementation of this procedure.

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### C. Virtual Bid Screening Process

If it is determined that Virtual Bid Screening is required for a market participant, the screening process will be conducted in the PJM eMKT web interface. The process will automatically reject all virtual bids and offers submitted by the PJM market participant if the participant's Credit Available for Virtual Bidding is exceeded by the **Virtual Credit Exposure** that is calculated based on the participant's submitted bids and offers as described below.

A Participant/Member's Virtual Credit Exposure will be calculated on a daily basis for all virtual bids submitted by the market participant for the next operating day using the following equation:

Virtual Credit Exposure = ? ((Higher of the Total MWh bid or the Total MWh offered hourly at each node) x Nodal Reference Price x 2 days) summed over all nodes and all hours.

A Member/Participant's Credit Available for Virtual Bidding will be the Member/Participant's Working Credit Limit less any unpaid billed and unbilled amounts owed to PJM, less any credit required for FTR or other credit requirement determinants as defined in this Policy.

Each PJM Market Participant that is identified as requiring Virtual Bid Screening based on bidding history will be screened in the following manner: If the participant's Virtual Credit Exposure exceeds its Credit Available for Virtual Bidding, the Market Participant will be notified via an eMKT error message, and the submitted bids will be rejected. Upon such notification, the Market Participant may alter its virtual bids and offers so that its Virtual Credit Exposure does not exceed its Credit Available for Virtual Bidding, and may resubmit them. Bids may be submitted in one or more groups during a day. If one or more groups of bids is submitted and accepted, and a subsequent group of submitted bids causes the total submitted bids to exceed the Virtual Credit Exposure, then only that subsequent set of bids will be rejected. Previously accepted bids will not be affected, though the Market Participant may choose to withdraw them voluntarily.

## IV. FORMS OF FINANCIAL SECURITY

Applicants/Participants/Members that provide Financial Security must provide the security in a PJM approved form and amount according to the guidelines below. Acceptable forms of Financial Security include cash deposits and letters of credit.

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Except when an event of default has occurred, a Participant/Member may substitute an approved PJM form of Financial Security for another PJM approved form of Financial Security of equal value. The Participant/Member must provide three (3) Business Days notice to PJM of its intent to substitute the Financial Security. PJM will release the replaced Financial Security with interest, if applicable, within (3) Business Days of receiving an approved form of substitute Financial Security.

#### **A. Cash Deposit**

Cash provided by a Participant/Member as Financial Security will be held in a depository account by PJM with interest earned at PJM's overnight bank rate, and accrued to the Participant/Member. Interest shall be paid to the Participant/Member upon written request, but not more often than quarterly. PJM has the right to liquidate all or a portion of the account balances at its discretion to satisfy a Participant/Member's Total Net Obligation to PJM in the event of default under this Credit Policy or one or more of the Agreements.

#### **B. Letter Of Credit**

An unconditional, irrevocable standby letter of credit can be utilized to meet the Financial Security requirement. As stated below, the form, substance, and provider of the letter of credit must all be acceptable to PJM.

- The letter of credit will only be accepted from U.S.-based financial institutions or foreign financial institutions with a US branch ("financial institutions") that have a minimum corporate debt rating of "A" by Standard & Poor's or Fitch Ratings, or "A2" from Moody's Investors Service, or an equivalent short term rating from one of these agencies. PJM will consider the lowest applicable rating to be the rating of the financial institution. If the rating of a financial institution providing a letter of credit is lowered below A/A2 by any rating agency, then PJM may require the Participant/Member to provide a letter of credit from another financial institution that is rated A/A2 or better, or to provide a cash deposit.
- The letter of credit shall state that it shall renew automatically for successive one-year periods, until terminated upon at least ninety (90) days prior written notice from the issuing financial institution. If PJM receives notice from the issuing financial institution that the current letter of credit is being cancelled, the Participant/Member will be required to provide evidence, acceptable to PJM, that such letter of credit will be replaced with appropriate Financial Security, effective as of the cancellation date of the letter of credit, no later than thirty (30) days before the cancellation date of the letter of credit. Failure to do so will constitute a default under this Credit Policy and one of more of the Agreements.

- The letter of credit must clearly state the full names of the "Issuer", "Account Party" and "Beneficiary" (PJM), the dollar amount available for drawings, and shall specify that funds will be disbursed upon presentation of the drawing certificate in accordance with the instructions stated in the letter of credit. The letter of credit should specify any statement that is required to be on the drawing certificate, and any other terms and conditions that apply to such drawings.
- The PJM Credit Application contains an acceptable form of a letter of credit that should be utilized by an Applicant/Participant/Member choosing to meet its Financial Security requirement with a letter of credit. If the letter of credit varies in any way from the PJM format, it must first be reviewed and approved by PJM. All costs associated with obtaining and maintaining a letter of credit and meeting the policy provisions are the responsibility of the Applicant /Participant/Member

## V. EVENTS OF DEFAULT

Failure to comply with this policy (except for the responsibility of an Applicant/Participant/Member to notify PJM of a Material change) shall be considered an event of default. Pursuant to §15.1.3(a) of the **Operating Agreement of PJM Interconnection, L.L.C.** and §1.7.3 of the **PJM Open Access Transmission Tariff**, non-compliance with the PJM Credit Policy is an event of default under those respective Agreements. In event of default under this Credit Policy or one or more of the Agreements, PJM will take such actions as may be required or permitted under the Agreements, including but not limited to the termination of Participant/Member's ongoing Transmission Service and participation in PJM Markets. A Participant/Member will have three (3) Business Days from notification of policy breach to remedy the situation in a manner deemed acceptable by PJM. PJM has the right to liquidate all or a portion of a Participant/Member's Financial Security at its discretion to satisfy Total Net Obligations to PJM in the event of default under this Credit Policy or one or more of the Agreements.

## VI. DEFINITIONS:

**Affiliate** – Affiliate is defined in the PJM Operating Agreement, §1.2.

**Agreements** – The Operating Agreement of PJM Interconnection, L.L.C. , the PJM Open Access Transmission Tariff, the **Reliability Assurance Agreement**, the **Reliability Assurance Agreement – West**, and/or other agreements between PJM Interconnection, L.L.C. and its Members.

**Applicant** – An entity desiring to become a PJM Member, or to take Transmission Service that has submitted the PJM Credit Application, PJM Credit Agreement and other required submittals as set forth in this policy.

**Business Day** – A day in which the Federal Reserve System is open for business.

**Capacity** – The installed capacity requirement of the Reliability Assurance Agreement, or available capacity requirement of the Reliability Assurance Agreement-West, or similar such requirements as may be established.

**Corporate Guaranty** – A legal document used by one entity to guaranty the obligations of another entity.

**Credit Available for Virtual Bidding** – An Applicant/Participant/Member's Working Credit Limit, less its Total Net Obligation.

**Credit Score** – A composite numerical score scaled from 0-100 as calculated by PJM that incorporates various predictors of creditworthiness.

**Financial Security** – A cash deposit or letter of credit in an amount and form determined by and acceptable to PJM, provided by an Applicant/Participant/Member to PJM as security in order to participate in the PJM Markets or take Transmission Service.

**Market Buyer** – A PJM Member that makes purchases in the PJM Interchange Energy Market or other PJM markets that may be established in the future.

**Market Participant** – A **Market Buyer** or **Market Seller**, or both.

**Market Seller** – A PJM Member that sells into the PJM Interchange Energy Market or other PJM markets that may be established in the future.

**Material** - For these purposes, material is defined in §I.B.3, Material Changes. For the purposes herein, the use of the term "material" is not necessarily synonymous with use of the term by governmental agencies and regulatory bodies.

**Member** – An entity that satisfies the requirements of §11.6 of the Operating Agreement of PJM Interconnection, L.L.C. and that (i) is a Member of PJM immediately prior to August 1, 1997, or (ii) has executed an Additional Member Agreement.

**Net Obligation** – The amount owed to PJM for purchases from the PJM Markets, Transmission Service, (under both Part II and Part III of the O.A.T.T.), and other services pursuant to the Agreements, after applying a deduction for amounts owed to a Participant by PJM as it pertains to monthly market activity. In addition, aggregate amounts that will be owed to PJM in the future for **Capacity** purchases within the PJM Capacity markets will be added to this figure. Should other markets be formed such that Participants may incur future **Obligations** in those markets, then the aggregate amount of those Obligations will also be added to the Net Obligation.

**Nodal Reference Price** – A probabilistic (97%) maximum price differential historically experienced between day-ahead and real-time market prices at a given location as defined in this policy. This number is used in Virtual Bid Screening.

**Obligation** – All amounts owed to PJM for purchases from the PJM Markets, Transmission Service, (under both Part II and Part III of the O.A.T.T.), and other services pursuant to the Agreements. In addition, aggregate amounts that will be owed to PJM in the future for Capacity purchases within the PJM Capacity markets will be added to this

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figure. Should other markets be formed such that Participants may incur future Obligations in those markets, then the aggregate amount of those Obligations will also be added to the Net Obligation.

**Operating Agreement of PJM Interconnection, L.L.C., (“Operating Agreement”)** – The Amended and Restated Operating Agreement of PJM Interconnection, L.L.C., dated as of June 2, 1997, on file with the Federal Energy Regulatory Commission, and as revised from time to time..

**Participant** – A **Market Participant** and/or **Transmission Customer**.

**Peak Market Activity** – The total amount, invoiced or expected to be invoiced for the **Participant**/Member’s transaction activity for all PJM markets and services, for the two consecutive months (or single month if greater) for which such total is greatest over a rolling-twelve month period.

**PJM Markets** – The PJM Interchange Energy Market and the PJM Capacity markets as **established** by the Operating Agreement. Also any other markets that exist or may be established in the future wherein Participants may incur Obligations to PJM.

**PJM Open Access Transmission Tariff (“O.A.T.T.”)** –The Open Access Transmission Tariff of PJM Interconnection, L.L.C., on file with the Federal Energy Regulatory Commission, and as revised from time to time.

**Reliability Assurance Agreement (“R.A.A.”)** – See definition in the Operating Agreement.

**Reliability Assurance Agreement–West** – See definition in the Operating Agreement.

**Tangible Net Worth** – All assets (not including any intangible assets such as goodwill) less all liabilities. Any such calculation may be reduced by PJM upon review of the available financial information.

**Total Net Obligation** – The unpaid prior month’s **Net Obligation** plus the unbilled current month’s Net Obligation incurred to date, as determined by PJM on a daily basis.

**Transmission Customer** – An entity taking service under Part II or Part III of the O.A.T.T.

**Transmission Service** – Any or all of the transmission services provided by PJM pursuant to Part II or Part III of the O.A.T.T.

**Uncleared Bid Exposure** - A measure of exposure from virtual bidding activity relative to a Member’s established credit as defined in this policy. It is used only as a pre-screen to determine whether a Member’s virtual bids should be subject to Virtual Bid Screening.

**Unsecured Credit** – Any credit granted by PJM to an Applicant/Participant/Member that is not secured by a form of Financial Security.

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**Unsecured Credit Allowance – Unsecured Credit** extended by PJM in an amount determined by PJM’s evaluation of the creditworthiness of the Applicant/Participant/Member. This is also defined as the amount of credit that an Applicant/Participant/Member qualifies for based on the strength of its own financial condition without having to provide Financial Security. See also: “Working Credit Limit.”

**Virtual Bid Screening** - The process of reviewing the Virtual Credit Exposure of submitted Day-Ahead market bids, as defined in this policy, against the Credit Available for Virtual Bidding. If the credit required is greater than credit available, then the bids will not be accepted.

**Virtual Credit Exposure** - The amount of potential credit exposure created by a market participant’s bid submitted into the Day-ahead market, as defined in this policy.

**Working Credit Limit** – This amount is 85% of the Participant/Member’s Unsecured Credit Allowance and/or 85% of the Financial Security provided by the Participant/Member to PJM. The Working Credit Limit establishes the maximum amount of Total Net Obligation that a Participant/Member may have outstanding at any time.

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