Load Serving Entities' Perspective on PJM ARR/FTR Market Design

PJM ARR FTR Market Task Force

May 27, 2020

NEXTera ENERGY RESOURCES

PSEG

Exelon

Guiding Principles

- Competitive Suppliers/Load Serving Entities value the current PJM ARR/FTR market design as it provides a way to manage basis risk and pass along savings to customers. The LSEs play a key role by returning congestion dollars to load through the process.

- Any changes contemplated to the PJM ARR/FTR market design should be evaluated to determine feasibility and impact to the PJM – Load Serving Entity – Customer relationship.

  - Changes to the ARR/FTR market design should not harm retail competition.

  - Changes to the ARR/FTR market design should benefit the customer.

NEXTera® ENERGY RESOURCES

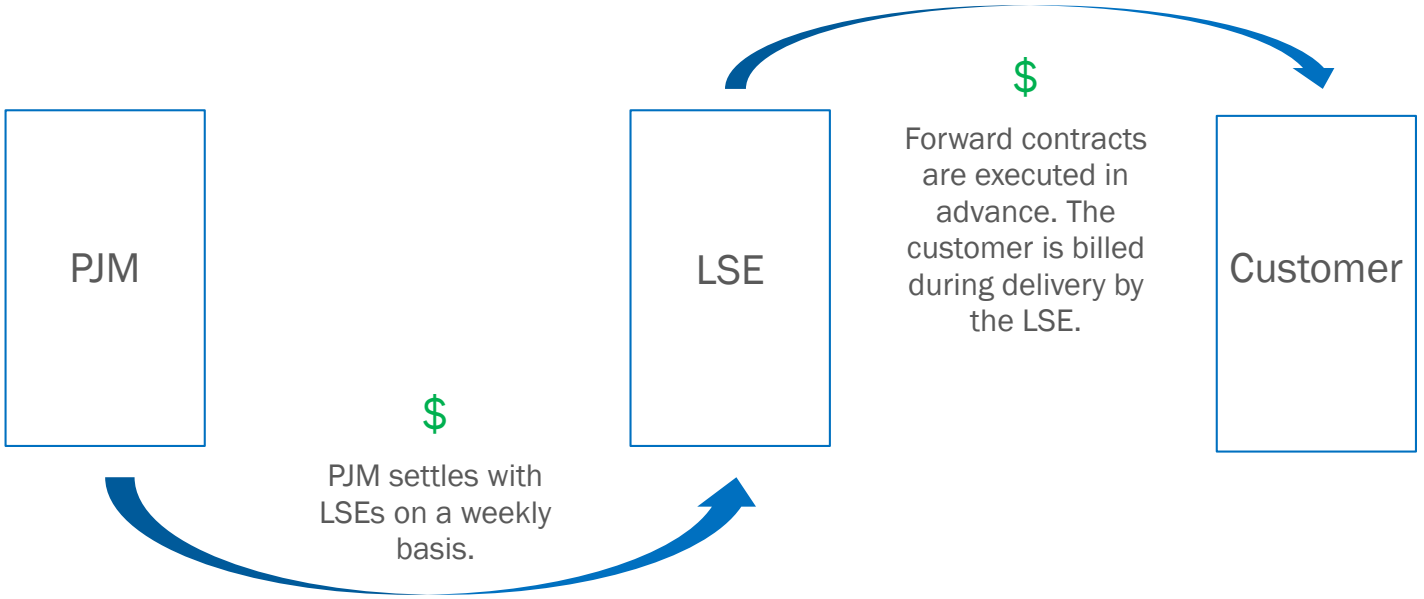
PSEG

Exelon.

Load Serving Entities Return Congestion Dollars to Customers

- Competitive Suppliers/Load Serving Entities will compete to win new business, with contracts commonly being secured for the next three delivery years

- Many factors need to be considered as pricing is developed to supply these customers
  - Forward market pricing for commodity, capacity prices, expected transmission expansion charges, ancillary service costs, basis assumptions, ARR assumptions, etc.



Load serving entities play a critical role in returning congestion dollars to customers via their competitive offerings.

Example: Basis and ARR/FTR Assumptions in Pricing

The most transparent and liquid over the counter forward energy prices are indexed to West Hub, which are used as a starting point for competitive suppliers' offer prices, but basis price risks exist due to the fluctuations in differences between PECO and West Hub prices and PECO ARR values. For this example, let's assume a $30/MWhr forward price for West Hub.

- Risk premiums charged to customers are minimized when basis risks can be priced and hedged effectively.
  - The FTR market provides transparency and liquidity to the forward market.
    - FTR market price transparency helps competitive suppliers estimate the forward price difference between West hub and PECO zone.
    - FTR market price transparency also helps competitive suppliers estimate the forward value of PECO Zone ARRs.
    - FTR market liquidity allows competitive suppliers to hedge forward basis price risks associated with meeting the customer's demand for a product with fixed forward PECO energy costs.
  - In order to meet customers' needs without the transparency and liquidity the FTR market provides, competitive suppliers would most likely be forced to warehouse more risk and therefore increase the risk premiums charged to meet those needs.

If competitive suppliers have a liquid and transparent FTR market, they will be able to price more competitively and pass along a greater benefit (lower cost) to their customers.

Proposals to Directly Allocate Congestion Dollars to LSEs will Hurt Customers

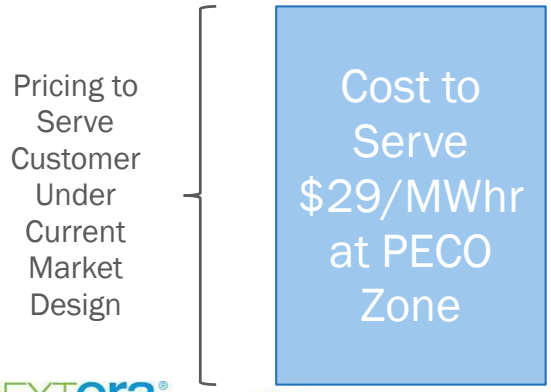
- The Monitoring Analytics' Proposal is flawed as it fails to understand how congestion and FTRs are currently employed by LSEs to manage risk.
- In our experience, 80% of our customers want fixed price contracts in PJM, typically 2-4 years ahead of the delivery period. This requires estimation of congestion/ARR/FTRs to reduce cost to customers.
- Changing the market design to directly allocate congestion dollars to LSEs increases the risk dramatically for LSEs.
  - The dollars being proposed to be directly allocated to LSEs are "mismatched" with the congestion risk faced by LSEs.
  - LSEs need to hedge the congestion risk in their portfolios, not the academic congestion risk posed to all load in PJM. LSEs are experienced at managing risk on behalf of their customers.
  - No one actually pays the academic congestion to all load in PJM on their PJM bill.
- Monitoring Analytics' Proposal will reduce the current benefits of the ARR/FTR market design, increase risk to LSEs, and increase costs to customers.

The PJM ARR/FTR Market Task Force will be better suited to focus on proposals that will improve the current ARR allocation to customers/LSEs, increase market participant optionality to acquire hedges, and other enhancements.

Proposals to Directly Allocate Congestion Dollars to LSEs will Hurt Customers

Current State

- LSEs can estimate the value of ARRs and FTRs to manage basis risk in their portfolios.
- The transparency of the current market design allows for benefits to be passed along to customers in advance of delivery with reasonable confidence.
- LSEs are experienced with hedging congestion risk in their portfolios and manage that risk on behalf of the customers.



Monitoring Analytics' Proposal

- LSEs would be challenged to manage the aggregate congestion risk across the entire pool. Congestion is "mismatched".
- Directly allocating congestion dollars to LSEs would create challenges with estimating future values years in advance of delivery and result in increased uncertainty for LSEs.
- Increased uncertainty for LSEs will result in risk premiums to customers and increased costs.