PJM STATEMENT REGARDING REPORTING
OF INTERNAL BILATERAL TRANSACTIONS

1. Applicable OA Provisions

Section 1.7.10 of Schedule 1 of the Operating Agreement sets forth the requirements for reportable IBTs and provides that:

- "Market Participants may enter into bilateral contracts for the purchase or sale of electric energy."

- "Such bilateral contracts shall be for the physical transfer of energy to or from a Market Participant."

- Market Participants must use "all reasonable efforts" to "limit the megawatt hours of such reported transactions to amounts reflecting the expected load and other physical delivery obligations of the buyer."

- "Bilateral contracts that do not contemplate the physical transfer of energy to or from a Market Participant . . . shall not be reported to and coordinated with the Office of the Interconnection."

2. Legal Background: Interpretation of Section 1.7.10

Market participants have raised with PJM questions concerning the "physical transfer of energy" component of the Operating Agreement's requirements governing the reporting of IBTs since issuance of FERC's order in DC Energy v. PJM, 138 FERC 61,165 (March 9, 2012).

Specific questions have sought PJM’s position on whether the “physical transfer” requirement would preclude a market participant from using the PJM market (say for instance a purchase at PJM West) to source a reported bilateral transaction (or IBT). To assist market participants in understanding PJM's view of the "physical transfer" requirement, PJM provides the following informal statement to describe transactions PJM would consider as meeting the physical transfer requirement.

Market participants, however, are cautioned to regard this Statement as PJM’s position. PJM cannot represent that this position is shared by the FERC. In fact, PJM notes that in the aforementioned March 9 Order in DC Energy the Commission, among other points, states at ¶ 89 that: “the source of energy (for an IBT) cannot be the PJM Interchange Energy Market.” (emphasis added). PJM does not necessarily agree with DC Energy that this statement represents “an erroneous finding of fact.” PJM believes ¶ 89 is more prudently regarded as a conclusion of law, interpreting the “physical transfer” rule in the PJM OA governing the types of bilateral transactions eligible for reporting as IBTs.
That said, and as evident from PJM’s Answer to DC Energy’s request for rehearing, PJM believes ¶ 89 is correct, up to a point, but overstates the scope of the “physical transfer” eligibility rule in considering the question of whether the PJM markets can serve as a source of supply for an IBT. PJM’s position is that that the PJM market can serve as a source of supply for a market participant’s bilateral transaction. This fact alone, however, says nothing about whether the bilateral is financial or physical in nature, and therefore whether it qualifies for reporting to PJM as an IBT. Other factors must be considered. The March 9 Order quite appropriately noted that “neither DC Energy nor (its affiliate) owns generation resources, is a load-serving entity, or acted as a marketer-intermediary by contracting with entities owning generation or having load-serving or other obligations.” PJM agrees with this perspective. The essence of a physical transaction is the presence of an actual generator or sale for end use consumption – elements entirely absent from the transactions in question in DC Energy.

In short, PJM’s position is that the PJM markets can be used, in certain circumstances (discussed more fully below), as either a source or sink for a physical bilateral transaction. And in these circumstances, the bilateral transaction would qualify for reporting to PJM as an IBT. Again, the distinction drawn by PJM here may not be supported by FERC, given its more sweeping statement in ¶ 89 of its March 9 Order. The March 9 Order is the subject of a pending rehearing request. Market participants are cautioned and are urged to seek the advice of counsel in conducting their IBT transactions to determine whether they comply with the Operating Agreement and the March 9 Order.

3. PJM’s View As To When The Market Can Serve As A Source Or Sink For an IBT

PJM believes an IBT meets the "physical transfer of energy" component of the Operating Agreement's requirements for IBTs if:

- either (a) physical generation (not the market) is contemplated as the ultimate contractual source of the energy that is the subject of the IBT, or (b) that a load-serving entity recognized as such under the RAA (not the market) is contemplated as buying the energy that is the subject of the IBT in order to meet that LSE’s load serving obligations.

- The ultimate contractual source and sink cannot both be the spot market. In other words,
  - The ultimate contractual source CANNOT be the market IF the ultimate sink is not a load serving entity with actual physical load (that is, not the spot market).
  - The ultimate contractual sink CANNOT be the spot market IF the ultimate source is not actual physical generation (that is, not the market).
- Intermediate IBTs may be reported if the reporting parties can demonstrate contractually that the ultimate sources and sinks comply with the foregoing.
For example, in a transaction chain A-B-C-D, if A is a physical generator, then the A-B, B-C, and C-D transactions all may be reported as IBTs, and D may then transact using that energy (including selling it to the spot market). Similarly, in a transaction chain A-B-C-D, if D is a load serving entity, then A's source may be the spot market, and the A-B, B-C, and C-D transactions all may be reported as IBTs.

PJM would take the position that a generation unit serving as the source for an IBT does not necessarily need to be operating or producing sufficient energy to satisfy the entire reported quantity of the IBT at all times in order for the transaction to qualify for submission to PJM as an IBT. The test stated in Section 1.7.10 is that the transaction “contemplate the physical transfer of energy.” However, a good faith expectation must exist that the contractually identified physical resource would have the capability to supply the IBT under conditions that can reasonably be expected to materialize.

Finally, PJM would take the position that energy exported or imported to or from an outside control area pursuant to a bilateral arrangement constitutes a “physical transfer” and is eligible for reporting as an IBT insofar as it involves the explicit use of physical transmission service.