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

PJM FRMSTF

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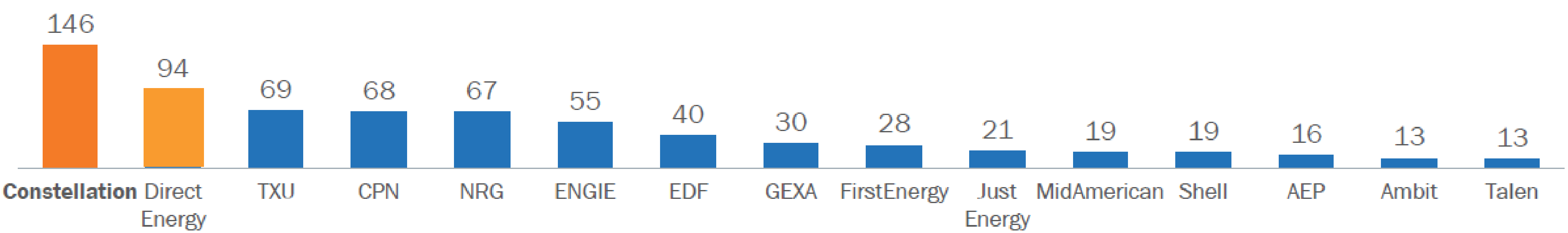
Our Perspectives

Exelon's Constellation business is a leading competitive retail and wholesale supplier of power, natural gas and energy products and services for homes and businesses across the continental United States.

Direct Energy is one of the largest retail suppliers in the United States and is a load serving entity and market participant in PJM, CAISO, MISO, NYISO, ISO-NE, and ERCOT.

Together, Constellation and Direct Energy serve over 33% of the retail load across the country.

Retail Load Served (TWhs)



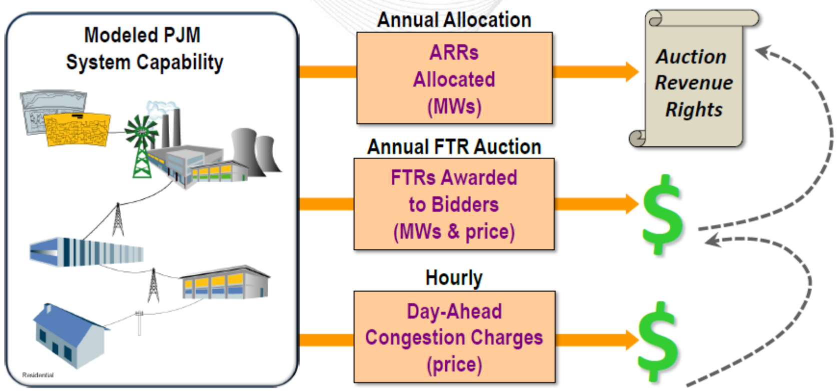
Source: DNV GL Retail Landscape November 2018

Direct Energy. Exelon.

Background on ARRs and FTRs

ARRs entitle the holder to receive an allocation of Annual FTR Auction revenues. They are allocated to firm transmission service customers (LSEs) annually in a two-stage allocation process.

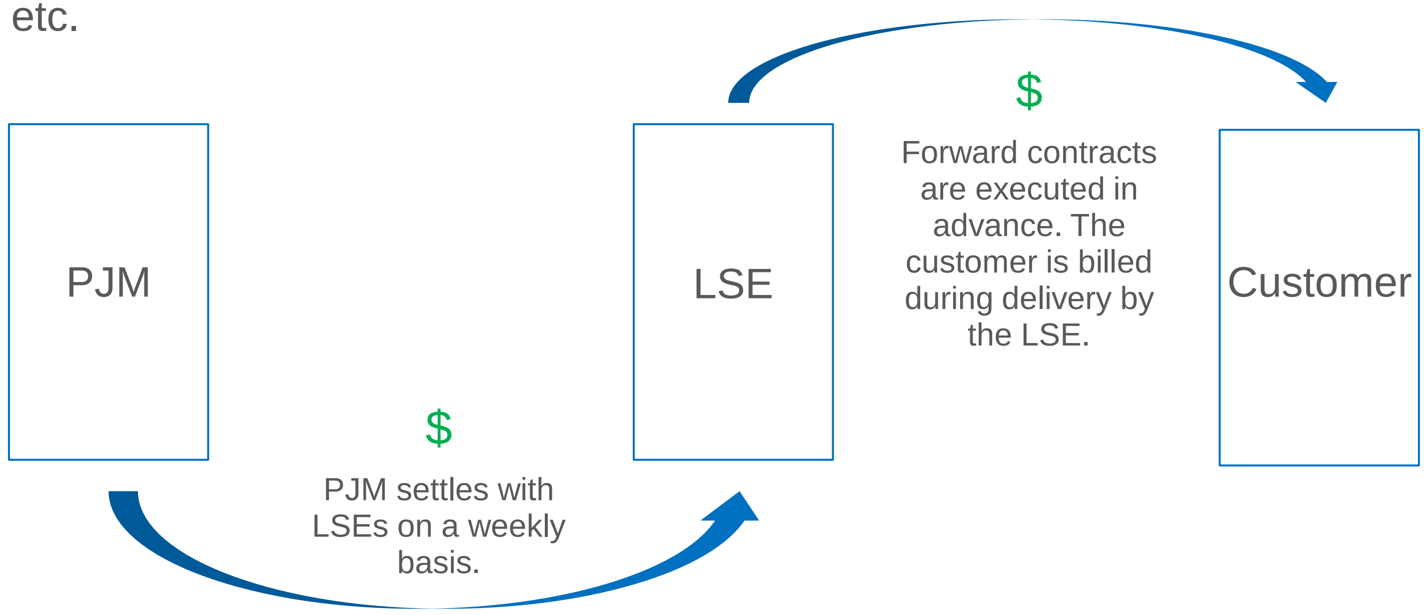
FTRs are financial instruments that are awarded to bidders in the FTR Auctions. They are a point-to-point hedging mechanism to offset future congestion costs. FTRs are paid out by collected congestion dollars, and may be subject to underfunding.



If excess revenues exist after ARR and FTR revenues are paid out, these surplus dollars are allocated to load/ARR holders. This rule change was effective for the 2018/2019 delivery year.

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 like Constellation and Direct Energy play a critical role in returning congestion dollars to customers via their competitive offerings.

Example: Basis and ARR/FTR Assumptions in Pricing

Consistent with many customers' desire for price certainty, a customer in the PECO zone is looking to lock in their energy costs for the next three years. 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.

Summary

- 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.