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February 24, 2017

VIA EMAIL

Mr. Howard Schneider, Chair
Mr. Andrew Ott, CEO
PJM Interconnection, LLC
P.O. Box 1525
Southeastern, PA 19399-1525

RE: Concerns Regarding the Stakeholder Process

Dear Messrs. Schneider and Ott:

We write to express concern regarding the significant discrepancies that have occurred during the stakeholder process of the Energy Market Uplift Senior Task Force ("EMUSTF"). XO Energy, LLC ("XO") has addressed its concerns during EMUSTF meetings and by email correspondence to, as well as in-person meetings with, certain staff of PJM Interconnection, LLC ("PJM"), to no avail. As such, XO is hereby (i) notifying the PJM Board of the unacceptable practices that have occurred, and (ii) requesting that certain remedial actions be taken immediately, as described below.

Background

The EMUSTF is tasked with evaluating the causes of energy market uplift charges, developing ways to minimize uplift while maintaining prices that are consistent with operational reliability needs, and exploring new methodologies for the allocation of make-whole payments. The EMUSTF has been conducted in three phases, summarized below:

Phase 1 (Drivers of Uplift): The senior task force spent in excess of one year holding education sessions as well as discussions of packages and options in Phase 1. During the December 2016 vote, one package received more than 50% support and has been presented to and approved by both the Markets and Reliability Committee ("MRC") as well as the Members Committee ("MC").

Phase 2 (Uplift Allocation): Once again, the senior task force spent significant time examining packages regarding uplift cost allocation. At least 13 packages were introduced as solutions for uplift allocation during the Phase 2 review process. The various packages were voted upon during a December 2016 EMU poll. The results of the poll indicated that no single package received a simple majority of the vote. The following week, PJM staff re-tallied the Phase 2 EMU votes. The results of this recalculation showed that one of PJM's proposals received more votes than was originally calculated. Notably, the recount did not garner enough votes to advance the package over the 50% threshold needed to proceed to the MRC.

Although not one package surpassed the 50% threshold required to move to a vote at the MRC, during the December MRC meeting, several stakeholders and PJM staff proposed that the packages return to the EMUSTF for another Phase 2 vote. Furthermore, it was decided that the stakeholders would consider only the top five packages. This proposal was passed in the MRC and the packages were re-voted upon at the EMUSTF. The revote resulted in a 58.9% approval of Proposal Q, a joint proposal between PJM and its Independent Market Monitor ("IMM").

Proposal Q is a triple capacity deviation package, that is, it proposes to include the (i) withdrawal end of a UTC in the allocation of Day-Ahead Uplift charges identically to the way a cleared DEC is charged; and (ii) injection and withdrawal ends of a UTC in the allocation of Real-Time Uplift charges identically to the way a cleared INC and DEC are charged. In fact, the UTC is a transmission product which does not impact capacity. Given the radical nature of this proposal, XO and several other market participants requested back-testing for Proposal Q on numerous occasions. In response, PJM presented very high-level, historic deviation data, which failed to quantify the overall financial impact to market participants. Using the more granular data provided by PJM under previously-proposed Package H from June 23, 2016, XO was able to conduct an analysis that demonstrated that this proposal would shift 76% of Real-Time Uplift charges and 25% of Day-Ahead Uplift charges, to the UTC product. (It should be noted that four sectors (Electric Distributors, End Use Customers, Transmission Owners, and Generation Owners) control 80% of the MRC vote, with only 66% required to pass a proposal. The MRC Phase 2 voting results indicated that 95% of these four sectors supported PJM's Proposal Q, while only 15% of the fifth sector (Other Supplier) voted in favor of this package. Given the composition of the MRC, the results of the vote are not surprising – the approval of Proposal Q successfully shifted 76% of uplift charges to the Other Supplier sector, a sector with an inconsequential presence.)

Following the revote, but prior to the January MRC vote, the Federal Energy Regulatory Commission ("FERC") issued an order in Docket No. EL14-37,[1] ruling on the FTR forfeiture aspect of the pending investigation under section 206 of the Federal Power Act, and holding uplift issues in abeyance pending the outcome of a simultaneously issued Notice of Proposed Rulemaking (the "Uplift NOPR") on uplift cost allocations and transparency in ISO/RTO markets.[2] The Uplift NOPR proposes to require ISO/RTOs that allocate uplift costs to deviations, to do so based upon cost causation principles, including netting transactions (supply and demand), distinguishing between helping and harming deviations, as well as capacity or transmission-related deviations, and a shift to an hourly (versus daily) deviation rate. In essence, the Uplift NOPR proposes to mandate the adoption of an uplift cost allocation methodology based on the MISO uplift structure to any ISO/RTO that allocates uplift to deviations. Under the MISO construct, UTCs would not be responsible to pay any capacity deviation.

Previously, the EMUSTF has been held in abeyance pending the outcome of uplift allocation issues, going on hold for nine months from June 2015 to March 2016, while awaiting FERC's decision in Docket No. EL14-37. Rather than proposing to hold the EMUSTF in abeyance here, PJM instead advocated moving forward with Package Q, a package that is inconsistent with

[1] *PJM Interconnection, L.L.C.*, 158 FERC ¶ 61,038 (2017).

[2] *Uplift Cost Allocation and Transparency in Markets Operated by Regional Transmission Organizations and Independent System Operators*, 158 FERC ¶ 61,047 (2017) ("Uplift NOPR").

the guiding tenets of the Uplift NOPR, presenting it for a vote at the January MRC meeting. PJM staff asserted that the Uplift NOPR's status was unclear, given that it had not yet been published in the Federal Register, and claimed that holding stakeholder processes in abeyance pending the resolution of a NOPR was not PJM's practice. Several stakeholders, including XO, specifically stated that while PJM may not generally hold stakeholder proceedings in abeyance based on a NOPR, in this case, FERC tied the outcome of the PJM-specific 206 investigation in Docket No. EL14-37 to the outcome of the Uplift NOPR. In other words, FERC has already explicitly drawn the link between the Uplift NOPR and PJM's pending stakeholder process.

Proposal Q passed after stakeholder motions to delay the vote were voted down; and was approved at the MC meeting on February 23, 2017. Despite the statement that "Package Q's goal is to make "minimal changes" to the current uplift cost allocation process,"[3] the reverberating effects on the UTC market will be swift—this triple capacity deviation proposal will be successful in shifting 75-79% (or $347,086,725) of the total Real-Time Uplift charges to UTCs, as well as 25% (or $41,460,963) of the Day-Ahead Uplift charges to UTCs, rendering the product worthless and obsolete. It is hard to envision any set of circumstances under which a $388,547,688 cost shift to a product without a capacity deviation could be construed as a "minimal change." At the same time, FERC is proceeding with the Uplift NOPR, with comments due by April 19, 2017, that will substantially rework uplift allocation methodology in the near future, particularly for PJM, and will have significant impacts on how uplift is calculated for virtual transactions, including the UTC.

Phase 3 (Biddable Points Available for Virtual Transactions): Phase 3 was added to the EMUSTF's charter following PJM's issuance of the Virtual Transactions Report,[4] which included suggestions to modify the biddable points at which INCs, DECs and UTCs would be available. As compared to Phases 1 and 2, the EMUSTF has spent very little time on education and package consideration. In December 2016, several stakeholders suggested postponing any consideration of Phase 3 until after changes resulting from Phase 2 had been approved and implemented. This suggestion was not supported by PJM staff and some incumbent stakeholders. Following the January 2017 vote on Phase 2, all final Phase 3 stakeholder proposals were due Friday, February 10, 2016, with a task force vote being open from Monday, February 13, 2017 to Friday, February 17, 2017. Following submission of new packages on February 10, 2017, no EMUSTF meeting was held to discuss or vet the new proposals. Rather, there has been an inexplicable rush to vote, despite concerns and objections raised by stakeholders.

Of particular note, just days after the Uplift NOPR was issued, PJM updated their Phase 3 proposal without prior notice to stakeholders. PJM elected to change the allowable UTC points to zones, hubs, and interfaces only, although PJM's previous proposal included generators and load aggregates. The Virtual Transactions Report clearly supported the more expansive set of allowable points, right up until the release of the Uplift NOPR. There was very little discussion

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[3] Energy Market Uplift Sr. Task Force Update, Feb. 23, 2017, *available at* http://www.pjm.com/~/media/committees-groups/committees/mc/20170223/20170223-item-02-emustf-presentation.ashx.

[4] Virtual Transactions in the PJM Energy Markets, Oct. 15, 2015 ("Virtual Transactions Report"), *available at* http://www.pjm.com/~/media/committees-groups/committees/mc/20151019-webinar/20151019-item-02-virtual-transactions-in-the-pjm-energy-markets-whitepaper.ashx.

regarding the rationale for PJM's sudden change, apart from the statement that it would "address some of the observed practices illustrated in the PJM paper that do not benefit the market at a level commensurate with the profitability of the transactions."

Concerns

The EMUSTF stakeholder process has raised a number of concerns which XO would like to bring to the PJM Board's attention.

1. PJM's Revote Process Represents a Voting Irregularity and Contributes to a Decrease in Transparency Within the Stakeholder Process

There have been several instances of voting irregularities during Phase 2 of the EMUSTF. As noted above, PJM staff undertook the revote process on their own initiative, without prompting from stakeholders, following the initial Phase 2 vote in December. Following the task force level vote, PJM staff proposed a revote at the December MRC in an effort to modify the voting parameters, in the hopes that reducing the number of packages would produce a simple majority to be voted on at the MRC.

Prior to the EMUSTF meeting held on January 25, 2017, PJM appeared to be split in its approach as to whether to proceed with voting or holding EMUSTF in abeyance. In conversations and email correspondence with the PJM President and CEO, market participants seemed to receive assurances that PJM would hold the Phase 2 vote in abeyance given the issuance of the Uplift NOPR. At the January MRC meeting, PJM announced that its staff was undecided as to whether to proceed with voting on Package Q or holding the vote in abeyance. While no one, including stakeholders and PJM, can know what the ultimate shape of the Uplift Final Rule will be, FERC has expressly tied the outcome of that Final Rule to PJM's current uplift cost methodology, by making the outcome of the investigation in Docket No. EL14-37 contingent on the outcome of the Uplift NOPR and Final Rule.

Given the voting irregularities and inconsistent communication from PJM staff regarding PJM's position, XO is concerned that there is a lack of transparency and automation in the collection and tallying of votes at the task force level. Furthermore, XO is understandably concerned about PJM's decision to recount the votes not once but twice in an effort to upset the results following valid voting procedures at the task force level. PJM's revote efforts resulted in its own package being elevated to the MRC level for a vote.

2. Lack of Due Process

The Phase 3 proposals were first discussed during the two September 2016 EMUSTF meetings, then resumed in December 2016. During the December 20, 2016 meeting, only three proposals were discussed and vetted. Three additional packages were proposed between the December 20, 2016 meeting and the January 25, 2017 meeting. At least one additional package was added after the January 25, 2017 meeting and prior to the commencement of the February 13, 2017 vote. The concept of voting on packages that have never been discussed in a stakeholder meeting is highly troubling. Stakeholders should be afforded the opportunity to engage in discussion, ask questions and suggest changes to the packages. It is standard process for PJM to hold a meeting to discuss all packages prior to a vote – and there does not appear to be a pressing reason to rush this vote.

Furthermore, XO is concerned that PJM has been attempting to rush the EMUSTF process, without holistic consideration of the market implications of the various packages. Rushing to a vote on Phase 3, without discussing all of the available packages and the implications on other phases of the task force's objectives, constitutes premature decision-making lacking consideration for the integrity of the PJM market.

3. Priority Given to Stakeholder's Fiduciary Obligations Versus Sound Market Design

The stakeholder process is driven by each stakeholder's fiduciary obligation to its constituent company, in other words, what is in the shareholders' financial interests. PJM, as a neutral administrator, has an obligation to administer its wholesale power market in an open, fair and competitive manner. PJM is required to act as a neutral body without giving priority to one sector over others. XO is concerned that the packages promulgated by PJM and its IMM, including Phase 2 Package Q, benefits load while producing great harm to the Other Supplier Sector, including the financial community. XO is concerned that inequitable, stakeholder-centric initiatives, which do not comport with fundamental market design principles, such as best practices and cost causation, are taking precedence.

PJM's proposals in both Phase 2 and Phase 3 will only exacerbate market inefficiencies, and demonstrate a significant step backwards, away from competitive market design, as highlighted by noted economists Dr. William Hogan and Dr. David Patton. Although the proposals to charge triple capacity deviations to the UTC product and decrease the number of biddable nodes for virtual transactions may be a welcome change to load serving customers, they are not consistent with the tenets of a competitive wholesale market.

PJM's current Phase 3 proposal to limit UTCs to zones, hubs, and aggregates cannot, by definition, enhance the convergence of the nodal markets or nodal transmission constraints. By limiting UTC transactions to hubs, interfaces and load zones, PJM would effectively remove the product's ability to mitigate local market power and converge nodal congestion in the PJM markets, as repeatedly highlighted in PJM's Report. FERC has repeatedly held that convergence of the day-ahead and real-time markets is a key measure of market efficiency. Decreasing the number of biddable nodes, thereby decreasing convergence, is inconsistent with economic theories advocated by both FERC and the academic community, which has quantified the enhanced value of nodal markets over zonal markets. In contrast to its current position, PJM's Virtual Transactions Report points to the "commitment convergence" gained with the expansion of UTC product to include all generators. At the nodal level, the UTC is a real-time congestion hedge that allows market participants to voluntarily hedge their real-time congestion exposure. This product is critical to well-functioning wholesale markets as well as retail power markets.

4. Perceived Negativity Towards Virtual Products and Financial Market Participants

In the past year or more, XO has witnessed an unwarranted negativity from PJM and its staff towards both financial products and the financial trading community. Overall, it appears that the intended goal of the EMUSTF stakeholder process, particularly the proposals put forth by PJM and its IMM, is to eradicate the UTC product and to reduce the volume of virtual trading in PJM. The recent rush to advance proposals without sufficient stakeholder support, combined with the lack of process for participants to discuss proposals, are severely undermining market participants' confidence in PJM. In addition, financial market participants feel bulldozed by PJM's perceived priority in advancing its own proposals through the voting process and its favoritism of other sectors. These actions are strongly affecting market participants' confidence in PJM's "neutral" administration of its duties and its operation of a fair and efficient market.

Board Action

XO submits this letter to the PJM Board to express our concerns regarding the positions taken by PJM and its staff during the EMUSTF stakeholder process. We encourage the Board to direct PJM staff to follow standard stakeholder procedure and to be aware of the significant market impacts, including the potential eradication of the FERC-mandated UTC, which will result from this unstructured, uninformed, decision-making process.

Specifically, XO requests that the Board direct PJM staff to hold EMUSTF, including all further action on Phase 2 Package Q passed at the MC on February 23, 2017 and Phase 3 Package A before the EMUSTF, in abeyance pending the outcome of the Uplift NOPR.

We appreciate your consideration of this matter and look forward to your response.

Sincerely,

Shawn Sheehan
President