VIA E-MAIL TRANSMISSION

January 9, 2003

MEMBERS COMMITTEE; ENERGY MARKET COMMITTEE

Dear Committee Members:

This letter provides a modification to the rules for pricing external transactions that are scheduled for delivery to or delivery from the PJM-VAP interface.[1] These rules were first introduced on Friday, July 19, 2002 and announced via the eData system and the OASIS and were clarified in letters dated August 1 and August 29, 2002. These modified rules will be in effect beginning on February 1, 2003 until further notice. The rules are provided in both a red-line and non-red-line version.

As a result of PJM's continuing investigation into loop flow and circulation on the PJM system and appropriate pricing points for external transactions, it has become clear that there is a need for additional modifications to the rules governing pricing for external transactions. PJM has determined that transactions that source or sink in the Associated Electric Cooperative Inc. (AECI) control area actually flow into or out of PJM primarily over the PJM-AEP interface rather than over the PJM-VAP interface. This conclusion is based upon a distribution factor analysis of the actual energy flow resulting from these transactions on the PJM interfaces. PJM has also determined that transactions that source or sink in the SPP (Southwest Power Pool) region also actually flow into or out of PJM primarily over the PJM-AEP interface rather than over the PJM-VAP interface. This conclusion is also based upon a distribution factor analysis of the actual energy flow resulting from these transactions on the PJM interfaces.

In order to reflect the actual flow of transactions associated with AECI and SPP, beginning February 1, 2003, PJM will price all transactions that source or sink in the AECI control area, as well as all transactions that source or sink in the SPP region, at the AEP interface price. This approach will provide consistent pricing for transactions to and from PJM and AECI, SPP, ECAR, MAPP and MAIN.

The PJM Market Monitoring Unit will continue to monitor transactions between now and February 1 to ensure that market participants do not attempt to unfairly take advantage of differences between prices at scheduled and delivered interface points.

PJM takes this action in accordance with 3.3.1(d) of Schedule 1 of the Operating Agreement, which states in part: "For pool External Resources the Office of the Interconnection shall model, based on an appropriate flow analysis, the hourly amounts delivered from each such resource to

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[1] As noted previously, interfaces are named after adjacent control areas. This naming convention does not imply anything about the companies that operate the adjacent control areas.

the corresponding interface point between adjacent Control Areas and the area comprised of the PJM West Region and PJM Control Area."

Please contact me if you have any questions. I can be reached at 610-666-4536 or via e-mail at bowrij@pjm.com.

Sincerely,

Joseph E. Bowring
Manager

Interim Rules For External Transaction Pricing (Red Line)

1. If a transaction path, based on the NERC tag, for a transaction into PJM at the PJM-VAP interface, includes an ECAR, MAPP, ~~or~~ MAIN, or SPP control area or the AECI control area as the source, then the transaction will be priced at the PJM-AEP interface price. For example, a transaction scheduled from a control area within MAPP to the PJM-VAP interface will be priced at the PJM-AEP interface price, regardless of the scheduled delivery point.
2. If a transaction path, for a transaction out of PJM from the PJM-VAP interface, includes an ECAR, MAIN, ~~or~~ MAPP, or SPP control area or the AECI control area as the sink, then the transaction will be priced at the PJM-AEP interface price. For example, a transaction scheduled from the PJM-VAP interface to a control area within ECAR will be priced at the PJM-AEP interface price, regardless of the scheduled source.
3. If a transaction or an increment offer is scheduled at the PJM-VAP interface in the day ahead market and a transaction, which is sourced in an ECAR, MAPP, ~~or~~ MAIN, or SPP control area, or the AECI control area, as defined in point 1 above, is scheduled in real time for delivery at the PJM-VAP interface, the real time transaction will be treated as delivered to the PJM-AEP interface and there will be a deviation from the day ahead position.
4. PJM will develop a method for pricing external transactions based on an analysis of implicit LMPs in external control areas. This method, when completed, will replace the method defined in points 1 through 3 above.

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2. If a transaction path, for a transaction out of PJM from the PJM-VAP interface, includes an ECAR, MAIN, MAPP, or SPP control area or the AECI control area as the sink, then the transaction will be priced at the PJM-AEP interface price. For example, a transaction scheduled from the PJM-VAP interface to a control area within ECAR will be priced at the PJM-AEP interface price, regardless of the scheduled source.
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