Market Monitoring Unit

REPORT

INTERFACE PRICING POLICY

PJM Market Monitoring Unit

February 28, 2003

On February 24, 2003, PJM notified market participants of a modification to the rules for pricing external transactions that are scheduled for delivery to or delivery from the PJM-VAP interface and the PJM-AEP interface.[1] These modified rules will be in effect beginning on March 1, 2003 until further notice. 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, August 29, 2002 and January 9, 2003.

PJM took this action in accordance with 3.3.1(d) of Schedule 1 of the Operating Agreement, governing payment for deliveries to the PJM spot market, 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 the corresponding interface point between adjacent Control Areas and the area comprised of the PJM West Region and PJM Control Area."

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 in PJM and sink in specified control areas should receive a price consistent with the associated power flows. The PJM sources will no longer include PJM-VAP or PJM-AEP interfaces but will be: PJM-NYIS; PJM-FE; PJM-DLCO; and PJM-AEPVPEXP. The PJM-AEPVPEXP interface will consist of the buses currently included in the PJM-AEP and PJM-VAP interface definitions dynamically weighted by the tie line export power flow patterns. Similarly, PJM has determined that transactions that sink in PJM and source in specified control areas should receive a price consistent with the associated power flows. The PJM sinks will be: PJM-NYIS; PJM-FE; PJM-DLCO; and PJM-AEPVPIMP. The PJM-AEPVPIMP interface will consist of the buses currently included in the PJM-AEP and PJM-VAP interface definitions dynamically weighted by the tie line import power flow patterns.

In order to reflect the actual flow of transactions associated with the PJM-AEP and PJM-VAP interfaces, beginning March 1, 2003, PJM will price all transactions that source in PJM and sink in one of the relevant defined control areas, at the PJM-AEPVPEXP interface price. Similarly, PJM will price all transactions that sink in PJM and source in one of the defined control areas, at the PJM-AEPVPIMP interface price. PJM will apply the same method for pricing transactions into and out of PJM, based on the actual power flow, at all the PJM interfaces. This approach will provide consistent pricing for transactions to and from PJM that are electrically comparable, regardless of the interface.

[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.

As shown in Table 1 and illustrated in Figures 1 and 2, the discrepancy between contract and actual power flows at the PJM-AEP and PJM-VAP interfaces increased beginning in June 2002. For example, the difference between actual and contract power flows at the PJM-AEP interface increased from an on-peak average of 904 MW in April and 1,042 MW in May, to 1,561 MW in June and 1,821 MW in the first 19 days of July. After the July rule change, these levels declined but began to increase again in December 2002 and January 2003 followed by a spike in February. Correspondingly, the difference in price between the PJM-VAP and PJM-AEP interfaces increased from an on-peak average of $7.19 per MWh in April and $6.49 in May, to $14.33 in June and $16.44 in the first 19 days of July. After the July rule change, the price differentials declined but also began to increase in December and January. The price differential in January of $24.58 exceeded the differentials preceding the July rule change and was followed by increasing price differentials including a spike to $98.12 on February 16.

Figure 1. April 2002 to Date, 2003 -- Actual minus Schedule Tie Flows and LMP Differentials

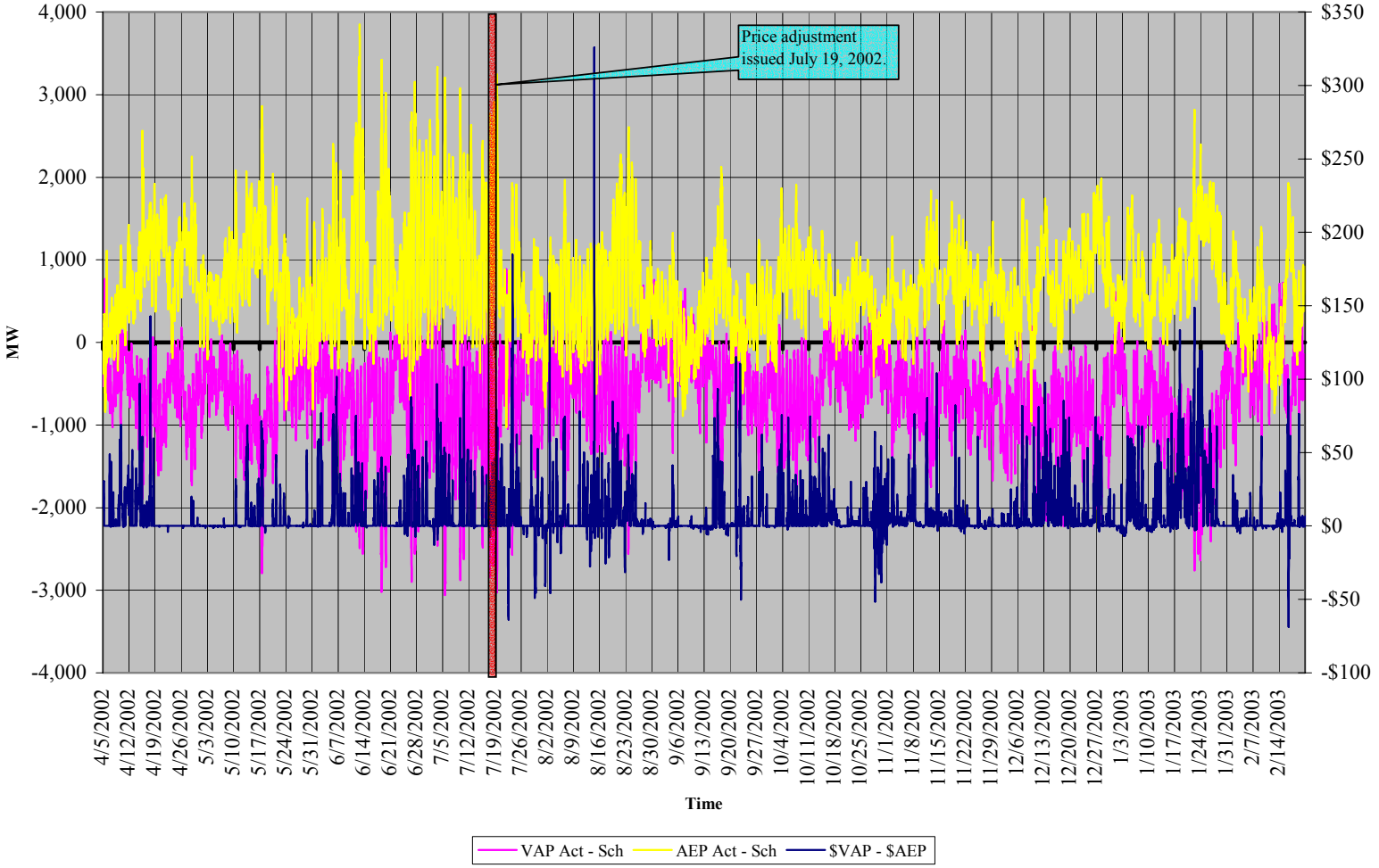

Figure 2. January 1 to February 20, 2003 -- Actual minus Schedule Tie Flows and LMP Differentials

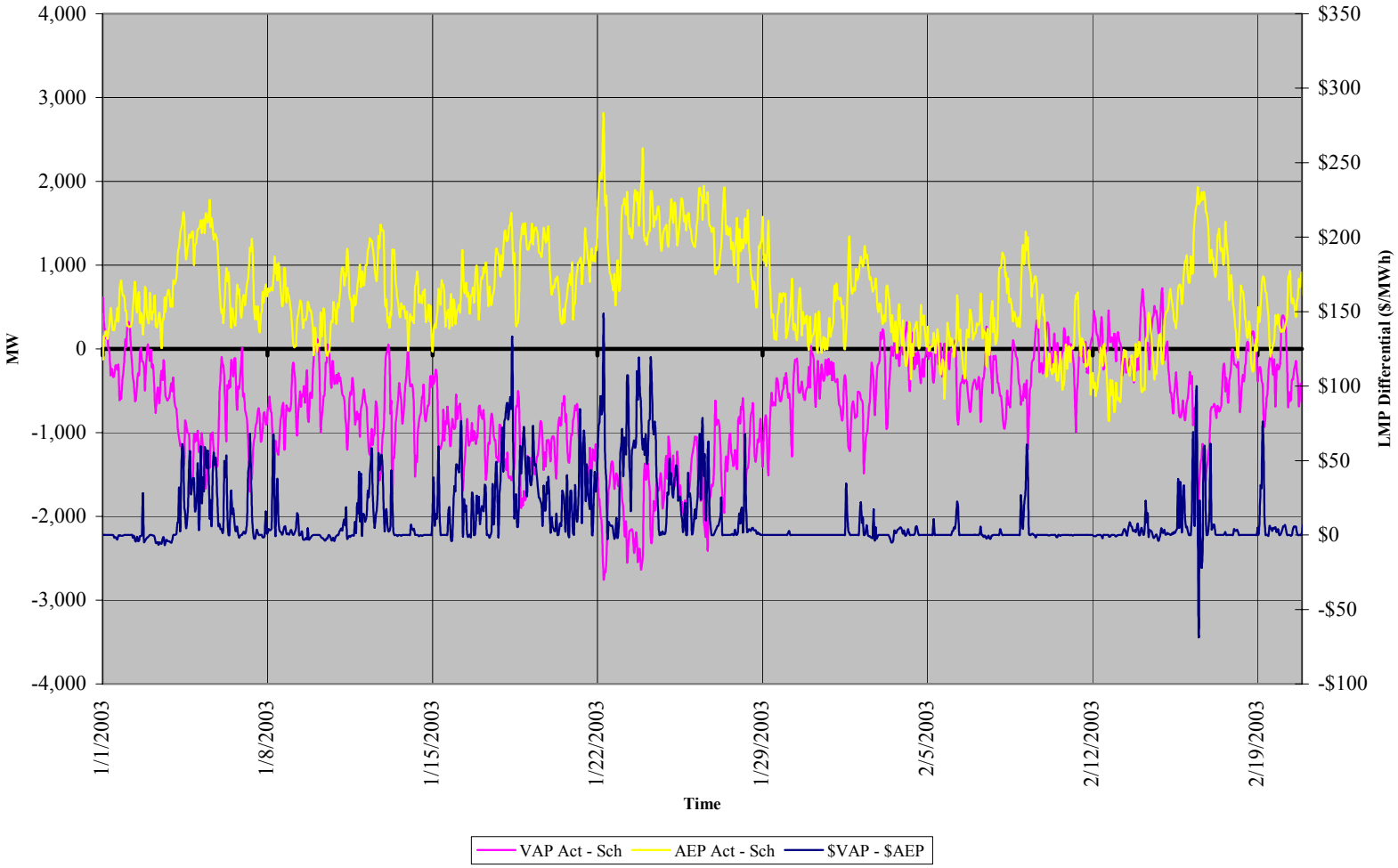

Table 1. Average Period Hourly Tie Flow Disparity and Price Differential

	Apr-02	May-02	Jun-02	Jul-02	July 1 thru 19, 2002	July 20 thru 31, 2002	Aug-02	Sep-02	Oct-02	Nov-02
Peak Hours Period										
$VAP - $AEP ($/MWh)	$ 7.19	$ 6.49	$ 14.33	$ 14.06	$ 16.44	$ 9.88	$ 10.12	$ 4.86	$ 7.36	$ 5.57
VAP Act - Sch (MW)	-533	-748	-1,323	-1,327	-1,577	-891	-295	-507	-641	-668
AEP Act - Sch (MW)	904	1,042	1,561	1,442	1,821	780	359	479	673	606
Off Peak Hours Period										
$VAP - $AEP ($/MWh)	$ 5.13	$ 0.01	$ 4.87	$ 6.16	$ 7.41	$ 4.38	$ 4.39	$ 3.94	$ 6.49	$ 3.61
VAP Act - Sch (MW)	-582	-460	-346	-364	-457	-229	-346	-205	-299	-574
AEP Act - Sch (MW)	740	459	457	476	633	251	457	223	504	687

Table 1 (cont.) Average Period Hourly Tie Flow Disparity and Price Differential			
	Dec-02	**Jan-03**	**2/1/2003 - 20/2003**
Peak Hours Period			
$VAP - $AEP ($/MWh)	$ 11.70	$ 24.58	$ 5.55
VAP Act - Sch (MW)	-955	-998	-378
AEP Act - Sch (MW)	715	992	514
Off Peak Hours Period			
$VAP - $AEP ($/MWh)	$ 8.56	$ 9.18	$ 0.91
VAP Act - Sch (MW)	-809	-909	-176
AEP Act - Sch (MW)	778	726	173