UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

FirstEnergy Solutions Corp. Allegheny Energy Supply Company, LLC, v. PJM Interconnection, L.L.C.	))))))))	Docket No. EL12-19-000

ANSWER AND MOTION FOR LEAVE TO ANSWER
OF THE INDEPENDENT MARKET MONITOR FOR PJM

Pursuant to Rules 212 and 213 of the Commission's Rules and Regulations,[1] Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM[2] ("Market Monitor"), submits this answer and motion to answer the answer filed by FirstEnergy Solutions Corp. and Allegheny Energy Supply Company, LLC ("FirstEnergy") on January 23, 2012. FirstEnergy's answer responds to the Market Monitor's comments on FirstEnergy's complaint that initiated this proceeding in a manner that would change this proceeding from a proposal to solve the so-called FTR underfunding issue into a proposal to fundamentally change the role of FTRs as a hedge against congestion. This answer is needed to respond to FirstEnergy's reframed argument and to avoid the significant confusion that FirstEnergy's response could create. The Market Monitor also responds to the answer filed by PJM on January 30, 2012.

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1 18 CFR § 385.212 & 385.213 (2011).

2 Capitalized terms herein are not otherwise defined have the meaning used in the PJM Open Access Transmission Tariff ("OATT").

In its January 23rd Answer, FirstEnergy rests its argument for relief on its assertion (at 2) that "FTRs are a day-ahead product" that is "intended to provide a hedge against day-ahead congestion (rather than real-time congestion)." FirstEnergy claims (*Id*.) that FTR holders do not "cause" real-time congestion. FirstEnergy concludes that the Commission should therefore avoid any examination of the reasons for FTR funding levels and the reasons for balancing congestion. FirstEnergy's arguments incorrectly define FTRs and incorrectly assume that the rationale for FTR funding is based on FTR holders causing market results of any kind. If accepted, FirstEnergy's proposal would fundamentally change FTRs. FirstEnergy's arguments have no merit, and the relief requested should be denied.

If the Commission allows FirstEnergy to define the issue narrowly as simply restoring the "correct" definition of FTR funding as described in its answer, then the complaint should be denied. FirstEnergy's narrow rationale for relief has no merit and is unsupported.[3] There is no reason why the complaint, as modified, could not be denied expeditiously.

If the Commission wants to explore all the issues raised by FirstEnergy's complaint, including the reasons for the level of FTR funding, such a proceeding cannot be expected to effectively conclude on a fast track basis prior to the commencement of the next Planning Period.

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3 In responding to FirstEnergy's initial petition, the Market Monitor stated (at 6): "If the PJM markets worked perfectly, with no uncertainty, and the models used by PJM worked in exactly the same way that this perfect world worked, then there might be a logical reason not to include balancing congestion in the calculation of FTR revenue." The Market Monitor would add that the "logical reason not to include balancing congestion in the calculation of FTR Revenue" is that there would be no balancing congestion under those hypothetical conditions.

I. ANSWER

A. FTRs Are Not a "Day-Ahead Product."

An FTR is "a right to receive Transmission Congestion Credits."[4] A Transmission Congestion Credit is a right to a share of all "the total Transmission Congestion Charges in each hour resulting from both the Day-Ahead Energy Market and the Real-Time Energy Market," adjusted on the basis of the Target Allocations for that hour.[5] FTRs provide a share of congestion revenues based on the actual difference between the total revenues paid to generating resources and the total revenues paid by loads, holding marginal losses aside. Those revenues reflect the nodal price of energy at levels in the Day-Ahead and Real-Time Energy Markets. The PJM rules have appropriately calculated Transmission Congestion Charges including both day ahead and balancing congestion since the establishment of the Day-Ahead Energy Market on June 1, 2000.

A complaint narrowly based on the unsupported and unsupportable assertion that FTRs are a day-ahead product should be denied.

B. That "FTR Holders Do Not Cause Real-Time Congestion" Is No Basis for Ignoring Balancing Congestion in Calculating Transmission Congestion Credits.

FirstEnergy states (at 2) that FTR Holders do not cause real-time congestion. The Market Monitor agrees, and would also agree that FTR Holders do not cause day-ahead congestion either. Holding an FTR does not cause any energy market result. Holding an FTR means holding a right to a share of congestion revenues.

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4 OATT Schedule 1 § 1.3.5.

5 OATT Schedule 1 § 5.2.5.

FirstEnergy's new argument is an attempt to disassociate its request for relief from FTR underfunding and the complicated evaluation of underfunding. This new argument modifies FirstEnergy's original argument (at 3) that "FTR holders are not causing the revenue shortfall in the real-time market due to incremental congestion." The Market Monitor also agrees with this assertion. Holding an FTR does not cause any energy market result. PJM also agrees with FirstEnergy's original argument, stating (at 20) "PJM agrees that the FTR holders themselves are not the root cause of underfunding." The Market Monitor agrees that FTR holders are not the cause of FTR underfunding.

The fact that FTR holders do not cause day-ahead or balancing congestion and do not cause over funding or under funding is irrelevant to the question of the appropriate compensation for FTR holders. The fact that FTR holders do not cause congestion is irrelevant to the question of whether FTRs should be redefined to be only a day-ahead product.

C. Including Balancing Congestion Creates the Correct Pricing Signals in FTR Markets.

The reasons for recent increased shortfalls in FTR funding, identified by PJM, support the continued use of the current definition of FTR revenues, which includes balancing congestion. The reasons offered by PJM are reduced transmission capability and the difficulty of modeling Midwest Independent System Operator, Inc. ("MISO") flowgates in the FTR Auction model. These both result in over selling FTRs. Over selling FTRs creates balancing congestion, which reduces the funds available to pay FTR holders. It is appropriate that FTR holders are paid less when FTR revenues, including balancing congestion, are reduced.

Both of the cited reasons resulted in PJM selling more FTR capability in the FTR auctions than exists. This is not a criticism of PJM. This recognizes the reality that FTR auctions are run well before the time that congestion is experienced and reality does not always match the model used in the auction to define available FTRs.

The difficulty in predicting flows on PJM/MISO flowgates used in market-to-market congestion management and the reduction in overall transmission capability in turn results in differences between day-ahead models and actual experience in real time.

FTR holders do not have guarantees from PJM or PJM transmission customers that their payments would depend on modeling assumptions in the day-ahead market rather than total congestion. FTR holders cannot reasonably expect that such payments would ignore balancing congestion. It would be inappropriate to have FTR holders' revenues depend solely on modeling assumptions rather than on actual total congestion, including balancing congestion.

Underfunding is a logical consequence of overselling FTRs. When FTRs are oversold, a decline in their value can be expected. A reduction in FTR revenue sufficiency is a market signal and a correct market signal. The level of FTRs sold reflects PJM's judgment. The logical conclusion is not that underfunding must be eliminated through a change in the funding mechanism but that it is an expected consequence of the ongoing transmission upgrades on the system, the unanticipated level of congestion on MISO flowgates, and PJM's choices about the level of FTRs sold. If full funding is the goal, fewer FTRs should be sold, reflecting the reduced capability of the transmission system.

Until the fundamental issues underlying FTR funding can be addressed, that level of revenue sufficiency will continue to be a correct market signal. FTR holders can pay less for

FTRs if they believe that their value has been reduced, or PJM can make fewer FTRs available. These are very similar outcomes.

D. Target Allocations Do Not Establish A Right Or An Expectation About FTR Funding

The concept of underfunding is based on the assertion that FTR holders are guaranteed payments based on the definition of target allocations. Target allocations do not establish an entitlement to any level of funding. FTR holders are not entitled to such a guarantee backed by an allocation of shortfalls to all transmission customers. FTR holders do not have a reasonable expectation of funding at that level. The valuation of FTRs by purchasers includes market risk. Market participants appropriately bear this risk and they should not be permitted to shift those risks to others. FTR holders are in position to assess the value of the FTRs that they purchase. If they are wrong, they appropriately bear the risks.

Target allocations serve as a cap on FTR payments by time period and therefore define the amount of over collections that are spread to other periods.

PJM could effectively guarantee full funding of FTRs by using more conservative assumptions in its auction model. But that would inappropriately tilt toward one end of the tradeoff between revenue sufficiency and maximizing the availability of FTRs.

E. The Value of FTRs

The value of FTRs is determined by the revenue available to fund them. The value of FTRs is not determined by the target allocation. FTRs are financial products which serve a number of market functions from hedging to speculation. FTRs are voluntarily purchased in the market. Neither FirstEnergy nor any other market participant has lost money as a result of FTR underfunding. Market participants have received less payment than their target allocation, but that is very different than losing money.

Contrary to FirstEnergy's assertion, it has not been established that it is "less equitable" to assign balancing congestion to FTR holders rather than all transmission customers.[6] The term "equitable" has not been defined by FirstEnergy as they use it in their filing. Nor has it been explained why transmission customers who did not purchase FTRs should play a role in funding FTRs by absorbing balancing congestion. Nor has FirstEnergy explained why creating another unavoidable uplift charge with no causal link to those paying it is superior to continuing to have the market value FTRs, and have FTR purchasers make rational decisions about how much to pay for FTRs based on expectations about available congestion revenues. The current approach results in an appropriate match between the decision maker and the result. The approach proposed by FirstEnergy disrupts the match between the decision maker and the result.

F. FTRs in PJM with ARRs Are Not The Same Product as FTRs in Markets Without ARRs

FirstEnergy continues (at 7–8) to confuse the role of FTRs as described by Professor Hogan with the role of FTRs in a system where the basic function of those original FTRs is performed by ARRs. PJM explains (at 7) that it is required to "maximize the use of the transmission system to allow the firm transmission service customers who paid for the transmission system to recover the fixed, embedded costs of the transmission system," and that this requirement resulted in the provision of FTRs to the firm transmission service

6 FirstEnergy Answer, Exhibit A (Supplemental Affidavit of Robert B. Stoddard) at 8.

customers who pay for the transmission system when PJM was formed.[7] The financially firm transmission service which resulted was provided to the firm transmission service customers who pay for the transmission system.

When ARRs were created, ARRs inherited this right to financially firm transmission service. It is the holders of ARRs who are the firm transmission service customers.

FTR holders, in this new structure, did not inherit that right to financially firm transmission service. FTR holders do not become FTR holders because they are firm transmission service customers. FTRs are a market product created in order to make available any excess transmission system capability not directly assigned to the firm transmission service customers. FTRs are purchased in a voluntary market. FTR holders do not have a right to full funding.

FTR funding should be and is determined by the level of congestion revenues, as currently defined in the PJM rules to include both day-ahead and balancing congestion.

The willingness of participants in the FTR auctions to pay for FTRs will affect the value of ARRs. The outcome of the FTR auction is the appropriate funding for ARRs and it is a market determined outcome. Such a market determined outcome is preferable to simply modifying an element of the market structure to appear to make the problem disappear while imposing costs on other market participants with no role in this issue.

G. The Causal Link Between Balancing Congestion and Underfunding FTRs Has Not Been Established.

Contrary to FirstEnergy's assertions (at 4–5), it has not been established that balancing congestion is the cause of the underfunding of FTRs. Contrary to FirstEnergy's

7 PJM cites, e.g., *PJM Interconnection, L.L.C.*, 84 FERC ¶61,212 (1998).

assertion, there has been no detailed inquiry by PJM in to the relationship between balancing congestion and FTR underfunding. In fact, it is clear that balancing congestion is not the cause of the underfunding of FTRs. There is no statistical or causal link between the level of balancing congestion and the level of FTR underfunding. There is no correlation between monthly FTR funding levels and monthly balancing congestion from 2005 through 2011. (See Attachment.) What has been established is that FTRs on particular paths have been oversold relative to capability, and there are systematic differences between the model used for the FTR auctions and actual conditions that have created the created the underfunding of FTRs. This can result in negative balancing congestion when the day-ahead model does not reflect reality as well as does actual experience in the real time market.

Without a causal link between balancing congestion and underfunding, it does not make sense to assign balancing congestion to transmission customers to address the underfunding issue, as FirstEnergy proposes to do.

Even if a causal link had been established, the solution is not to arbitrarily assign balancing congestion to all transmission customers. The solution would be to determine the reasons for balancing congestion and to address them directly.

H. Further Analysis of FTR Funding Should Be Pursued.

Nothing in the Market Monitor's filings on this matter should be taken as a criticism of PJM's modeling efforts. We agree with PJM that PJM has done an excellent job in balancing the sometimes conflicting objectives in modeling and selling FTRs. This does not mean that the assumptions made in the modeling and their basis in market developments should not be carefully reviewed in order to understand their role in underfunding.

PJM correctly states that it is attempting to meet two competing objectives. Funding FTRs is a valid objective. Maximizing the efficient usage of the transmission system by optimizing the sale of FTRs is also a valid objective. FTR underfunding reflects PJM's efforts to balance competing objectives. FTR revenue shortfalls are not evidence that there is any deficiency with PJM's approach.

The Market Monitor would be happy to participate in an analysis of underfunding with PJM as proposed in PJM's Answer (at 6).

II. MOTION FOR LEAVE TO ANSWER

The Commission's Rules of Practice and Procedure, 18 CFR § 385.213(a)(2), do not permit answer to answers or protests unless otherwise ordered by the decisional authority. The Commission has made exceptions, however, where an answer clarifies the issues or assists in creating a complete record.[8] In this answer, the Market Monitor provides the Commission with information useful to the Commission's decision-making process and which provides a more complete record. Accordingly, the Market Monitor respectfully requests that this answer be permitted.

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8 *See*, *e.g.*, *N.Y. Indep. Sys. Operator, Inc.*, 121 FERC ¶61,112 at P 4 (2007) (answer to protest accepted because it provided information that assisted the Commission in its decision-making process); *PJM Interconnection, L.L.C., 119 FERC ¶ 61,318 at P 36 (2007) (accepted answer to answer that* "provided information that assisted … decision-making process*"); California Independent System Operator Corporation*, 110 FERC ¶61,007 (2005) (answer to answer permitted to assist Commission in decision-making process); *New Power Company v. PJM Interconnection, L.L.C.*, 98 FERC ¶ 61,208 (2002) (answer accepted to provide new factual and legal material to assist the Commission in decision-making process).

III. CONCLUSION

The Market Monitor respectfully requests that the Commission afford due consideration to this answer as the Commission resolves the issues raised in this proceeding.

Respectfully submitted,

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Dated: February 2, 2012

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Eagleville, Pennsylvania,
this 2nd day of February, 2012.

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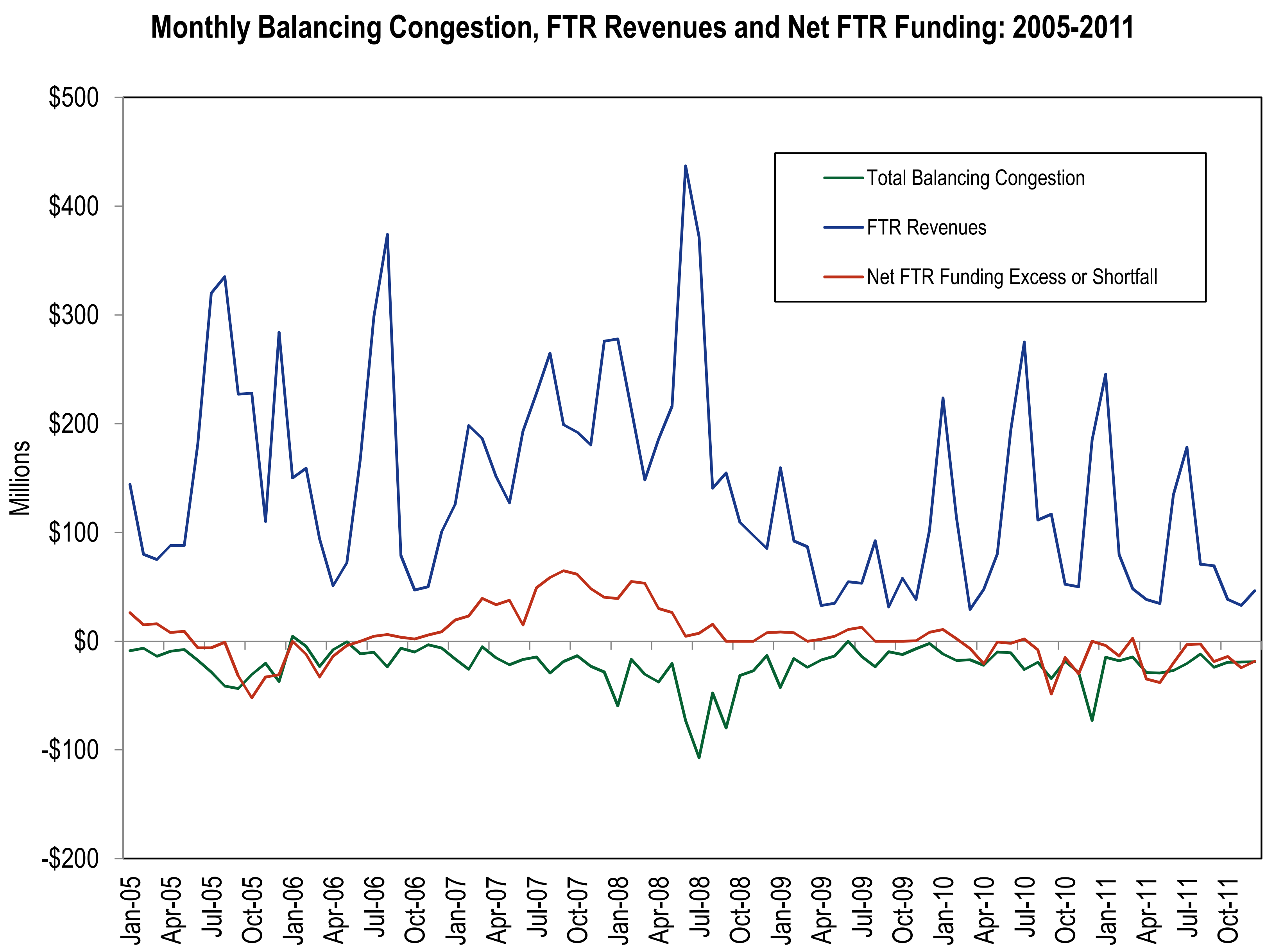
ATTACHMENT



Monthly Balancing Congestion, FTR Revenues and Net FTR Funding: 2005-2011
Total Balancing Congestion
FTR Revenues
Net FTR Funding Excess or Shortfall
Millions
$500
$400
$300
$200
$100
$0
-$100
-$200
Jan-05
Apr-05
Jul-05
Oct-05
Jan-06
Apr-06
Jul-06
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Jan-07
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