UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

PJM Interconnection, L.L.C.	)	Docket No. EL16-6-000
	)	
v.	)	
	)	
PJM Interconnection, L.L.C.	)	
	)	
	)	

ANSWER OF THE INDEPENDENT MARKET MONITOR FOR PJM

Pursuant to Rule 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 to the comments or protests submitted by numerous parties on November 9, 2015.[3] PJM's filing is a significant and constructive step towards addressing the longstanding revenue adequacy issue. That some FTR holders have FTRs with both positive and negative target allocations (a portfolio) and others only have FTRs with

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[1]   18 CFR § 385.213 (2015).

[2]   Capitalized terms used herein and not otherwise defined have the meaning used in the PJM Open Access Transmission Tariff ("OATT") or the PJM Operating Agreement ("OA").

[3]   Parties with comments or protests to which this answer reponds include: Appian Way Energy Partners, LLC ("Appian Way"); DC Energy, LLC et al. ("DC Energy"); Direct Energy Business Marketing, LLC ("Direct Energy"); Dominion Resources Services, Inc. ("Dominion"); Elliott Bay Energy Trading, LLC ("Elliott Bay"), including an Affidavit of Dr. Brian Lonergan ("Lonergan Affidavit"); Dayton Power and Light Company and FirstEnergy Service Company ("Dayton/FirstEnergy"); J. Aron & Company ("J. Aron"); Old Dominion Electric Cooperative and American Electric Power ("ODEC/AEP"); Public Service Electric and Gas Company, et al. ("PSEG"); and Shell Energy North America ("Shell").

positive target allocations (no portfolio) is not a reason why the latter should pay subsidies to the former. These unjust and unreasonable transfers cause the revenue adequacy to be worse for holders of FTRs with positive target allocations than is consistent with actual congestion revenues. Arguments raised in opposition to PJM's filing have no merit. The cross subsidies should be eliminated and PJM's proposal should be approved.

I. COMMENTS

A. Elimination of Portfolio Netting Would Eliminate the Resulting Subsidies.

Financial participants assert that the current netting approach is fair and symmetrical. It is neither. A few simple examples illustrate how the current approach to netting creates a subsidy from holders of positively valued FTRs to holders of negatively valued FTRs. Both examples provided by financial participants are flawed in that they fail to properly account for negative target allocations, rather than only net negative, as a source of revenue to pay positive target allocation holders. This flaw is corrected in the Market Monitor's examples and the difference helps to demonstrate the subsidies created by the current netting process.

In order to understand the advantage that counter flow FTRs receive through portfolio netting it is important to understand how counter flow FTRs generate profit. FTR prices, in both the auction and Day Ahead Market, are based on the sink minus source price of the points selected. A prevailing flow FTR is acquired with the expectation that the sink price will be greater than the source price. Prevailing flow FTRs will have a positive auction price and a positive target allocation. The participant pays for the FTR in the auction and is paid for the FTR from congestion revenue. A prevailing flow FTR, purchased solely for profit, makes money when the price paid in the auction is less than the amount of hourly target allocations received. In contrast, a counter flow FTR is acquired with the expectation that the sink price will be less than the source price. Counter flow FTRs will have a negative auction price and a negative target allocation. The participant is paid to take the FTR in the auction, and pays the congestion revenue. A counter flow FTR, purchased solely for profit,

makes money when the price received in the auction is greater than the amount of hourly target allocations paid back. Counter flow FTRs can be, and generally are, profitable when their target allocations are negative.

For example, node A is priced at $5 and node B is priced at $10. Participant X chooses a 1 MW prevailing flow FTR from A to B. Participant X pays $5 in the auction for this FTR. Participant Y chooses a counter flow FTR from B to A. Participant Y is paid $5 to take this FTR position. At the end of the FTR's liquidation period, target allocations (congestion) across the A to B path are equal to $4. In this case, Participant X loses $1 for their prevailing flow FTR because they paid $5 for the FTR and only received $4. Participant Y profits by $1 because they were paid $5 to take the FTR and were only required to pay $4 back.

The simple examples presented will show how the treatment of positive target allocations changes based on a participant's portfolio structure, and will show how portfolio construction can be used to reduce the impact of revenue inadequacy on a participant by subsidizing negative target allocations. Treating all negative target allocations as a source of revenue before netting is the appropriate way to allocate the revenue collected in the FTR market because it treats all positive target allocation FTRs the same, regardless of portfolio construction.

1. Example 1: Two portfolios with and without netting

The first example is a case in which one participant has only positively valued FTRs and one participant has only negatively valued FTRs. The example illustrates the fundamentals of the issues related to the treatment of positively and negatively valued FTRs. Table 1 demonstrates the payout a participant will receive with and without portfolio netting when a participant has only positive or only negative target allocations. In the example in Table 1, Participant X has positive FTR target allocations of $210, and Participant Y has negative FTR target allocations of -$10, with total congestion revenue of $147 and a payout ratio of 70.0 percent.

Participant X receives 70.0 percent of its target allocation, or $170. Participant Y pays the full value of its negative FTR target allocations of -$10. There are two critical points illustrated: Participant Y's payment of $10 is 100 percent of its negative target allocation; Participant Y's payment of $10 contributes to FTR funding for positively valued FTRs.

Table 1 Example 1: Payouts with and without portfolio netting

Example with Portfolio Netting Payout = 70.0%			
	Participant X	Participant Y	Available Revenue
Congestion Collected	-	-	$137
Positive Target Allocations	$210	$0	$0
Negative Target Allocations	$0	-$10	-$10
Net	$210	-$10	$147
Total Payout with Netting	$147	-$10	-
Example without Portfolio Netting Payout = 70.0%			
Congestion Collected	-	-	$137
Positive Target Allocations	$210	$0	$0
Negative Target Allocations	$0	-$10	-$10
Net	$210	-$10	$147
Total Payout without Netting	$147	-$10	-
With/Without Netting Difference	$0.00	$0.00	-

In this example, there is no subsidization between Participant X's positive target allocations and Participant Y's negative target allocations. There is no difference in the example when portfolio netting is eliminated. The payout ratio and congestion available remain unchanged because net negative target allocations are already accounted for as a source of revenue to pay positive target allocations. The example illustrates that an equal treatment of FTRs between a market with and without portfolio netting only exists if there are not mixed portfolios. The example illustrates the application of PJM's current rules.[4]

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[4]   PJM Manual 28 (Operating Agreement Accounting) at 57.

2. Example 2 and Example 3: Two portfolios with and without netting with prevailing and counter flow FTRs added

Example 2 and Example 3, in Table 2 and Table 3, demonstrate the effects on participants with and without portfolio netting. In Example 2 there are two participants with the same portfolio. In Example 3 Participant X buys an additional prevailing flow FTR from A to B, and Participant Y buys an additional counter flow FTR from B to A for the same quantity.

In Example 2, there are two participants, each with positive target allocations of $10 and $14 in congestion collected. This results in a 70 percent payout ratio ($14/$20=0.70). In Example 2, with netting, both participants are paid $10*0.70=$7, for a total payout of $14, equal to the total congestion revenue available. All calculations are the same without netting for these participants because there are no negative target allocations to account for.

Table 2 Example 2: Payout for two participants with only positive target allocations with and without portfolio netting

	Participant X	Participant Y	Available Revenue
Example with Portfolio Netting			
Payout = 70.0%			
Congestion Collected	-	-	$14
Positive Target Allocations	$10	$10	$0
Negative Target Allocations	$0	$0	$0
Net	$10	$10	$14
Total Payout with Netting	$7	$7	-
Example without Portfolio Netting			
Payout = 70.0%			
Congestion Collected	-	-	$14
Positive Target Allocations	$10	$10	$0
Negative Target Allocations	$0	$0	$0
Net	$10	$10	$14
Total Payout without Netting	$7	$7	-
With/Without Netting Difference	$0.00	$0.00	-

In Example 3, there are the same two participants as in Example 2. Both participants buy an additional 1MW FTR. There is $14 in total congestion revenue. Participant X purchased a prevailing flow FTR from A to B worth an additional $10 in target allocations,

for a net target allocation of $15. Participant Y has been paid to take a counter flow FTR from B to A, with a target allocation of -$10 for a net target allocation of $5. (This payment to take the counter flow FTR is not included in these examples. Neither is the fact that the apparent negative target allocation for counter flow FTRs is generally less than the payment received to take the FTR.) There is a total of $20 in positive target allocations for both participants. This results in a 70 percent payout ratio in this example ($14/$20=0.70) with portfolio netting. In this case, under the current rules, the payout ratio of each participant is multiplied by their net positive target allocations for payouts of $10.50 and $3.50 for Participant X and Y.

The second half of Example 3 illustrates how the elimination of portfolio netting impacts both participants. In this example, the payout ratio has increased due to the accounting of negative target allocations as a source of revenue. Without portfolio netting, the congestion collected is $14, but the -$5 target allocation is a source of revenue, resulting in a total of $19 in available revenue. This $19 will be used to pay the total positive target allocations, which are $15+$10=$25. This increases the payout ratio from 70.0 percent ($14/$20=0.70) to 76.0 percent ($19/$25=0.76). This new payout ratio is then applied to each participant's positive target allocations before netting their portfolio. For this example, Participant X receives an additional $0.90 due to the 6 percent increase in payout ratio which changes their payout from $15*0.70=$10.50 to $15*0.76=$11.40. Participant Y's payout is changed because the increased payout ratio is first applied to their positive target allocations, and then their negative target allocations are subtracted. This changes their payout received from $5*0.70=$3.50 to ($10*0.76)+(-$5)=$2.60, a difference of -$0.90. This difference in payout is a subsidy Participant Y was previously receiving from Participant X as a result of portfolio netting, and which is eliminated by eliminating portfolio netting. Another way of looking at this is that Participant Y is now, correctly, paid $7.60 for their positive target allocations, and the full -$5.00 from their negative target allocations, for a total payment of $2.60.

Table 3 Example 3: Payout ratio for two participants incremented from Example 2, with and without portfolio netting

	Participant X	Participant Y	Available Revenue
Example with Portfolio Netting			
Payout = 70.0%			
Congestion Collected	-	-	$14
Positive Target Allocations	$15	$10	$0
Negative Target Allocations	$0	-$5	$0
Net	$15	$5	$14
Total Payout with Netting	$10.50	$3.50	-
Example without Portfolio Netting			
Payout = 76.0%			
Congestion Collected	-	-	$14
Positive Target Allocations	$15	$10	$0
Negative Target Allocations	$0	-$5	-$5
Net	$15	$5	$19
Total Payout without Netting	$11.40	$2.60	-
With/Without Netting Difference	$0.90	-$0.90	-

3. Example 4: Elliott Bay Example

DC Energy and Elliott Bay both provide examples of how revenue accounting would work in a system without portfolio netting. Both examples contain errors. When corrected, the examples demonstrate how the elimination of portfolio netting would eliminate subsidies and result in an appropriate assignment of the risks and rewards associated with holding positively and negatively valued FTRs.

In the examples presented by Elliott Bay,[5] presented in Table 4, initially Participant X and Participant Y hold FTRs with $200 in net target allocations with a 70 percent payout ratio, resulting in a payment to Participant X and Y of $200*0.70=$140. Elliott Bay defines the example presented in Table 4 under the current netting rules as: if Participant X were to buy an additional 1 MW FTR from A to B (prevailing flow) they would receive an additional $10 of target allocation, for a total positive target allocation of $210 and would be

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5   Lonergan Affidavit at para. 22.

paid $210*0.70=$147. This represents a $7 increase in payout to the participant, consistent with the 70 percent payout ratio.

Elliott Bay then states under the current netting rules: if Participant Y had the same portfolio as Participant X initially, but were to buy a counter flow FTR from B to A, they would receive $10 for taking the FTR, and negative $10 of target allocation, for a net positive target allocation of $190, and would be paid $190*0.70=$133. This represents only a $7.00 reduction in payout to the participant rather than the full $10.00 of negative target allocation.

Elliott Bay asserts that this outcome is symmetric.[6] But this outcome is not symmetric. The apparent symmetry reflects the fact that the holders of positively valued FTRs are required to pay for a portion of Participant Y's negative target allocations.

Under the current netting rules, Participant X's target allocation is increased by $10 and the participant receives an increase in payout of $7, consistent with the 70 percent payout ratio. Participant Y's target allocation is reduced by $10 but the participant would pay only an additional $7 over their initial payment.

This illustrates that Participant X, who only holds positive target allocations, is subsidizing Participant Y's negative target allocation holders, in the amount of $3 under the current rules. If both participants had their payouts calculated based only on their positive target allocations, paid from available congestion revenue and payments of losses on negatively valued FTRs, the subsidy would be eliminated.

Elliott Bay's example demonstrates the issues with the current netting rules and why PJM's proposal addresses the issues.[7] Participant X purchases a prevailing flow FTR worth $10 and Participant Y purchases a counter flow FTR worth negative $10. The payout ratio remains 70 percent. This means that Participant X has only positive target allocations of

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[6]   Lonergan Affidavit at para. 25.

[7]   Lonergan Affidavit at para. 40–41.

$210, and Participant Y has positive target allocations of $200 and negative target allocations of -$10.

Elliott Bay ignores the fact that the payout ratio for positive target allocation holders should change as a result of the correct accounting of negative target allocations as a source of revenue. In this example, the congestion available to pay net positive target allocations is $280 because 70 percent of total net target allocations of $400 is $280. Elliott Bay glosses over the fact that portfolio netting changes the payout ratio calculation, saying it will be insignificant in total. The actual market results show that it is not insignificant in total. With portfolio netting, the payout ratio is reduced because negative target allocations are subtracted from the congestion available to pay positive target allocations. Without portfolio netting, the negative target allocations are a direct source of funding for positively valued FTRs. The total positive target allocations in the example are $410. The total congestion available to pay the target allocations, including the contribution of $10 from negative target allocations, is $290 available to pay $410 in positive target allocations, for a payout ratio of 70.7 percent. The payouts received result in Participant X, with only positive target allocations, receiving an additional $1.54, and Participant Y paying an additional $1.54. The additional revenue collected directly from negative target allocations does not disappear, as Elliott Bay claims, but is paid directly to Participant X to eliminate the existing subsidy. Without portfolio netting, Participant X is no longer subsidizing Participant Y's negative target allocations, and Participant Y is paying their mandated 100 percent payout ratio on negatively valued FTRs.

Table 4 Example 4: Reallocation of congestion revenue with and without portfolio netting

	Participant X	Participant Y	Available Revenue
Example with Portfolio Netting			
Payout = 70.0%			
Congestion Collected	-	-	$280
Positive Target Allocations	$210	$200	$0
Negative Target Allocations	$0	-$10	$0
Net	$210	$190	$280
Total Payout with Netting	$147	$133	-
Example without Portfolio Netting			
Payout = 70.7%			
Congestion Collected	-	-	$280
Positive Target Allocations	$210	$200	$0
Negative Target Allocations	$0	-$10	-$10
Net	$210	$190	$290
Total Payout without Netting	$148.54	$131.46	-
With/Without Netting Difference	$1.54	-$1.54	-

4. Example 5: DC Energy Example

The example provided by DC Energy et al. includes the same error as the Elliott Bay example. In both cases, the examples ignore the fact that the subsidy included in portfolio netting decrease the payout ratio. Conversely, the examples ignore the increased payout ratio that would result from the elimination of portfolio netting.[8]

In the DC Energy example, participants hold portfolios of prevailing and counter flow FTRs. The example assumes a payout ratio of 72 percent which, given the net target allocations presented, represents $10.80 collected in congestion revenue. In DC Energy's example, this payout ratio results in Participant A, with a positive target allocation of $5, receiving $3.60 both with and without netting in their example. Participant B, with a positive target allocation of $20 and a negative target allocation of -$15, receives $3.60 with netting and -$0.60 without netting. Participant C, with a positive target allocation of $110 and a negative target allocation of -$105, receives $3.60 with netting and -$25.80 without

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8   *See* "DC Energy at 38.

netting. These results are incorrect because DC Energy et. al. do not account for the change in payout ratio that occurs from properly accounting for negative target allocations as a source of revenue.

Table 5 corrects the DC Energy example. In fact, there are a total of $135 in positive target allocations to be paid, and a total of -$120 in negative target allocations to help pay the $135. This raises the total revenue available to pay positive target allocations from $10.80, at a 72 percent payout ratio for net positive target allocation holders, to $130.80, for a 96.9 percent payout ratio for all positive target allocations. The result is that Participant A now receives $4.84 instead of $3.60, Participant B now receives $4.38 instead of $3.60 and Participant C now receives $1.58 instead of $3.60.

The elimination of portfolio netting means that positive target allocations are paid the full amount of congestion revenue available, including negative target allocations. This results in an increased payout ratio for positive target allocations, and a reduced subsidy for negative target allocations. The positive target allocations should be treated equally despite the construction of the portfolio. The examples all illustrate that such equal treatment can only be accomplished through the elimination of portfolio netting.

Table 5 Example 5: Payouts with and without portfolio netting

Example with Portfolio Netting Payout = 72.0%			
	Participant A	Participant B	Participant C	Available Revenue
Congestion Collected	-	-		$10.80
Positive Target Allocations	$5.00	$20.00	$110.00	$0.00
Negative Target Allocations	$0.00	-$15.00	-$105.00	$0.00
Net	$5.00	$5.00	$5.00	$10.80
Total Payout with Netting	$3.60	$3.60	$3.60	-
Example without Portfolio Netting Payout = 96.9%			
Congestion Collected	-	-		$10.80
Positive Target Allocations	$5.00	$20.00	$110.00	$0.00
Negative Target Allocations	$0.00	-$15.00	-$105.00	-$120.00
Net	$5.00	$5.00	$5.00	$130.80
Total Payout without Netting	$4.84	$4.38	$1.58	-
With/Without Netting Difference	$1.24	$0.78	-$2.02	-

This is a very different result than that asserted by DC Energy, and demonstrates how the elimination of portfolio netting would benefit positive target allocation holders while eliminating subsidies to negative target allocation holders. In the DC Energy example, only Participant C, with a large share of negative target allocation FTRs that are subsidized under the current netting rules, would receive less revenue, and the difference would be allocated to Participants A and B to contribute to funding their positive target allocations.

The DC Energy example also illustrates how Participant C can structure their portfolio to shield themselves from revenue inadequacy. In the example, Participant A has a small positive target allocation of $5 with no negative target allocation FTRs, Participant B has both medium and small positive and negative target allocation FTRs, and Participant C has both large positive and negative target allocation FTRs. The positions of Participants A, B and C all net to $5 with portfolio netting. This is equivalent to Participant A receiving the stated payout ratio of 72.0 percent ($10.80/$15=0.72), Participant B receiving a payout ratio for their positive target allocations of 93.0 percent and participant C receiving a payout ratio of 98.7 for their positive target allocations, and then netting their portfolio.

Under the proposed rules there is no change in counter flow funding as suggested by several complainants.[9] Holders of counter flow FTRs will continue to pay 100 percent of their target allocations and continue to be paid 100 percent of their profits, so there will be no impact on their funding in a revenue inadequate market.

B. Inclusion of Portfolio Netting Has a Substantial Negative Impact on Holders of Positively Valued FTRs.

Elliott Bay has stated (at 10) "The sum total of PJM's evidentiary support for the Netting Elimination Proposal appears…without any analysis of the ramifications of PJM's proposal on the market." There is substantial evidence that portfolio netting has resulted in

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9   *See* DC Energy at 8.

a significant shift of revenues away from the holders of positively valued FTRs to the holders of FTRs with negative target allocations. While the elimination of portfolio netting does not generate additional congestion revenue, it does eliminate subsidies and as a result, it does increase the payout ratio significantly for holders of positively valued FTRs. Under the PJM proposal, holders of positive target allocation FTRs are, appropriately, the only participants that receive congestion revenues.

Table 6 shows the impact of portfolio netting on the holders of positive target allocation FTRs for the 2012 to 2013 and monthly for the 2013 to 2014 planning periods. More current planning periods are not used because PJM has eliminated revenue inadequacy through the arbitrary reduction of Stage 1B ARR allocations. The elimination of portfolio netting would have resulted in a substantial increase in the payout ratio for positive target allocation FTR holders. The increase in the payout ratio would have been 16.8 percentage points, from 67.7 percent to 84.5 percent for the 2012 to 2013 planning period, and 14.7 percentage points, from 72.8 percent to 87.5 for the 2013 to 2014 planning period.

The change in revenue received by positive target allocations results from the elimination of the subsidy that is created by netting. With the elimination of portfolio netting, negative target allocations will be considered a source of revenue to pay positive target allocations. As an example, in November 2013, there were $71.5 million in net positive target allocations and $4.6 million in net negative allocations, resulting in a payout ratio of 66.9 percent. However, removal of netting would have resulted in positive target allocations of $156.6 million, a 119.0 percent increase, and negative target allocations of $89.8 million, a 185.2 percent increase, and therefore a payout ratio of 85.9 percent. This clearly demonstrates that, through proper accounting for negative target allocations, the payout ratio for positive target allocation holders would have been increased by 19.0 percentage points in one month. For the entire 2013 to 2014 planning period, the elimination of portfolio netting would result in an additional $2,850.6 million for positive target

allocations. Contrary to Elliott Bay, 2.8 billion dollars in a year is a significant market impact.

**Table 6 Market impacts of portfolio netting**

	Net Positive Target Allocations	Net Negative Target Allocations	Per FTR Positive Target Allocations	Per FTR Negative Target Allocations	Total Congestion Revenue	Reported Payout Ratio (Current)	No Netting Payout Ratio (Proposed)
Jun-13	$ 86,723,727	$ (4,836,912)	$ 164,066,220	$ (82,101,063)	$64,060,468	78.3%	89.1%
Jul-13	$ 134,302,957	$ (6,017,378)	$ 255,724,128	$ (127,113,708)	$113,548,567	88.8%	94.2%
Aug-13	$ 51,545,380	$ (5,741,003)	$ 104,601,365	$ (58,796,985)	$43,059,687	94.1%	97.4%
Sep-13	$ 126,168,822	$ (10,172,695)	$ 279,972,757	$ (163,977,565)	$66,719,631	57.5%	82.4%
Oct-13	$ 69,748,034	$ (5,779,197)	$ 158,354,017	$ (94,365,761)	$47,353,545	74.1%	89.5%
Nov-13	$ 71,460,441	$ (4,566,566)	$ 156,649,135	$ (89,755,253)	$44,748,426	66.9%	85.9%
Dec-13	$ 123,125,598	$ (7,182,127)	$ 256,139,289	$ (140,195,812)	$84,974,997	73.3%	87.9%
Jan-14	$ 1,081,718,330	$ (37,626,711)	$ 2,042,537,214	$ (998,445,595)	$815,789,461	78.1%	88.8%
Feb-14	$ 257,630,277	$ (14,286,013)	$ 581,660,982	$ (338,316,718)	$167,731,282	69.0%	87.0%
Mar-14	$ 381,568,930	$ (14,281,323)	$ 823,861,546	$ (456,573,940)	$245,465,062	66.9%	85.3%
Apr-14	$ 115,047,446	$ (2,753,503)	$ 255,732,814	$ (143,428,606)	$60,894,528	54.3%	79.9%
May-14	$ 126,329,939	$ (13,141,697)	$ 362,871,684	$ (249,683,438)	$65,163,098	57.6%	86.8%
2012/2013 Total	$ 992,878,752	$ (86,061,137)	$ 1,897,830,880	$ (990,471,801)	$614,014,377	67.7%	84.5%
2013/2014 Total	$ 2,625,369,880	$ (126,385,125)	$ 5,442,171,151	$ (2,942,754,444)	$1,819,508,754	72.8%	87.5%

C. There is No Support for Assertions About Negative Impacts on Liquidity.

Financial participants frequently claim that changes affecting the profitability of their FTR positions have a negative impact on liquidity. Prior claims that revenue inadequacy would cause a decline in liquidity were not borne out and it did not occur.

Figure 1 shows what did happen. Figure 1 shows the FTR bid volume by FTR type in lines, with the payout ratio for the given planning period as a bar. The current planning period is a dotted bar to indicate that the final payout ratio for the planning period is unknown. Figure 1 shows that, even through planning periods of decreasing revenue adequacy, there was a steady or increasing volume of bid counter flow FTRs, contrary to the claims of the financial participants.

Figure 1 Annual Bid FTR Auction Volume: Planning period 2009 to 2010 through 2015 to 2016
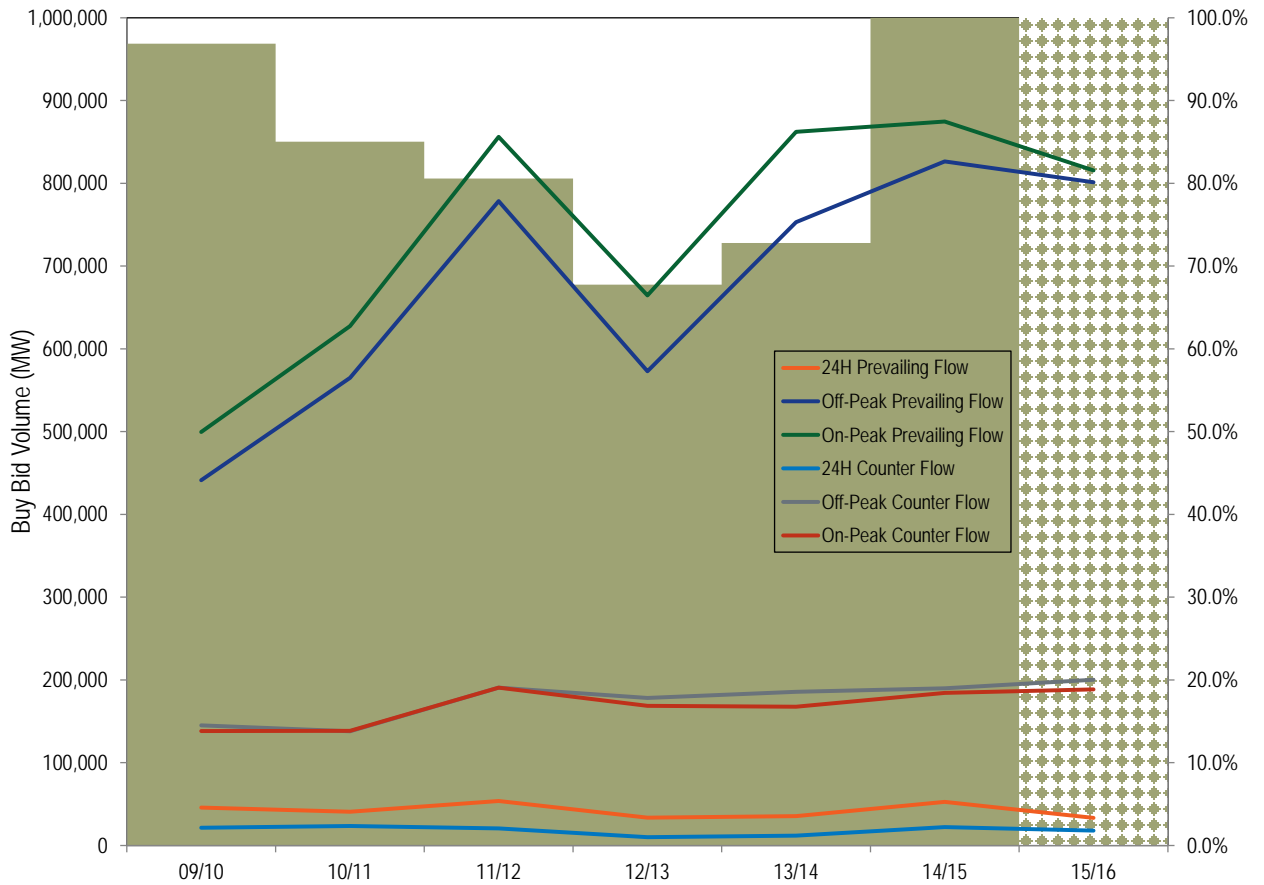
There is no reason to expect a change in liquidity given the proposed market rule changes. Participants are aware of existing market rules, and their changes, and can appropriately adjust their bid strategies to account for any changes that may happen. Counter flows are profitable under the current rules and will remain profitable under the proposed changes to the market rules. If some counter flow FTRs were profitable solely as a result of netting, then those counter flow FTRs were not efficient and the loss of those counter flow FTRs would be an improvement in market outcomes.

D. End of Planning Period Surplus Manipulation Is Not a Valid Concern.

The issue of end of planning period surplus manipulation under the proposed rules is a red herring designed to draw attention away from the actual multibillion dollar

subsidies that result from the current netting rules.[10] DC Energy asserts that a participant can purchase an unlimited amount of offsetting prevailing and counter flow FTRs to increase their portion of any end of planning period surplus that may exist, and this will enable them to reap an endless, risk free, windfall due to the proposed market rules. That is not correct.

At the end of the planning period any excess congestion revenue, or required uplift, is allocated to participants in proportion to their position at the end of the planning period. Under the current rules, the percent of uplift/excess for a participant is calculated as their individual net total target allocations divided by the total net positive target allocations of all participants. This percentage is then multiplied by the excess/shortfall, and the participant is paid, in the event of excess revenue, or required to pay, in the event of revenue inadequacy, this amount at the end of the planning period.

The elimination of portfolio netting would alter how this calculation is done. Instead of including net positive target allocations, the calculation would include positive target allocations, without netting. This would change the calculation of uplift/excess proportion to the positive target allocation of a participant divided by the total positive target allocations of all participants, all before netting.

There are several factors that reduce the probability of the success of the DC Energy strategy to zero or near zero. Any end of planning period gains that may be realized by purchasing offsetting prevailing and counter flow FTRs are distributed over all FTR participants. As a participant attempting to manipulate the end of planning period distribution increases their positive target allocation, this impact would be distributed among all FTR participants with positive target allocations because the denominator of the proportion equation is increasing. For an individual participant in the FTR market, the benefit of this activity decreases proportional to the volume of participants' positive target

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[10]   *See* DC Energy at 18.

allocations. The more participants in the FTR market, the lower the marginal benefit of such activity. For the 2013 to 2014 planning period there were 438 individual participants that held positive target allocations.

This is not a risk free activity as DC Energy purports it to be. Predictions about the end of a planning period excess or shortfall are not guaranteed. A participant using this approach risks paying a larger proportion of the shortfall, rather than receiving more of the excess.

If the Commission is concerned with this potential behavior, a combination of rule changes and monitoring could address it.

E. Balancing Congestion Does Not Cause Revenue Inadequacy and Should Remain Part of the FTR Funding Calculation.

Several commenters assert that the stakeholder process has failed to find a path forward, so the reallocation of balancing congestion should be reexamined.[11] These commenters continue to attempt to raise this issue because it is to their advantage to shift risk to other participants. This option has been clearly rejected by the Commission. This option has also been clearly rejected by PJM stakeholders. In the most recent FTR Senior Task Force, several proposals were put forward at the Task Force level for consideration that included reallocating a portion or all of balancing congestion out of the FTR market. None of these proposals made it out of the Task Force for further voting.[12] The stakeholders have clearly spoken on the issue of balancing congestion; retaining balancing congestion as part of congestion in the definition of FTR funding is appropriate.

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[11]   DC Energy at 20–24; J. Aron at 17–21; Elliott Bay at 4–5.

[12]   *See* PJM Presentation to the FTR Senior Task Force (FTRSTF) (May 11, 2015), which can be accessed at: *<http://www.pjm.com/~/media/committees-groups/task-forces/ftrstf/20150526/20150526-voting-results.ashx>*.

FERC has ruled that "neither PJM's Tariff nor Commission policy guarantees FTRs will be fully funded."[13] In this order the FERC ruled that balancing congestion belongs within the FTR market because FTR market participants are in the best position to properly value this congestion. The FERC recognized that balancing congestion is not the root cause of revenue inadequacy.

F. More Improvements to the Existing ARR/FTR Market are Needed.

The Market Monitor does not believe that the elimination of portfolio netting and the adoption of the 1.5 percent growth adder are a complete solution to the revenue problems experienced in the PJM market.

The Market Monitor has made eight proposals to improve revenue adequacy.[14] PJM committed to one proposal, the proper reporting of the payout ratio on a monthly basis, during the stakeholder process. Implementation requires no rule changes. PJM's filing includes a second proposal, the elimination of portfolio netting. This proposal was initially made by PJM in 2011.[15] PJM's filing includes part of a third proposal to address the over allocation of Stage 1A ARRs. The Market Monitor continues to recommend the remaining proposals to address the actual causes of revenue inadequacy in the FTR market.

In addition, there should be a comprehensive review of the basis for the allocation of ARRs, currently on the basis of generation to load patterns that existed in 1998, the year

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13   151 FERC ¶61,205, at P 7 (2015)

14   *See* Answer and Motion for Leave to Answer of the Independent Market Monitor for PJM, Docket No. EL13-47-001 (January 16, 2014) at 7–8; Answer and Motion for Leave to Answer of the Independent Market Monitor for PJM, Docket No. EL13-47-000 (April 18, 2013) at 7–10 ("April 18th Answer"); Request for Rehearing of the PSEG Companies, Docket No. EL13-47-000 (July 5, 2013) *passim*.

15   *See* PJM Presentation to the FTR Task Force (FTRTF) (September 1, 2011), which can be accessed at: *<http://www.pjm.com/~/media/committees-groups/task-forces/ftrtf/20110901/20110901-item-02-pjm-presentation.ashx>*.

before the PJM markets opened, and a comprehensive review of the approach taken by PJM to model and clear the FTR model for FTR auctions.

G. Summary

Given the substantial dollars at stake, it is not surprising that financial participants strongly defend the existing system of subsidies and argue for a major expansion of those subsidies by eliminating balancing congestion from congestion revenues. It is easy to forget that FTRs/ARRs were created and continue to exist in order to ensure that load is provided the benefits in reduced congestion payments that result from the transmission system that load has paid for and continues to pay for. That goal should remain primary in considering how to modify the FTR/ARR rules. FTRs/ARRs do not exist to make it easy or riskless for financial participants to speculate or to hedge positions. FTRs have remained highly profitable for financial participants even at the lowest levels of FTR payout ratios. Existing subsidies that accrue primarily to financial participants, like the current netting rule, should be eliminated and the other sources of revenue shortfalls should be considered seriously. But as the Commission has clearly ruled, FTR holders are not guaranteed a 100 percent payout ratio.

II. MOTION FOR LEAVE TO ANSWER

The Commission's Rules of Practice and Procedure, 18 CFR § 385.213(a)(2), do not permit answers 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. 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.

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: November 23, 2015

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 23rd day of November, 2015.

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