

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

DC Energy, LLC)	Docket No. EL18-170-000
v.)	
PJM Interconnection, L.L.C.)	

COMMENTS OF THE INDEPENDENT MARKET MONITOR FOR PJM

Pursuant to Rule 211 of the Commission’s Rules and Regulations,¹ and the Notice of Request for Comments issued in this proceeding on February 6, 2023 (“Notice”), Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor (“Market Monitor”) for PJM Interconnection, L.L.C. (“PJM”),² submits these comments responding to the questions in the Notice. The Commission asks whether issues raised in the complaint filed by DC Energy (“DCE”) initiating this proceeding on June 4, 2018 (“Complaint”) and in the resulting paper hearing have been addressed, and if not, should be addressed. The Complaint proceeding has been in abeyance since November 9, 2018.³

As outlined in the Complaint and in comments made during the paper hearing, there were a number of issues raised with PJM’s FTR market credit and collateral rules and whether they satisfied the just and reasonable standard and the Commission’s rules on collateralization and capitalization requirements. Arguments were made that PJM’s FTR

¹ 18 CFR § 385.211 (2022).

² Capitalized terms used herein and not otherwise defined have the meaning used in the PJM Open Access Transmission Tariff (“OATT”), the PJM Operating Agreement (“OA”) or the PJM Reliability Assurance Agreement (“RAA”).

³ *DC Energy, LLC v. PJM Interconnection, L.L.C.*, 164 FERC ¶ 61,216 (2018). The abeyance was renewed on December 10, 2018, April 19, 2019, December 20, 2019, and July 6, 2020.

credit and collateral rules would not, as defined at the time of the Complaint, result in credit and collateral requirements and/or minimum capitalization standards that ensure that FTR traders did not impose the risk of defaults on other market participants. The issues raised were that PJM's credit requirements were not related to the risk of default and that PJM's capitalization requirements were not sufficient to mitigate remaining participant risk. Inadequate credit and collateral requirements put PJM's membership at inappropriate risk for FTR participant defaults.

Since the time of the Complaint there have been significant reforms to PJM's credit requirements approved by the Commission. But more needs to be done to ensure that FTR traders did not impose the risk of defaults on other market participants.

I. COMMENTS

A. Background

At the time of the Complaint, PJM's credit requirement calculation was based on comparing the purchase price of an FTR to a reference price, called the Adjusted FTR Historical Value. The Adjusted FTR Historical Value was calculated from a three-year, weighted historical average of the day-ahead CLMP based price difference between the source and sink of an FTR, with a 50 percent weight given to the previous year's average price difference of the source and sink, a 30 percent weight given to the two year old average price difference of the source and sink, and a 20 percent weight to the three year old average price difference of the source and sink. Under the PJM rules at the time of the Complaint, PJM provided a collateral credit to an FTR in a portfolio that had a lower auction/purchase price Adjusted FTR Historical Value of that FTR path and a credit requirement to an FTR in a portfolio that had a lower auction/purchase price Adjusted FTR Historical Value of that FTR path. Further adjustment was made to the FTR Historical Values by scaling up or scaling down credit requirements depending on whether the FTR historical value was a counterflow (negative historic value) or prevailing flow (positive historic value).

To protect against participant risk, PJM's Credit Policy required (and does require) market participants to demonstrate a tangible net worth in excess of \$1 million or tangible assets in excess of \$10 million. PJM had (and has) an exception process that allows posting \$500,000 of cash as collateral in lieu of demonstrating tangible net worth in excess of \$1 million or tangible assets in excess of \$10 million.

B. Issues from the DCE Complaint

DC Energy's (DCE) Complaint asserted that PJM's collateral and capitalization requirements that existed at the time of their Complaint were inadequate to protect other market participants from the risks imposed by FTR holders.

DCE proposed revisions to PJM's credit rules at the time of the Complaint. To address the PJM credit requirements that allow a market participant to acquire a large open FTR portfolio while posting no or very little credit, DCE (at 3) proposed that FTR portfolios be subject to a volumetric \$0.05 per MWh collateral requirement. To address the PJM credit requirements that do not adjust to reflect changes in FTR portfolio valuations after purchase based on changing market conditions, DCE proposed (at 3, 16 & 28) that that FTR portfolio credit and collateral requirements be subject to mark to auction valuation updates. DCE proposed (at 26) that minimum capitalization requirements be increased for participants with large portfolios of long tenor open FTRs. In the paper hearing, DCE recommended (at 3) a reduction in credit and collateral requirements for holders of counterflow FTRs. To address participant risk under PJM's rules, DCE suggested the implementation of a general \$10 million gross asset test for FTR holders.

C. PJM's Updated Rules Remain Deficient

PJM and its stakeholders have made a number of improvements to PJM's credit and collateral requirements since DCE's 2018 filing which directly address DCE's proposals. But PJM's updated credit rules and capitalization requirements rules still do not meet the just and reasonable standard in identified areas.

1. Credit Rules

Since the paper hearing, PJM filed and the Commission approved specific changes to the credit rules. The Commission approved Know Your Customer (KWC) revisions for FTR market participants, intended to identify potential FTR market participants that may pose risk due to their history or collateral.⁴ The Commission accepted revisions to Attachment Q to the OATT that include approved RTEP upgrades in the FTR valuation process.⁵ The Commission approved a \$0.10/MWh volumetric minimum credit requirement in order to strengthen the minimum credit requirements.⁶ The Commission accepted mark-to-auction revisions.⁷ The Commission accepted removing the undiversified adder; revising the \$0.10/MWh volumetric minimum charge to apply after ARR credits and mark-to-auction value adjustments.⁸ The Commission accepted, effective August 3, 2022, subject to the outcome of the paper hearing, PJM's proposal to use the historical simulation initial margin (HSIM) model with a 97 percent confidence interval for purposes of determining both the initial and continuing margin requirements for FTR portfolios.⁹

Under PJM's conditionally approved rules the HSIM model is regularly updated with new pricing information for every FTR path after every auction, and for each participant's entire portfolio, even if the participant did not take any positions in the latest auction. Combined with the other rule changes, the adoption of the HSIM model for credit

⁴ *PJM Interconnection, L.L.C.*, 171 FERC ¶ 61,173 (2020).

⁵ *PJM Interconnection, L.L.C.*, Letter Order, Docket No. ER18-425-000 (January 19, 2018).

⁶ *PJM Interconnection, L.L.C.*, 164 FERC ¶ 61,215 (2018).

⁷ *PJM Interconnection, L.L.C.*, 167 FERC ¶ 61,002 (2019).

⁸ *PJM Interconnection, L.L.C.*, 178 FERC ¶ 61,146 (2022).

⁹ *PJM Interconnection, L.L.C.*, 180 FERC ¶ 61,073.

requirement determination is an improvement over PJM's use of Adjusted FTR Historical Value, but it is not adequate.

There is no basis for PJM's claims that its use of an HSIM based on a 97 confidence interval instead of the private market industry standard 99 confidence interval is just and reasonable.¹⁰ PJM's data supports using an HSIM based on a confidence interval of 99 percent or higher.¹¹ PJM's proposal would impose the risk resulting from the market activity of FTR traders on PJM members as a whole. This is inconsistent with a fundamental principle of markets which is to require investors and direct market participants to pay for the risk which they are in the best position to manage.

2. Capitalization Requirements.

PJM states that the improvements to FTR credit rules were intended to address FTR portfolio risk rather than FTR participant risk. PJM identified participant risk as "the risk that a particular participant will prove incapable of meeting its obligations in the PJM market, due to financial strength (or lack thereof) specific to the participant."¹² PJM states that it has multiple tools to assess and mitigate participant risk, including Know Your Customer reforms, restricted timelines for collateral call payments, enhanced material adverse change language, required audited financials, the implementation of financial models, the addition of unreasonable credit risk as a basis for collateral calls, and the ability to limit and suspend market participation.¹³

PJM's capitalization requirements need to be revised. Picking an arbitrary dollar amount (\$500,000 in posted cash collateral or \$10 million dollars in gross capitalization

¹⁰ See Response of PJM Interconnection, L.L.C. to Paper Hearing Order, and Request for Confidential Treatment, Docket No. ER22-2029-000 et al. (October 3, 2022) at 4.

¹¹ See Comments of the Independent Market Monitor for PJM, Docket No. ER22-2029-000 et al. (October 31, 2022) at 2-4)

¹² *Id.*

¹³ *See id.*

without recognition of offsetting liabilities) for participation in the PJM market has not been supported and could act as an unnecessary barrier to entry for small participants. The issue is not the size of the participant, the issue is the size of the potential portfolio and its risk relative to the capitalization of the participant.

There is a tradeoff between the required confidence level that determines the credit requirement and the capitalization requirements. If the required confidence level were 100 percent, and calculated correctly, and updated daily, the capitalization requirement would be irrelevant. The industry standard of 99 percent is based on a private market model in which defined clearing members take on the remaining risk as part of their for profit business model. Those clearing members have their own rules about capital requirements.

In the case of PJM, PJM market participants as a whole are required to cover the remaining risk; it is not voluntary for PJM market participants as it is for the clearing members in the private market industry standard and PJM market participants do not earn profits for providing this credit backstop. In the case of PJM, the choice between a 100 percent confidence level and required capitalization is the choice between imposing part of the risk of FTR traders involuntarily on all other market participants and requiring FTR traders to cover all of their own risk. Use of the 100 percent confidence level would automatically scale the credit requirements to the level of FTR trading activity rather than imposing an arbitrary level of capitalization.

Another way to address the issue, based on a combination of credit requirements at a 99 percent confidence level and a requirement to have net assets, would be to scale the asset requirement to the level of risk taken by the market participant. The Commission should require PJM to make a proposal for a net asset requirement scaled to the level of risk taken by market participants.

II. CONCLUSION

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

Respectfully submitted,



Jeffrey W. Mayes

Joseph E. Bowring
Independent Market Monitor for PJM
President
Monitoring Analytics, LLC
2621 Van Buren Avenue, Suite 160
Eagleville, Pennsylvania 19403
(610) 271-8051
joseph.bowring@monitoringanalytics.com

General Counsel
Monitoring Analytics, LLC
2621 Van Buren Avenue, Suite 160
Eagleville, Pennsylvania 19403
(610) 271-8053
jeffrey.mayes@monitoringanalytics.com

Howard J. Haas
Chief Economist
Monitoring Analytics, LLC
2621 Van Buren Avenue, Suite 160
Eagleville, Pennsylvania 19403
(610) 271-8054
howard.haas@monitoringanalytics.com

Dated: March 10, 2023

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 10th day of March, 2023.



Jeffrey W. Mayes

General Counsel

Monitoring Analytics, LLC

2621 Van Buren Avenue, Suite 160

Eagleville, Pennsylvania 19403

(610) 271-8053

jeffrey.mayes@monitoringanalytics.com