

I. ANSWER

A. No Evidence Exists That False Arbitrage Activity Is Needed or Is Beneficial to PJM or PJM Markets.

The Financial Marketers claim (at 7) that “Up-To Congestion transactions help to highlight the modeling inefficiencies that have resulted in FTR underfunding.” The Financial Marketers further claim (*id.*) that “without (UTC) presence in the market, PJM staff cannot as accurately or as effectively locate those modeling discrepancies and correct them.”

UTC activity has taken advantage of modeling differences between the day ahead and real time markets. This activity has no benefit to the market or to PJM’s ability to locate and address modeling differences.

Modeling differences between the day ahead and real time market are inevitable, not only due to real time conditions (outages and loop flow) that were not anticipated in the day ahead market, but due to differences in fundamental market design (ancillary service products, marginal loss calculations and voltage concerns). Where systematic modeling differences create arbitrage incentives, such as differences between the day-ahead and real-time modeled transmission contingencies and marginal loss calculations, virtual bids and offers cannot result in more efficient market outcomes. Such offers may be profitable but cannot change the underlying reason for the price difference. The virtual transactions will continue to profit from the activity for that reason. This is termed false arbitrage. This behavior and market result have no benefit to the market as a whole, only to the virtual player at the expense of the rest of the market.

The September 8, 2014, refund date means that all virtual transactions (INCs, DEC’s and UTCs) have an incentive to account for uplift. The logical result has been a significant reduction in submitted and cleared UTC bids, particularly the high volume of speculative, low margin UTC transactions that had been taking advantage of false arbitrage opportunities provided by small, but persistent, price differences caused by modeling

discrepancies between the day ahead and real time markets. Due to the threat of uplift charges, UTC activity has shifted to more profitable locations.³

B. UTCs Have Contributed to FTR Underfunding.

The Financial Marketers state (at 8) that “PJM and the IMM have each historically conducted studies regarding the causes of FTR underfunding in PJM... neither study found Up-To Congestion transactions to be a cause of FTR underfunding.”

The Market Monitor agrees that UTC activity is not the root cause of FTR underfunding. The root cause of FTR underfunding is the over allocation of FTRs relative to the physical capabilities of the system and modeling discrepancies between the day ahead and real time market. But the study did show that UTCs have exacerbated the underfunding issues by dramatically increasing day ahead constraints and congestion relative to what has been realized in real time, resulting in greatly inflated target allocations relative to congestion dollars collected.⁴

The results from the Market Monitor study supports the hypothesis that UTC transactions contribute significantly to FTR underfunding.⁵ The data indicate that removal of UTCs significantly improved FTR funding for each of the five study days.⁶ The magnitude of the effect depends on the day, but the results indicate that the removal of UTC takes PJM FTRs from a state of underfunding to a state of surplus for the five days studied.

³ See IMM Answer and Motion for Leave to Answer of the Independent Market Monitor for PJM, Docket No. EL14-37 (October 6, 2014) at 7–8.

⁴ See 2013 State of the Market Report for PJM, v.2 Section 13 (March 13, 2014) at 397–398.

⁵ See 2013 State of the Market Report for PJM, v.2 Section 13 (March 13, 2014) at 397–398.

⁶ These conclusions are based on data for the five days selected by PJM and for which PJM provided data.

II. MOTION FOR LEAVE TO ANSWER

The Commission's Rule 213 does not permit answers to answers or protests unless otherwise ordered by the decisional authority.⁷ 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.

III. 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,



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⁷ 18 CFR § 385.213(a)(2).

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).

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Dated: October 21, 2014

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 21st day of October, 2014.



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