UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Black Oak Energy, L.L.C. EPIC Merchant Energy, L.P. and SESCO Enterprises, L.L.C. v. PJM Interconnection, L.L.C.	)))))))))	Docket No. EL08-14-010

BRIEF OF THE INDEPENDENT MARKET MONITOR FOR PJM

Pursuant to the Commission's order in the above referenced proceeding, issued February 20, 2014, Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM ("Market Monitor"),[1] submits this brief regarding the issues remanded by that order.

I. ARGUMENT

A. The effects, if any, on the operations of the PJM market of requiring Virtual Marketers to return already-paid refunds.

Allowing the recoupment of already-paid refunds will have no effect on the operations of the PJM market in a literal sense. Neither the payment of refunds nor the recoupment of refunds wrongfully paid has relevance to market operations. These are instead billing matters that impact the accounts of Market Participants. The transactions that generated the

[1] 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").

funds in question settled between December 3, 2007, and March 3, 2009.[2] Those transactions were not resettled when refunds were paid, and they will not be resettled to whatever extent those refunds are recouped. As the Commission noted in its order in this proceeding of July 21, 2011, precedent requiring utilities to issue refunds based on overcollections generally differs from precedent not requiring refunds based on a faulty allocation of funds that were collected at the proper level.[3]

If the Commission means to broadly construe "market operations," then the impact on markets and on market incentives is positive. Participants should expect that they will not be permitted to retain payments that result from mistakes, and that any such payments already made are subject to review and recoupment up through the final decision of the final authority. This is true even if the participants' position has merit. When a participants' position has no merit, they should have an increased expectation that a decision awarding refunds may be reversed. This specifically reduces the incentive to continue to engage in the questionable behavior because participants understand that the money that is inappropriately received will have to be repaid based on the final decision of the final authority.

This specific case involved the refund of an allocation of funds from the marginal loss surplus. After the Commission ordered PJM to allocate the marginal loss surplus "equitably among all parties that support the fixed cost of the transmission system, without regard to

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2 *See Black Oak Energy, L.L.C., at al. v. PJM*, 128 FERC ¶ 61,262 at P 35 (2009).

3 *Black Oak Energy, L.L.C., at al. v. PJM*, 136 FERC ¶ 61,040 at P 25 n.35 & n.36, citing *See, e.g., Westar Energy, Inc. v. FERC*, 568 F.3d 985, 989 (D.C. Cir. 2009); *Consol. Edison Co. of N.Y. v. FERC*, 347 F.3d 964, 972 (D.C. Cir. 2003); *La. Pub. Serv. Comm'n v. Entergy Corp.*, 135 FERC ¶ 61,218 (2011); *Portland Gen. Elec. Co.*, 106 FERC ¶ 61,193, at P 5 (2004) (accepting rate design change on a prospective basis); *Consumers Energy Co.*, 89 FERC ¶ 61,138, at 61,397 (1999) (same); *Union Elec. Co.*, 58 FERC ¶ 61,247, at 61,818 (1992) (same); *Commonwealth Edison Co.*, 25 FERC ¶ 61,323, at 61,732 (1983); *accord Second Taxing Dist. v. FERC*, 683 F.2d 477, 490 (D.C. Cir. 1982) (affirming determination to make rate design changes prospective only); *Batavia v. FERC*, 672 F.2d 64 (D.C. Cir. 1982) (same).

whether such parties serve load,"[4] PJM implemented an approach allocating the marginal loss surplus on the basis of hourly scheduled energy and not on the basis of the total contribution to the fixed costs of the transmission system.[5] Under this approach, a party could receive a share of the marginal loss surplus proportionately greater than its contribution to the transmission system. For example, a financial trader that paid $0.67/MWh for transmission service for an up to congestion transaction received a payment of $1.29/MWh from the marginal loss surplus. The financial trader received a greater allocation of the marginal loss surplus than the cost of the associated transmission service. This is a plainly improper result and cannot, by definition, reflect an allocation of the surplus based on payments for transmission service. Financial traders received unjustified windfalls, starting with the reallocation of marginal loss surplus funds for the fifteen-month period between their complaint and PJM's new allocation approach becoming effective. Financial traders then began to take advantage of the rule, engaging in up to congestion transactions that were economic only as a result of this unjustified windfall. PJM had to take emergency action to correct this market design flaw, although instead of proposing to correct its flawed allocation of the marginal loss surplus, PJM instead removed the transmission charge for up to congestion transactions. PJM continues to apply the flawed allocation approach, but up to congestion transactions no longer pay for transmission service and therefore do not receive a share of the marginal loss surplus. Under these circumstances and in similar circumstances, it is better for the markets that participants believe that the benefits of this behavior may be reversed and that they will not be permitted to keep the money allocated to them based on what was an obvious error.

Conversely, the failure to require refunds by the Financial Marketers in this case would create negative incentives for parties to seek to reverse incorrect decisions. To the extent

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4 *See Black Oak Energy, L.L.C., at al. v. PJM Interconnection, L.L.C.*, 126 FERC ¶61,164 at P 5 (2009).

5 128 FERC ¶ 61,262 at 6.

that a party cannot for some reason avoid paying refunds, such as by operation of PJM's billing arrangements, then that party will have less incentive to seek rehearing of Commission orders, even in the case of faulty decisions that the Commission would likely reverse given an opportunity. This increases the likelihood that bad precedents would stand unchallenged.

B. The legal and/or policy basis for not permitting recoupment of previously-paid refunds, when the Commission has agreed with rehearing requests seeking recoupment and determined that its initial order to originally direct refunds was in error.

Ample legal and policy precedent exists to support an order directing recoupment of refunds that the Commission determined were paid in error in a later stage of a proceeding. The Commission has for decades applied the equitable doctrine of recoupment. The Commission has broad discretion in determining what constitutes an appropriate remedy to undo what is wrongfully done by virtue of an order that has been upset on judicial review.[6] In *Tennessee Gas Pipeline Company*, the Commission approved a refund recoupment mechanism after a final order had been remanded after review by the District of Columbia Court of Appeals.[7] The recoupment mechanism allowed Tennessee to recoup refunds made to a specific class of customers by socializing the cost of the refunds amongst all of its current customers, including customers who did not receive a refund.[8] The Commission found that the public interest in a final and supportable outcome outweighed the concerns of inequity voiced by the contesting parties.[9] The recoupment was justified based upon the practical and administrative concerns of eliminating litigation costs stemming from a ten

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6 *See Tennessee Gas Pipeline Company*, 65 FERC ¶ 61,138 (1993).

7 *Id*. at 2–3.

8 *Id*.

9 *See Id*. at 10.

year delay in resolving the case.[10] At the time the recoupment mechanism was implemented, the Commission found it had sufficient remedial powers following remand to authorize recoupment based on an absence of case law directly prohibiting the recoupment of refunds.[11]

The Commission has permitted the recoupment of excessive refund payments in the past. In *Area Rate Proceeding*, the Commission allowed pipeline companies to recoup amounts refunded to customers in excess of the applicable rate plus interest.[12] Recoupment of over collections has been permitted through adjustments to subsequent billings, which is the approach PJM employs.[13] In specific cases where the refund is not timely recouped, the Commission has reserved the right to require interest to be paid.[14]

C. How much of the $37 million refund amount has PJM already recouped, what amount is still outstanding, and what has PJM done with the amount already recouped.

The Market Monitor expects that PJM will provide a detailed response to this inquiry. The Market Monitor understands that PJM has been unable to recoup about 25 percent of the $37 million refund amount. In some cases, parties subject to recoupment have sought to evade recoupment by transferring their assets to another entity. In at least two instances, PJM is pursuing collection actions.[15]

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10 *See Id.* at 6.

11 *See Id.* at 6.

12 *See Area Rate Proceeding, et al*, 11 FERC ¶ 61,315 (1980).

13 *See El Paso Natural Gas Company*, 30 FERC ¶ 62,075 (1985).

14 *See Id*. at 15.

15 *See PJM Interconnection, LLC et al. v. Round Rock Energy, LP, et al.,* No. 8086, Delaware Court of Chancery (December 6, 2012); *PJM Interconnection, LLC et al. v. City Power Marketing, LLC. et al*, No. 12C-11-062 JRS, November 7, 2012 (DE Sup. Ct.).

D. If PJM were not permitted to recoup the refunds, which class(es) of customers should fund the refunds, and why. In particular, how such allocation should affect those class(es) of customers that initially sought rehearing of the refund requirement.

The Market Monitor takes no position on this issue at this time.

E. The potential effect on the timely payment of refunds ordered by the Commission in future proceedings, if the Commission cannot reverse on rehearing an erroneous decision that directed refunds.

A Commission policy against recoupment could effectively bar meritorious claimants from receiving payments in a timely fashion.

A policy denying opportunity for recoupment would strongly encourage parties to avoid paying refunds required by an initial order for at least as long as rehearing proceedings or appeals are pending and the potential for a reversal exists. Such a policy would violate the legal principal that an agency can undo what is wrongfully done by virtue of its order.[16] If the Commission were unable to enforce refund recoupment mechanisms, parties would either be permitted to retain a windfall, or refuse to pay, absent a final order. Assuming that the Commission typically arrives at the appropriate result would work to the disadvantage of parties with meritorious claims for recoupment.

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[16] *See Tarpon Transmission Co.*, 53 FERC P61,033, 10, (October 5, 1990).

II. CONCLUSION

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

Respectfully submitted,

/s/ Maeve C. Tibbetts

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Dated: April 7, 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 7th day of April, 2014.

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