UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

FirstEnergy Solutions Corp.	)	
Allegheny Energy Supply Company, LLC,	)	
	)	Docket No. EL13-47-000
v.	)	
	)	
PJM Interconnection, L.L.C.	)	
	)	

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, Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM ("Market Monitor"), submits this answer and motion for leave to answer a number of comments and protests filed in this proceeding on or about March 18, 2013,[1] in response to the complaint filed by FirstEnergy Solutions Corp., et al., on February 15, 2013 ("February 15th Complaint").

The Market Monitor lists eight solutions that could be implemented in the near term that would demonstrably resolve the bulk of the FTR funding issue and return payout ratios to historical levels. The proposed solutions are consistent with a market based approach including increased transparency, elimination of cross subsidies and improved modeling. All of the proposed solutions have been publicly discussed in PJM meetings and most have been advanced by market participants.

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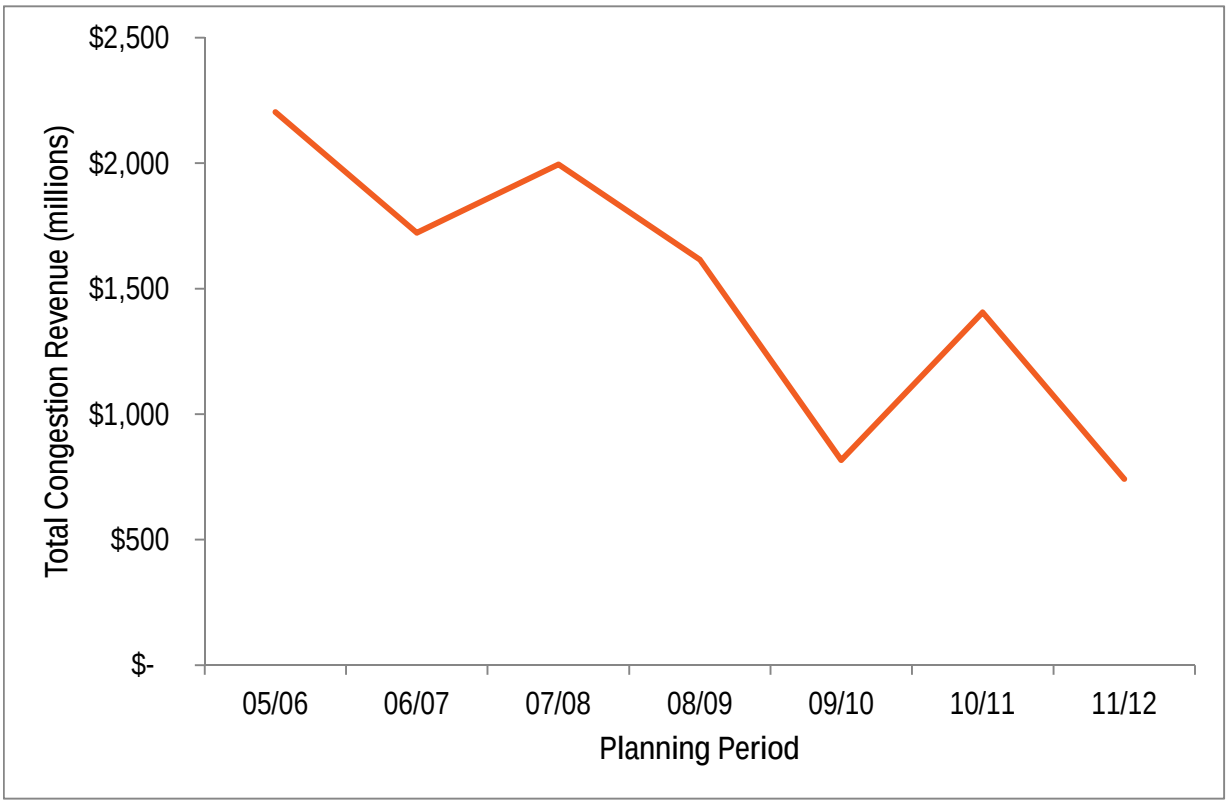
[1] The comments and pleadings include: Comments in Support by DC Energy, and Vitol, Inc. of Complaint and Request for Fast Track Processing of the FirstEnergy Companies (March 18, 2013) ("DC Energy"); Comments of the Financial Marketers (March 18, 2013) ("Financial Marketers"); Motion to Intervene and Comments of J. Aron & Company (March 18, 2013) ("J. Aron"); Motion to Intervene and Comments of the PSEG Companies (March 18, 2013) ("PSEG").

The Market Monitor also points out that total congestion has declined significantly from the 2005/2006 planning year to the 2011/2012 planning year, the last full planning year.[2] (Figure 1) This decline in total congestion is a key underlying factor in the FTR funding issue as it means that there are fewer congestion dollars to fund FTRs and that FTR payout ratios are much more sensitive to the underlying issues like subsidies and outage modeling.

Figure 1 Total congestion revenue collected for the 2005 to 2006 through 2011 to 2012 planning periods



Comments filed in support of the February 15th Complaint generally confuse the FTR revenue adequacy issue and seek to redirect what could be a useful discussion about how to address the root causes of FTR funding issues to a recommendation to make load pay

[2] Source data from the *2012 State of the Market Report for PJM*, p 306.

twice for an offset to congestion. The approach suggested by FirstEnergy is not a market based approach but an approach which includes continued mismatches in modeling, a reduction in transparency, and an increase in subsidies. While this may be consistent with the short term financial interests of some market participants, it is not a logical way to proceed to improve the FTR market.

The relief requested by FirstEnergy, "that real-time congestion costs be allocated broadly to all transmission users," does not address the FTR revenue adequacy issue but would rather conceal the issue by requiring an unjust, unreasonable and illogical transfer of funds from all transmission customers to FTR holders.

No evidence supports the claim that balancing congestion constitutes a root cause of the FTR funding issue. Balancing congestion is not a root cause but a symptom. As a symptom, balancing congestion has served its critical function in alerting PJM members that there are fundamental issues with the FTR process.

This pleading demonstrates that there is a straightforward path to resolving the FTR funding issue. This pleading also briefly addresses some of the faulty arguments advanced by FirstEnergy and its supporters, but the existing record adequately demonstrates why the relief requested by FirstEnergy has no merit and should be rejected.[3] The February 15th Complaint should be denied with prejudice, and the issues of FTR revenues should be addressed in the stakeholder process or an alternative proceeding before the Commission limited to the consideration of solutions that directly address the underlying sources of FTR funding. Should this proceeding continue to hearing or settlement discussions, the relief requested by FirstEnergy should not be among the options considered for addressing the FTR revenue issue.

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[3] *See* Comments of the Independent Market Monitor for PJM, Docket No. EL13-47-000 (March 18, 2013) ("IMM March 18th Comments").

I. ANSWER

A. The Proposal to Remove Balancing Congestion from the Calculation of Congestion Revenues Should Be Rejected Because It Is Based on Confusion About the Causes of The FTR Revenue Issue and the Nature of Participation in FTR Markets.

In order to fix the FTR revenue issue, it is first necessary to distinguish between cause and symptom. Negative balancing congestion reflects a mismatch between the day-ahead market model and the real-time market. FTR funding issues are also a result of the mismatch between the FTR auction model and the day-ahead market model. FTR funding issues are also the result of significant subsidies among groups of FTR market participants. Negative balancing congestion is a symptom and is not the problem. Simply requiring all transmission customers to pay for balancing congestion outside the FTR process would conceal the symptom while eliminating the incentive for most parties to address the underlying issues that remain unaddressed despite a multi year review process.

Unless and until the underlying issues are addressed, the market is the best available corrective mechanism. A participant in an auction must decide how much to offer for an FTR based on what it believes the FTR will pay out. A participant receiving an ARR must decide whether to convert it to an FTR based on what it believes the associated auction revenues will be versus what it believes the FTR will pay out. The level of payout is unknown. No level of payout is guaranteed. The payout depends on the level of congestion revenues collected and the share of those revenues that are allocated to the FTR path.

Any analysis of the issues must be based on the facts about what FTRs are, how the market values them, and how congestion revenues are allocated. For example, PJM states (at 5): "The value of an FTR is based upon the difference between Day-Ahead Congestion Prices at the specific source and sink points on the transmission system." In fact, the value of an FTR is based on the expected payout which results from the total congestion revenues

that PJM collects, the FTR holdings of others and how they are treated under the allocation rules.[4] Congestion prices are unknown at the time an FTR is purchased at auction.

J. Aron states:

> Significant negative balancing congestion can only occur if the day-ahead transmission model differs significantly from the real-time conditions. If the day-ahead transmission model were modified to be closer to the real-time conditions, it would reduce the level of balancing congestion but would not improve revenue adequacy for FTRs. It would instead shift the transmission changes from real-time to day-ahead and the transmission model linked to FTR payments would still be inconsistent with that used for awarding FTRs.[5]

This argument proves too much. J. Aron acknowledges that if PJM improves the match between day-ahead and real-time models, as the Market Monitor recommends, then the revenue adequacy problem is not solved, it just manifests itself as an inconsistency between the FTR auction model and the day-ahead market model. J. Aron demonstrates that the solution must be both an improved match between day-ahead and real-time models and between the FTR auction model and the day-ahead model.

Financial Marketers assert (at 3):

> The absurdity of allocating negative balancing congestion to FTRs is clearly illustrated by a simple thought experiment. If all FTR market participants withdrew from the market, it would have no impact on negative balancing congestion costs. They would

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[4] Those rules include provisions that equalize losses affecting particular paths over all paths. OA Schedule 1 § 5.2.5. Those rules cap potential upside for congestion revenues that exceed the target allocations. *Id*. This rule is fine if FTR holders believe that equalizing revenue inadequacy and limited potential upside serves their interests. However, this rule means that FTR holders have exposure to revenue inadequacy on any part of the system and not just the paths that they purchase. This rule exposes FTR holders to the consequences of business decisions made by other participants, and it limits the ability of FTR holders to protect their own position from the consequences of PJM's administrative decisions. Another approach would limit exposure to FTR holders to revenue inadequacy only as it affects, for better or worse, the FTRs that they purchase.

[5] J. Aron, Exhibit A (Affidavit of Harry Singh) at 6.

> continue, because they are a Real-time Market phenomenon, but there would be no one to pay for them.

Of course another thought experiment would have illustrated to the Financial Marketers the absurdity of allocating day ahead congestion to FTRs. If all FTR market participants withdrew from the market, it would have no impact on day-ahead congestion costs. In fact, the Financial Marketers ignore the historical fact that the distinction between FTRs and ARRs was introduced to provide a benefit to financial market participants. The FTR market would work perfectly well if the ARR/FTR distinction were reversed, all current FTR holders that are not load serving entities withdrew from the market, and FTRs were assigned directly to load because load pays for the transmission system that makes funding FTRs possible.

Commenters also advance incorrect arguments about the relationship of target allocations to the FTR product. Negative total congestion revenue in an hour does not reduce FTR target allocations, and cannot produce any underfunding.[6] Hours with negative total congestion have target allocations of zero dollars.[7] No underfunding is possible when target allocations are zero.

Another misunderstanding concerns alleged unfairness to counter flow FTR holders. DC Energy asserts (at 6–7) that counter flow FTR holders are especially harmed by FTR revenue inadequacy. DC Energy states that FTR payout ratios less than one result in lower FTR auction clearing prices and lower payments to counter flow FTR holders, while counter flow FTR holders must pay 100 percent of their target allocation. Buyers of counter flow FTRs make a voluntary decision to accept payment in return for the expectation that they will pay less back and therefore earn a profit. DC Energy fails to note that holders of

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[6] ***See*** J. Aron at 4–5, Figure 1, which appears to suggest underfunding can result when total congestion is negative.

[7] *See* PJM Manual 28 § 8.4.3 at 51–52.

counter flow FTRs are not only not disadvantaged, they are subsidized by holders of prevailing flow FTRs. The payments by counter flow FTR holders should increase above the target allocation if the payout ratio is less than one in order to retain parity with prevailing flow FTRs. Without that change, counter flow FTR holders will be held harmless from lower FTR funding levels.

B. There Are Defined Solutions To FTR Funding Issues Which Should Be Implemented Rather Than Assuming Away The Issue By Assigning All Balancing Congestion To Load.

If the Commission desires to take action with respect to FTR revenue adequacy, a number of solutions have been identified that would resolve most of the underlying problem. Implementation of these solutions would provide market signals more closely linked to actual FTR holdings and make the FTR market more efficient and more transparent. Many of those proposing to remove balancing congestion from FTR funding recognize that these solutions would address the underlying issues and agree that these solutions make sense. The simplistic proposal to remove balancing congestion rather than address the issues arises from what has been a frustrating stakeholder process. But that frustration should not be allowed to result in a seriously flawed resolution to FTR funding issues. These solutions should be implemented as soon as practicable, following the appropriate process:

1. Correct reporting of the payout ratio. The current incorrect reporting of the payout ratio makes the problem appear larger than it is.[8] Correct reporting would reflect the fact that the payout ratio participants actually receive via PJM settlements is higher than the payout ratios published by PJM and relied upon by participants in this matter.[9]

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[8] See IMM March 18th Comments at 12–13, 18.

[9] See for example Comments of J. Aron & Company (March 18, 2013) Figures Nos. 2 and 3 (at 5–6).

Correcting the reporting of the payout ratio would have increased the payout ratio in the first seven months of the 2012-2013 planning year from 74.7 percent to 77.6 percent.

2. Eliminate portfolio subsidies (portfolio netting). Holders of positively valued FTRs are required to subsidize those who hold both positively valued and negatively valued FTRs in their portfolios. The result is that the same FTR is paid more when held in such a portfolio than when it is held alone. This result is clearly inappropriate. Such subsidies are inefficient and should be eliminated. Elimination of this subsidy would have increased the payout ratio the first seven months of the 2012-2013 planning year from 77.6 percent to 88.1 percent. The Market Monitor explains this issue in its Comments filed earlier.[10]

3. Eliminate subsidies to counterflow FTRs. The payout received by holders of counterflow FTRs is unaffected by reduced payout ratios while holders of prevailing flow FTRs receive reduced payments. The subsidy from holders of prevailing flow FTRs to counterflow FTRs are inefficient and should be eliminated. Elimination of this subsidy would have increased the payout ratio in the first seven months of the 2012-2013 planning year from 88.1 percent to 91.2 percent. The Market Monitor explains this issue in its Comments filed earlier.[11]

4. Eliminate geographic subsidies. Holders of positively valued FTRs in New Jersey subsidize holders of negatively valued FTRs at the PJM/MISO border, as an example of a geographic subsidy. Such subsidies are inefficient and should be eliminated. The result would be that purchasers of FTRs would receive revenues consistent with the actual market performance of their FTRs rather than receiving a pro rata share of all FTR revenues. Such an approach would provide a market solution to FTR funding issues as buyers would pay less for low value FTRs and buyers of high value FTRs would receive the appropriate payments. DC Energy recommends (at 13–14) moving towards a more

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[10] IMM March 18th Comments at 13–15; *see also 2012 State of the Market Report for PJM* at 357– 363.

[11] *Id*. at 16–17; *see also 2012 State of the Market Report for PJM* at 357– 363.

geographically separated FTR model, citing PJM's report that shows significant negative balancing on MISO border regions.

5. Improve transmission outage modeling in the FTR auction model. For the Annual FTR Auction only transmission outages planned to last more than two months and known in advance of the FTR auction are included in that auction. For the monthly and multi-monthly auctions only transmission outages planned to last five days or more and known in advance of the auctions are included in the auctions. This approach ignores the fact that many more transmission outages will occur than are modeled. The result is that PJM sells too many FTRs which directly results in funding issues. PJM should use a probabilistic approach to modeling transmission outages to more realistically reflect the actual available transmission capability during the FTR year. This would be analogous to the current use of probabilistic forced outage rates for generating units. The Market Monitor explains this issue in its earlier comments.[12]
6. Reduce FTR sales on paths with persistent underfunding. Specific paths with persistent underfunding can be identified. Sales of FTRs on these paths should be eliminated or reduced to levels consistent with full funding. This is consistent with the proposal to eliminate geographic subsidies.[13]
7. Implement seasonal ARR allocation. Use of seasonal ARR allocations would also permit a more accurate match between actual transmission system conditions and modeled transmission system conditions. The result would be an improvement in FTR funding. This is an alternative way to address the need to improve outage modeling as it makes more accurate outage data available, but is not likely to be as effective as directly modeling outages on a probabilistic basis.

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12 *Id*. at 17–19; *see also 2012 State of the Market Report for PJM* at 357– 363.

13 *See* "FTR Task Force Recommended Changes," presented to the PJM Market Implementation Committee (April 10, 2013).

8. Eliminate overallocation of ARRs in the first round. ARRs are currently overallocated in the first round of ARR allocations. The result is a funding issue. PJM estimates that this would eliminate approximately $90 million in funding shortfalls for the 2012 to 2013 planning period.[14] This revenue, assuming that it is split evenly over the months of the current planning period, would eliminate $67.5 million of the current funding issue in the first seven months of the 2012-2013 planning year. Elimination of this subsidy would have increased the payout ratio in the first seven months of the 2012-2013 planning year from 91.2 percent to 95.9 percent.

   The over allocated facilities for the 2012 to 2013 planning period are largely MISO flowgates. PJM expects these MISO flowgates to continue to be over allocated because they are newly created and it will take time to complete transmission upgrades needed to handle the required levels of allocation.

Table 1 shows the impact on the payout ratio of each proposed modification in sequence based on implementation of the prior adjustment. The impact of each proposed modification is cumulative. Thus, the corrected reporting adjustment increases the payout ratio from 74.7 percent to 77.6 percent. The elimination of portfolio subsidies adjustment results in increasing the payout ratio from 77.6 percent to 88.1 percent. This assumes that the corrected reporting adjustment has taken place. Not all the adjustments could be quantified. The nonquantified adjustments can be expected to have a significant impact on FTR funding, including the proposal to reduce FTR sales on persistently underfunded paths, the related elimination of geographic subsidies, the improvement of outage modeling and the seasonal allocation of ARRs.

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[14] *See* "PJM Options to Address FTR underfunding." (April 30, 2012) at 6.

Table 1 Cumulative Impact of Proposals on Payout Ratio: June through December 2012

Topic	Payout Ratio June-Dec 2012
Reported	74.7%
Corrected Reporting	77.6%
Elimination of Portfolio Subsidies	88.1%
Counter Flow Adjustment	91.2%
Stage 1A Requirement	95.9%

While implementing these proposals will not solve all FTR related issues, it will address most of the revenue inadequacy issue and allow for continued logical and productive discussion of next steps to address the differences between the FTR model and the day-ahead model and the differences between the day-ahead model and the real-time model, which will have additional benefits.

An order on hearing or a settlement process limited to these and similar solutions to the underlying issue could improve the FTR market design and resolve most of the FTR funding issue in PJM. All of these ideas have been raised by participants in the stakeholder process and/or the Market Monitor.

However, continued discussion of the specific relief requested on complaint, removal of balancing congestion from the calculation of overall congestion, has no potential to improve PJM markets. It would instead degrade them. Continued consideration of this proposal only distracts attention from potential improvements. This proposal would, if accepted, impose unjust and unreasonable costs on transmission customers, precisely the participants to whom the benefits of ARRs and FTRs should accrue.

If the scope of any future process cannot be limited to discussion of true solutions to the FTR revenue inadequacy, then this complaint should be denied with prejudice and the prospect for future filings that address the root causes of FTR revenue inadequacy kept open.

II. MOTION FOR LEAVE TO ANSWER

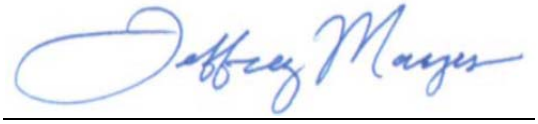
The Commission's Rules of Practice and Procedure, 18 CFR § 385.213(a)(2), do not permit answers to answers or protests unless otherwise ordered by the decisional authority.

The Commission has made exceptions, however, where an answer clarifies the issues or assists in creating a complete record.[15] 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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[15] *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: April 18, 2013

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 18th day of April, 2013.

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