

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

RTO Energy Trading, LLC)
) Docket No. EL15-38-000
)

PROTEST OF THE INDEPENDENT MARKET MONITOR FOR PJM

Pursuant to Rule 211 of the Commission’s Rules and Regulations,¹ Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM (“Market Monitor”), submits this protest to the petition submitted in the above captioned proceeding by RTO Energy Trading, LLC (“RET”) on January 14, 2015 (“Petition”). The Petition requests an order from the Commission confirming that: (i) “common control” should be the exclusive basis for treating two entities as “jointly subject” to the PJM tariff; (ii) “overlap in capital control, even if significant,” should be ignored, and (iii) RET is not related to any other market participant for any purpose under the PJM tariff, provided that RET follows certain RET-proposed safeguards. The Commission should deny each of these requests. Consideration of overlaps in capital control is essential to the proper application of the FTR Forfeiture Rule to the “holder of a Financial Transmission Right” (“FTR Holder”).² The FTR Forfeiture Rule protects PJM markets from participants manipulating the value of their FTRs by engaging in virtual transactions at nodes influencing the value of such FTRs. The Market Monitor has prepared and included as a non public Attachment an analysis that shows the RET-proposed safeguards do not work. Preserving the effectiveness of the FTR

¹ 18 CFR § 385.211 (2014).
² See PJM Operating Agreement Schedule 1 § 5.2.1(b).

Forfeiture Rule must take precedence over all of the policy arguments that RET advances. The public must have justified confidence in the integrity of the markets. An effective FTR Forfeiture Rule is critical to that purpose.

I. COMMENTS

A. The FTR Forfeiture Rule.

The Commission has recognized that the purpose of the FTR Forfeiture Rule is “to provide for retrospective adjustment based on the application of an objective mitigation rule.”³ The rule prevents manipulation of the value of FTRs through virtual trading at nodes that artificially inflate the value of those FTRs by removing the incentive to engage in such trades. Because PJM has an effective FTR Forfeiture Rule, PJM markets have avoided abuses of the type that have significantly harmed other markets and have required costly and lengthy litigation.⁴

An FTR Holder may be subject to forfeiture of any profits from an FTR if it meets the criteria defined in the FTR Forfeiture Rule. If a participant FTR Holder has a cleared increment offer, decrement bid or UTC for an applicable hour at or near the source or sink of any FTR they own and day-ahead congestion is greater than real-time congestion on the FTR path, the profits from that FTR are subject to forfeiture for that hour. An increment offer or decrement bid is considered near the source or sink point if 75 percent or more of the energy injected or withdrawn as the increment offer or decrement bid, and which is withdrawn or injected at any other bus, is reflected on the constrained path between the FTR source or sink. The FTR Forfeiture Rule only applies to increment offers, decrement

³ *PJM Interconnection, L.L.C.*, 129 FERC ¶ 61,250 at P 185 (2009).

⁴ *See MISO Virtual and FTR Trading*, 146 FERC ¶ 61,072 (2014); *Deutsche Bank Energy Trading, LLC*, 142 FERC ¶ 61,056 (2013).

bids and up to congestion transactions (“UTCs”) that would increase the price separation between the FTR source and sink points.

The FTR Forfeiture Rule does not currently prohibit the full scope of virtual trading on FTRs that could constitute prohibited market manipulation. The rule does not currently apply to counterflow FTRs. It is the Market Monitor’s view that PJM’s implementation of the rule with regard to UTCs is not consistent with the application of the forfeiture rule for INCs and DECs. Despite those limitations, the FTR Forfeiture Rule affords significant protection against the manipulation of the market to increase FTR revenues.

B. RET’s Focus on Administrative Control Is Misplaced; The Beneficial Owner Is the Proper Focus.

The purpose of the FTR Forfeiture Rule is to prevent FTR Holders from artificially influencing the value of their FTRs through virtual transactions that increase payments to the FTR Holder. Ownership of the FTR is the basis of concern. Ownership of an entity that is trading virtuals so as to improve the profitability of the FTR Holders’ FTR position is relevant to that concern. If there is common beneficial ownership, then this violates the FTR Forfeiture Rule. Ownership creates a form of control based on incentives, and those incentives can make administrative controls irrelevant and ineffective, especially when the activity to be controlled is a highly specialized and complicated endeavor like trading in virtual transactions and FTRs. Whether actual, tactical and continual administrative control of trading exists or whether routine sharing of information occurs is less important than beneficial ownership. Showing a lack of such administrative control or lack of routine information sharing is not a reason to ignore common beneficial ownership and the resultant incentives. This is even more the case if the actions of the beneficial owners violate the FTR Forfeiture Rule to the benefit of the FTR Holder.

The incentive of an entity and its personnel to act in ways that benefit the owner exist regardless of whether the owner can actively direct and coordinate the owned entities’ activities. An important purpose of the FTR Forfeiture Rule is to avoid the need to

determine what the traders know or intend when their trading on an FTR position triggers the FTR Forfeiture Rule.

The FTR Forfeiture Rule refers to “a *holder* of a Financial Transmission Right” in order to reinforce the focus on ownership (emphasis added). RET argues (at 13), “This term is not ambiguous; it clearly refers to the entity that actually holds the relevant FTR.” The rule is concerned with the holder and makes no distinction about exactly how the FTR is held or affected or how the increments and decrements are held, such as by related entities. It does not matter whether the affected FTR is directly or indirectly held. The rule is triggered if the ultimate beneficial owner of the FTR and the ultimate beneficial owner or controller of the virtual trading activity are the same. The term FTR Holder is broad enough to capture these concepts. However important formal distinctions between affiliates and related entities may be in other contexts, these distinctions are unimportant in the context of the FTR Forfeiture Rule.

The scope of the rule is broadly conceived by design. The rule could not serve its purpose if participants could evade the rule by dividing activities into different corporations, subject only to restrictions on formal affiliate status or restrictions on ongoing information exchange. Establishing thresholds for acceptable levels of administrative control and ignoring common beneficial ownership is simply an invitation for gaming.⁵ Anti-manipulation rules such as the FTR Forfeiture Rule must be sufficiently broad in scope to resist attempts to design stratagems around them.

RET makes a number of argument about the bright line rules that should apply (at 11–12), but fails to make any arguments about how its preferred approaches would ensure an effective application of the FTR Forfeiture Rule. RET’s bright line would be in the wrong

⁵ See, e.g., Tony Clark and Robin Z. Meidhof, “Speeches: Ensuring Reliability and a Fair Energy Marketplace,” Colorado Nat. Res., Energy & Env. L. R. v. 25, Issue 2, which can be accessed at: <<http://www.colorado.edu/law/sites/default/files/Clark%20%26%20Meidhof%2025-2.pdf>>.

place. Defining the rule according to factors that have nothing to do with the purpose of the rule would permit defeat of the rule.

The FTR Forfeiture Rule does not concern, for example, structuring corporations so as to limit investor liability. RET's arguments (at 11) about Commission policies on "pierc[ing] the corporate veil and treat[ing] the two entities as a single entity," or determining whether there is a "unity of interest," are relevant to limited liability, not application of the FTR Forfeiture Rule. Likewise, PJM's definition of an affiliate for determining voting rights, section designation or annual membership fees is relevant to PJM governance and administration, not application of the FTR Forfeiture Rule.

The point of the FTR Forfeiture Rule is to prevent the owners of FTRs from benefiting from virtual transactions that influence the value of the FTR that they hold. No interpretation of the FTR Forfeiture Rule that interferes with that overriding purpose is valid.

C. RET's Measures to Show Lack of Common Control Cannot Be Relied Upon.

RET describes (at 2-4) a number of measures that RET believes would "ensure" that RET and its personnel "lack both the knowledge and the incentive to coordinate with other market participants." These measures includes: (i) an information firewall; (ii) prohibitions on information sharing; (iii) separate information and trading systems; and (iv) prohibition on storing positions of individual FTR positions.

None of these restrictions proposed by RET will prevent RET trading personnel from knowing the FTR positions of other entities under common beneficial ownership with RET. Participants' FTR positions are public knowledge.⁶ This is the only item of information that a trader needs in order to use virtual transactions to artificially influence the value of an

⁶ For example, see PJM posted FTR auction results, which can be accessed at: <http://www.pjm.com/markets-and-operations/ftr/auction-user-info.aspx>.

FTR position. The restrictions developed by RET do not matter, do not protect the markets and serve no other useful purpose.

To the extent that the restrictions proposed by RET are considered, these restrictions rely on RET and its personnel to comply in good faith with prohibitions that would be difficult to monitor. The markets cannot rely on an honor system. The public should not be forced to rely on commitments that do not offset strong incentives to evade or violate them. The movement of personnel from the FTR holding entity to an FTR trading entity is one way that information on trading positions and strategies could be conveyed without violating the letter of RET's proposed restrictions.

Presumably RET intends that information prohibitions that it proposes should prevent the application of the FTR Forfeiture Rule even if activity occurs that would, but for reliance of RET's restrictions, have triggered application of the rule. Such activity would still constitute evidence of manipulation. RET has not explained why such activity would not constitute evidence of manipulation.

The best policy is continued reliance on the FTR Forfeiture Rule. The FTR Forfeiture Rule does not rely on information exchange prohibitions that are unlikely to deter bad behavior and impossible to enforce. De minimis activity triggering the rule means de minimis disgorgement of profits. High volumes of activity triggering the rule mean significant disgorgements. If heavy anomalous virtual trading on FTR positions occurs with information restrictions in place, that is evidence that the information restrictions are not working. Such trading, in the presence of information restrictions, would be clear evidence to those responsible for protecting the integrity of the markets that information exchange restrictions are not effective. The FTR Forfeiture Rule is automatic, proportional, efficient, reliable and effective. None of this can be said for RET's alternative.

D. Evidence Exists That RET's Measures Do Not Work.

The Market Monitor has performed an analysis that provides clear evidence that the measures included in the Petition do not work. A copy of the analysis is included as a confidential non public Attachment.

To the extent that release of the non public information can be avoided, it should be avoided. It is not in the public interest that access to the information included in this Attachment be allowed to parties that own FTRs regardless of whether they sign the Non-Disclosure Agreement that RET included with its Petition or any similar agreement.

RET, as the petitioner, may request access to the information included in the Attachment. The Market Monitor would have no objection to such access because the information adds nothing to publicly available information available to RET. However, it should be observed that if RET does access this information, RET would then have access to the information that RET claims its behavioral restrictions and standards are designed to avoid disclosing. The potential exchange of confidential information in proceedings such as this is an example of why reliance on information disclosure restrictions would be misplaced.

E. No Policy Objective Raised by RET Justifies Weakening the Protection Afforded to PJM Markets by the FTR Forfeiture Rule.

1. No Confusion Will Result from Applying the FTR Forfeiture Rule as Intended.

RET states (at 16): "The Commission has consistently treated affiliation as a matter of control, not ownership. It could create a great deal of confusion if a different rule is applied only for certain transactions and only in PJM's markets."

The FTR Forfeiture Rule uses the term "holder of a Financial Transmission Right," shortened here to FTR Holder. It does not use "affiliate" as defined elsewhere in the PJM Market Rules or in the Commission's Regulations. Accordingly, a proper, effective, common sense application of the rule will not create any confusion about the meaning of "affiliate" in other contexts. Even if some confusion were created, that would be a minor

consideration relative to the benefits of preventing market manipulation through an automatic rule rather than lengthy case by case investigations and referrals.

RET ignores the confusion that following its alternative approach would create. Confusion would result from interpreting FTR Holder in a manner inconsistent with the purpose of the FTR Forfeiture Rule. The core problem is the risk that virtual trading would be used to artificially increase the value of FTR positions. Virtual trading on FTR positions can benefit a common owner regardless of whether the owner directs the behavior or coordinates communications. Personnel could reasonably expect owners to care more about the level of profits than the details of where they originated. Trading personnel do not need explicit orders from investors to know how to benefit the investors.

Defining “FTR Holder” in terms of administrative control rather than beneficial ownership weakens the FTR Forfeiture Rule, creates confusion about the purpose of the rule, and serves no useful purpose. Significant levels of overlap in capital control create incentives for market activities that implicate the FTR Forfeiture Rule. RET’s argument about confusion has no merit and should be rejected.

2. Monitoring Is Not an Effective Substitute for the FTR Forfeiture Rule.

RET states (at 17): “the RTO/ISOs, and the Market Monitors all have the tools to detect suspicious trading patterns and to take effective enforcement action.” Neither the Market Monitor, PJM nor the Commission can rely entirely on ex post monitoring and enforcement. Effective rules for ex ante mitigation are needed, are widely used in PJM markets and are an efficient and effective way to prevent and deter market manipulation and the exercise of market power.

The FTR Forfeiture Rule is the essential tool relied upon in PJM markets to prevent the use of virtual transactions to manipulate the values of FTRs. Because PJM has an

effective FTR Forfeiture Rule, PJM markets have avoided abuses of the type that have significantly harmed other markets and have required costly and lengthy litigation.⁷

The FTR Forfeiture Rule operates all of the time. It removes incentives to engage in manipulative activity and removes the benefits of manipulative activity. It would be inefficient and ineffective to rely on case by case investigations and referrals by the Market Monitor to the Commission. The case by case approach would create uncertainty and, given the number of FTR forfeitures every month, result in either missed enforcement or a large backlog of cases. Even if misconduct is detected, referred and remedied, such manipulation cases can undermine public confidence in markets.

RET's argument that case-by-case monitoring is an effective substitute for the automatic operation of the FTR Forfeiture Rule has no merit and should be rejected.

3. The Market Monitor Is Not Concerned that RET Could Exchange Information with Related Parties to Avoid Application of the FTR Forfeiture Rule.

RET states (at 17), "If entities are required to exchange certain information and change behaviors because of such information, there is a greater likelihood of the appearance of, or actual, market manipulation." No one proposes to require RET to exchange any information on trading or FTR positions with any other party. The FTR Forfeiture Rule operates automatically and without any requirements of market participants. When market activity is captured by the rule, the result is a billing adjustment. An anomalous and durable pattern of violations of the rule may result in an inquiry from the Market Monitor. Unless that inquiry identifies a reason for the behavior not covered by the operation of the FTR Forfeiture Rule, there is no reason for concern about actual or

⁷ See *MISO Virtual and FTR Trading*, 146 FERC ¶ 61,072 (2014); *Deutsche Bank Energy Trading, LLC*, 142 FERC ¶ 61,056 (2013).

apparent market manipulation. RET's argument that the FTR Forfeiture Rule requires parties to exchange information is not valid and should be rejected.

4. The FTR Forfeiture Rule Is Effective.

RET states (at 17): "The Commission also has a long policy history of not prohibiting the existence of even commonly-owned entities that engage in activities that might give them an advantage in one market over a competitor (e.g., common ownership of transmission and generation assets); rather the Commission regulates those entities' behavior to prevent anticompetitive behavior, for example, through restrictions on access to information and other standards of conduct."

The FTR Forfeiture Rule does not prohibit any corporate relationship. The rule cannot provide any protection to the markets unless it treats commonly owned entities as a single entity, which they effectively are for the purposes of the rule.⁸ The rule does regulate anticompetitive behavior by requiring the disgorgement of profits earned when the test is failed. Thus, the FTR Forfeiture Rule is entirely consistent with RET's stated policy goal.

That the Commission has at times relied on behavioral safeguards referred to by RET (at 17) is not relevant. PJM has an effective FTR Forfeiture Rule. The rule does not need to be replaced with an approach that is less effective and less efficient. The FTR Forfeiture Rule does not exist to preserve a level playing field in the markets, which is the objective of the behavioral safeguards that RET thinks appropriate (*id.*). The rule exists to prevent manipulation. If anything, the scope of protection afforded by the rule should be increased. RET's argument that rather than focusing on the purpose and function of the FTR Forfeiture

⁸ See, e.g., *Capital Tel. Co., Inc. v. FCC*, 498 F.2d 734, 738 (D.C. Cir. 1974) ("[t]he courts have consistently recognized that a corporate entity may be disregarded in the interest of public convenience, fairness and equity. . . . [W]hen the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.") (quoting *United States v. Milwaukee Refrigerator Transit Co.*, 142 F. 247, 255 (C.C.E.D. Wis. 1905); see also *Town of Brookline v. Gorsuch*, 667 F.2d 215, 221 (1st Cir. 1981) (following *Capital Tel. Co.*).

Rule, the Rule should be weakened is based on irrelevant comparisons to behavioral safeguard rules used in other contexts, has no merit and should be rejected.

II. CONCLUSION

The Market Monitor respectfully requests that the Commission afford due consideration to these comments 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
Valley Forge Corporate Center
Eagleville, Pennsylvania 19403
(610) 271-8051
joseph.bowring@monitoringanalytics.com

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

Dated: February 25, 2015

Attachment

(Redacted in Public Version)

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 25th day of February, 2015.



Jeffrey W. Mayes

General Counsel

Monitoring Analytics, LLC

2621 Van Buren Avenue, Suite 160

Valley Forge Corporate Center

Eagleville, Pennsylvania 19403

(610) 271-8053

jeffrey.mayes@monitoringanalytics.com