

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

PJM Interconnection, L.L.C.)	Docket No. ER19-19-000
)	
PJM Interconnection, L.L.C.)	Docket No. ER19-24-000
)	
)	
)	(not consolidated)

**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,¹ Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor (“Market Monitor”) for PJM Interconnection, L.L.C. (“PJM”),² submits this answer in response to the pleadings filed by DC Energy, LLC, Mercuria Energy America, Inc.; Mercuria SJAK Trading, LLC; and TPC Energy, LLC (“DC Energy et al.”) filed October 22, 2018,³ and PJM filed November 6, 2018, in the above referenced proceedings (not consolidated).

On October 1, 2018, PJM submitted a series of proposed revisions to their credit rules that apply when a participant defaults, and that would apply for the GreenHat Energy,

¹ 18 CFR §§ 385.212 & 385.213 (2018).

² 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”).

³ See Comments and Request for Clarification of DC Energy, LLC, Docket No. ER19-19-000 (October 22, 2018); Comments and Request for Clarification of DC Energy, LLC, Docket No. ER19-24-000 (October 22, 2018) (“DCE Oct. 22nd Comments”).

LLC. (“GreenHat”) proceedings and all future defaults.⁴ In Docket No. ER19-24-000, PJM proposed rules that would transfer FTRs back to the bilateral seller when the bilateral buyer defaults. In Docket No. ER19-19-000 PJM proposed rules that would, rather than liquidating, require PJM to settle the defaulting party’s FTRs at day-ahead prices. That settlement would define the charges and credits that will be paid for by all members.

The Market Monitor shares some of the concerns raised by DC Energy et al. The most general concern is that PJM not impose a long term solution without further, in depth, discussions about the best options to address future defaults under a range of scenarios. For example, the immediate solution adopted by PJM participants, PJM and the Commission after the Tower issue was not adequate to address the GreenHat default.⁵ A comprehensive solution is needed.

I. COMMENTS

A. PJM’s Bilateral Indemnification Proposal Is Inconsistent with the Purpose of the Current Indemnification Rules.

The Market Monitor agrees with DC Energy et al. that the proposed tariff changes concerning bilaterally traded FTRs need further clarification, explanation and discussion but does not agree with all of DC Energy’s analysis of the issues.⁶

PJM states that “[t]he indemnification provision serves an important function by protecting PJM and Members from the possibility that a bilateral FTR sale—which FTR

⁴ See Docket Nos. ER19-19-000, -23-000, -24-000, -25-000.

⁵ See [PJM Interconnection, L.L.C., 122 FERC ¶ \(2008\)](#) (accepting certain revisions to PJM credit rules and rejecting rules intended to prevent abusive practices by groups of affiliated companies). The Commission also investigated claims that certain participants fraudulently concentrated risk in and deliberately under capitalized certain affiliates to detriment of PJM members, but found “insufficient evidence of manipulation.” See *PJM v Accord Energy, LLC, et al.*, 127 FERC ¶ 61,007 at P 3 (2009).

⁶ See DCE Oct. 22nd Comments at 4.

holders are generally free to make—will result in socialized default charges to the rest of the Members if a party to the bilateral FTR transaction defaults on its obligations.”⁷

PJM’s proposal concerning bilaterally traded FTRs is likely to cause unintended shifts in realized default costs among participants relative to the result under the current bilateral indemnification provisions in PJM’s tariff. PJM does not dispute this possibility.⁸ The possibility of cost shifts under PJM’s proposal is at odds with the stated purpose of the current indemnification rules, which is to have the bilateral seller indemnify PJM and the PJM membership from any charges associated with a buyer default.

Under the current tariff provisions, PJM requires the seller in a bilateral FTR transaction to indemnify PJM for any uncovered settlement costs associated with the transferred FTR in the event that the buyer in the bilateral FTR transaction defaults.⁹ More specifically, the tariff requires that the seller indemnify PJM for “the buyer’s obligation to pay any charges associated with the transferred Financial Transmission Right and for which payment is not made to PJM Settlement by the buyer under such a bilateral transaction.”¹⁰ Based on PJM’s interpretation, the tariff requires that a bilateral seller of a bundle of FTRs to a buyer is responsible to indemnify PJM for the charges of individual FTRs in that bundle. Based on PJM’s interpretation of the tariff, the seller’s indemnifying obligations are not offset by any credits earned from any of the other individual FTRs in the bundle.¹¹

⁷ See Answer of PJM Interconnection, L.L.C. to Protest and Comments, Docket No. ER19-24-000 (November 6, 2018) at 3–4 (“PJM Answer”).

⁸ See *id.* at 5.

⁹ OA Schedule 1 § 5.2.2(d)(iv). The bilaterals referenced in this filing are bilaterals between PJM members and not bilaterals between a PJM member and a non PJM member.

¹⁰ OA Schedule 1 § 5.2.2(d)(iv).

¹¹ See PJM Answer at 3–4.

Under the proposed tariff provisions, the indemnifying seller would have a one time option to assume ownership of all the negatively valued FTRs that the seller sold to the defaulting buyer.¹² The problem is that, when combined with PJM's proposal to charge customers for the defaulted FTRs only based on the actual payments to those FTRs as they come due, negatively valued FTRs cannot be accurately defined prior to those payments. Nonetheless, under the proposed tariff provisions, negatively valued FTRs are defined as those FTRs that have clearing prices in the most recent FTR auction lower than their original auction purchase price. The remaining positively valued FTRs would not be made available to the seller. Profits from the positively valued FTRs would offset any membership default allocation accounts. Losses from the positively valued FTRs would be assigned to the seller.

If the bilateral seller did not take the option to assume ownership of all the negatively valued FTRs that the seller sold to the defaulting buyer, the seller would have to pay all FTR losses as they were actually realized over the life of the FTRs.

PJM argues that its proposed "revisions will allow indemnifying sellers to assume the negatively valued FTR positions that they are already responsible for because, as required by the Tariff when selling the FTRs in the first instance, such a seller has agreed to indemnify the membership from a defaulting bilateral FTR buyer as to the FTRs it sold to such buyer."¹³ PJM argues that, relative to the existing tariff obligations, "[t]his filing is not changing the indemnification obligation of the indemnifying bilateral seller."¹⁴

However, as DC Energy et al. point out, and PJM admits in its subsequent answer, the "assumption of negatively valued FTRs by the indemnifying seller does in theory

¹² See PJM Filing, Docket No.ER 19-24-000 (Oct. 1, 2018) Appendix A, proposed revised OA Schedule 1 § 7.3.9 (b) and (c).

¹³ See *id.* at 2.

¹⁴ PJM Answer at 2.

change the allocation of benefits and burdens.”¹⁵ ¹⁶ The reason is that an FTR defined to be negatively valued under the proposal could result in a positive value for the seller and that positive value would remain with the seller rather serving as an offset to the default payments by members.

The existing tariff requires that the seller indemnify PJM for any charges on any FTR in the bilateral buyer’s portfolio obtained through the specific bilateral transaction. But this is not consistent with PJM’s proposal to allow the seller to indemnify PJM only for the charges associated with the FTRs with the most recent auction prices lower than the original purchase price from the portfolio of FTRs involved in a bilateral arrangement. Allowing assignment of a subset of the negatively valued FTRs to the seller will change the indemnification obligation of the seller and will change the costs of the default on the membership relative to the current tariff provisions.

The net effect of PJM’s proposal, relative to the current tariff indemnification provisions, on the seller’s indemnification obligations and on the residual default assignments to the membership, will depend on the subsequent net value of the FTRs assigned to the seller and retained by PJM under the proposal. This is because an FTR auction price at the time of default that is less than the original sale price is not necessarily an indication that an FTR has net negative value or will remain net negative in value over the life of the FTR. The net value of an FTR is the difference between the revenue generated by an FTR from target allocations and the cost of the FTR, not the change in the auction price from one period to the next. It is equally true that an FTR auction price at the time of default that is higher than the original sale price is not necessarily an indication that the FTR has net positive value, or will remain net positive in value over the life of the FTR.

¹⁵ DCE Oct. 22nd Comments at 2–3.

¹⁶ PJM Answer at 5.

Under PJM’s proposal, a seller could be assigned a portfolio which is ultimately net positive in value, the seller would keep the positive value, and PJM members would lose that benefit. If this occurred, PJM’s proposal would increase the costs of the default assignments to the PJM members and decrease the costs of indemnification to the seller, relative to the current tariff provisions.

B. The Inconsistency in Bilateral Indemnification Outcomes Should Be Eliminated.

PJM states that the current “indemnification provision serves an important function by protecting PJM and Members from the possibility that a bilateral FTR sale—which FTR holders are generally free to make—will result in socialized default charges to the rest of the Members if a party to the bilateral FTR transaction defaults on its obligations.”¹⁷ PJM argues that an important component of this protection from socialized default charges is that “an indemnifying seller has an obligation to ‘pay any charges’ associated with the FTRs it sold to a buyer, but does not grant an indemnifying seller any right to the positive gains from an FTR it sells on the bilateral market.”¹⁸

There is, however, no basis for PJM’s assertion that the current requirement for “an indemnifying seller to ‘pay any charges’ associated with the FTRs it sold to a buyer” is essential to prevent socialized default charges due to the bilateral between the seller and the buyer. If the indemnifying seller were responsible for the net charges associated with the FTRs it sold to a buyer (with any gains netted against losses), this would still eliminate socialized default charges to the rest of the members that would otherwise be caused by this full portfolio of FTRs that had been sold bilaterally.

By failing to net the indemnification obligation within the full portfolio of FTRs sold in a bilateral transaction, PJM’s current interpretation of the rule goes beyond having the

¹⁷ PJM Answer at 3.

¹⁸ PJM Answer at 3–4.

seller indemnify PJM against losses associated with a bilateral trade with the defaulting buyer. PJM's interpretation of the indemnification rule requires that the seller pay any charges associated with the bilateral FTRs, regardless of the net value of the portfolio of bilateral FTRs. Even if the value of the portfolio of bilateral FTRs is net positive, the seller still pays any charges associated with any individual FTRs in that portfolio. This means that PJM is requiring the seller to indemnify PJM against charges over and above those incurred by the relevant bilaterally traded FTRs.

The indemnification rule could be modified so that the indemnifying seller was responsible for the net charges associated with the FTRs it sold to a buyer and this would still eliminate socialized default charges associated with the bilateral arrangement between the seller and the buyer. PJM's proposal to allow the indemnifying seller a onetime option to assume ownership of the negative bilateral FTRs could be modified to allow the seller to acquire all the FTRs the seller sold to the defaulting buyer. With this modification, no snapshot determination of the relative value of the FTRs is needed. In terms of socialized costs to the membership, this change in the rules and proposal would eliminate the inconsistency in the indemnification by bilateral and auction transactions.

C. The Indemnification Rules Should Be Eliminated

An alternative to modifying the indemnification rules would be to eliminate the indemnification provisions for bilateral trades completely. Combined with strong credit requirements, the current rules for a bilateral trade of FTRs eliminates the need for indemnification of a seller for a default of a buyer. It is not clear why it is reasonable to hold bilateral sellers to stronger requirements than other sellers of FTRs. If PJM treats, for credit purposes, a bilateral sale like a direct sale, there is no reason for special bilateral rules when the buyer is a PJM member.

The OA requires that PJM consent to the transfer of an FTR from seller to buyer and "[s]uch consent shall be based upon the Office of the Interconnection's assessment of the buyer's ability to perform the obligations, including meeting applicable creditworthiness

requirements, transferred in the bilateral contract.”¹⁹ The credit requirements for the buyer of the FTR via a bilateral trade are the same as they are for the seller of the FTR, and these are the same requirements that apply for purchases in PJM’s FTR auction. In terms of credit risk exposure for the membership this means that, other than the indemnification clause, there is no difference between the buyer acquiring the FTR via the auction or via a bilateral trade, nor should there be. The requirements and obligations to hold an FTR should be the same regardless of how the FTR was acquired.

Similarly, the requirements and obligations associated with selling an FTR should be the same regardless of how the FTR was sold. If the seller was to offer and sell an FTR into a PJM auction, the seller is not required to indemnify PJM for a default of the buyer of that FTR. Assuming the same credit requirements for holding an FTR regardless of source, the same indemnification rules should apply in the case of a bilateral trade of that same FTR between the buyer and seller.

If the indemnification rules are justified because the credit rules are insufficient to protect PJM and the membership from default risk in the case of bilateral arrangements of FTRs, then these same credit rules are not sufficient to protect PJM and the membership from default risk generated by FTR auction allocations. This would indicate that the credit rules are flawed, not that the bilateral trading of FTRs generates a new level of risk that cannot be captured in the credit rules.

However, if bilateral trades do generate some level of risk that cannot be addressed in a uniform set of credit rules, then bilateral trades should be eliminated so that any trading of FTR positions must occur through auction.

¹⁹ OA Schedule 1 § 5.2.2(iii).

D. The Costs of FTR Defaults Should Be Contained Within the ARR/FTR Market.

PJM's current default rules are not designed to fully contain the costs of an FTR default within the ARR/FTR market. PJM's indemnification rules, for example, require that a bilateral seller of an FTR pay any costs associated with that FTR if the buyer defaults. But this is not a significant offset. The residual costs of the default are allocated to the membership. The costs of FTR defaults should be contained within the ARR/FTR construct rather than distributed to all PJM members.

To this end, during the expedited discussions that led to PJM's proposal, the Market Monitor proposed that the FTR positions and associated ARR obligations of the defaulting member be eliminated. This approach would eliminate the need for a default allocation being imposed on all PJM members, regardless of their level of FTR activity, and would contain any costs associated with the default within the ARR/FTR market. Any short term shortfall in congestion dollars relative to target allocations that resulted could be paid from congestion surplus, or it could cause a revenue shortfall within a specific period. However, in each subsequent FTR auction where the defaulted FTR portfolio would be relevant, PJM could adjust the FTR market model, by reducing available FTRs for example, so that all awarded rights would be simultaneous feasible and consistent with full funding of FTRs. PJM already has rules and procedures to manage the situation when revenues are less than target allocations, and these could be applied here too. The costs of eliminating the defaulted position would be absorbed by the ARR/FTR market as a change in available FTRs, with resulting market prices reflecting the prospective value of the new set of simultaneously feasible rights by path, based on expected available congestion rents. The expected congestion revenues do not change due to the elimination of the defaulted positions, but the set of FTRs will be different.

E. Permanent Tariff Changes Should Undergo Further Discussion

In PJM's Docket No. ER19-24 filing, PJM proposes new default rules which would allow a participant's FTR portfolio to settle at the hourly day-ahead price. In effect, this

maintains the defaulted FTR portfolio, but allocates any charges or credits to the default allocation assessment that is proportionally divided among all members. The stakeholder discussion on this topic was held under an understandably tight timeline, and did not necessarily allow full clarification and exploration of all of the ramifications of the proposed rule change. As DC Energy et al. note, “[e]xtraordinary circumstances do not provide the appropriate conditions for considering changes to generally applicable policies.”²⁰ The Market Monitor agrees.

The Market Monitor does not oppose the PJM approach for the GreenHat case. The members approved this definition of the default monetization and this allocation of the default amount and it is the members’ money. However, the Commission should direct PJM to take the time for a more complete stakeholder discussion, including input from outside experts so that the final approach to defaults can be comprehensive and forward looking rather than about the specific events of the GreenHat default. Those lessons will include those from the investigation by the PJM Board of Managers and may incorporate more far reaching changes to the FTR Market to address the broader questions.

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.²¹ In this answer, the Market Monitor provides the

²⁰ See DCE Oct. 22nd Comments at 4.

²¹ See, e.g., *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); *N.Y. Independent System Operator, Inc.*, 121 FERC ¶61,112 at P 4 (2007)

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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Dated: November 27, 2018

(answer to protest accepted because it provided information that assisted the Commission in its decision-making process).

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 27th day of November, 2018.



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