

allocation of potential Day-Ahead congestion surplus.”³ The Joint Protesters claim that PJM’s current proposal is inequitable and unduly discriminatory because it would expose “FTR holders to underfunding risk with no potential for offsetting surpluses.”

There is no basis for these assertions. Holding aside the fact that FTRs cannot be underfunded because FTRs confer only a right to a portion of total congestion collected, up to, but not exceeding their target allocation, PJM’s proposal does not change the risk of revenue inadequacy for FTRs.⁴ Under PJM’s proposal, only the end of year surplus after paying all FTRs their target allocations, will be allocated to ARR holders. This does not change the risk of paying FTRs less than their target allocation (so called “revenue inadequacy”) relative to the current rules. If there is a surplus at the end of the year available to ARR holders, this indicates that FTRs have been paid their target allocations in every hour of the year. Allocating this year end surplus to ARR holders does not increase the risk of revenue inadequacy for FTR Holders.

The PJM proposal does appropriately remove the possibility, in aggregate, of overfunding FTRs in excess of their target allocations. This does not create an increased risk of revenue inadequacy, as there can be no revenue inadequacy if there are congestion revenues in excess of FTR target allocations. Instead, PJM’s proposal corrects, in part, the current wealth transfer, in the form of congestion associated with unallocated system capability, from ARR holders to FTR Holders. FTRs provide the right to congestion collected from the network (not necessarily related to specific FTR paths), up to the FTR target allocation but not more than that. Any surplus congestion in excess of total target allocations by definition comes from network system capability that was not allocated as an

³ “Protest of DC Energy, LLC; Monolith Energy Trading LLC; Mercuria Energy America, INC.; TPC Energy, LLC; and Vitol Inc.,” Docket No. ER18-1245 (April 20, 2018) (“Joint Protesters Filing”), at 3

⁴ Congestion is the difference between what load pays for energy and generation pays for energy in both the day-ahead and balancing markets.

ARR or sold in the form of an FTR, and therefore not acquired by ARR or FTR Holders. Any congestion collected from this unallocated system capability belongs to the residual rights holders, represented by ARR holders. The fact that this congestion is now provided to FTR Holders is the inappropriate wealth transfer. Allocating this surplus to ARR holders instead of FTR Holders corrects the current inequitable and unduly discriminatory treatment of ARR holders, contrary to the Joint Protesters' assertions.

B. Risk Premiums Are Correctly Part of Market Evaluations and Do not Cause Underbidding or Improper Valuations

The Joint Protesters claim that "the potential for underfunding without any offsets would cause market participants to apply a risk premium and, thus, under-bid in FTR auctions, ultimately devaluing the ARRs allocated to load serving entities."⁵

The Joint Protesters argue that efficient market prices depend on an absence of any risk in the market. In other words, in the presence of any risk, the price for a product in any market will be incorrectly valued. The Joint Protesters' argument is ludicrous on its face.

The existence of risk does not cause market failures. Quantifiable risks, internalized by rational market participants, do not cause underbidding and do not cause a discount, relative to an efficient equilibrium, in the pricing of a competitive market.

The Joint Protesters are voluntary participants in the FTR Market. As voluntary, rational agents, they are free to include what risk assessments they deem necessary in their bidding strategies in order to profit from their activity in the FTR Market. To date, FTR Holders, as a group, have systematically profited from PJM's FTR Market, regardless of realized funding levels and any risks associated with modeling uncertainties and interactions between the day ahead and real time market. FTR Holders have demonstrated they are capable of successfully managing and pricing the ever present sources of risk.

⁵ *Id.*, at 4

Regardless of higher or lower prices paid by FTR Holders based on changing levels of risk, ARR's have always been fully funded.

Table 1 Planning period profits and excess revenue distribution by company type

		2012/2013	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018*
Financial	Profit	\$63,457,511	\$557,583,317	\$236,692,290	\$41,264,165	(\$13,519,824)	\$202,170,878
	Excess	(\$80,450,357)	(\$256,820,253)	\$44,410,625	\$11,897,525	\$20,968,663	
	Total	(\$16,992,846)	\$300,763,064	\$281,102,915	\$53,161,690	\$7,448,839	\$202,170,878
Physical	Profit	(\$25,069,434)	\$217,693,500	\$65,085,246	(\$16,904,899)	(\$11,239,145)	\$42,375,064
	Excess	(\$83,332,665)	(\$104,947,376)	\$14,485,066	\$5,072,985	\$10,533,444	
	Total	(\$108,402,099)	\$112,746,125	\$79,570,312	(\$11,831,914)	(\$705,701)	\$42,375,064
Physical ARR	Profit	(\$40,633,441)	\$183,450,850	\$95,609,153	\$39,490,527	(\$117,128,185)	\$34,176,722
	Excess	(\$128,497,763)	(\$316,929,138)	\$80,692,482	\$25,484,394	\$44,883,161	
	Total	(\$169,131,204)	(\$133,478,288)	\$176,301,636	\$64,974,921	(\$72,245,025)	\$34,176,722
Total		(\$294,526,149)	\$280,030,900	\$536,974,863	\$106,304,698	(\$65,501,886)	\$278,722,663

* Ten months of the 2017/2018 planning period

Table 1 shows the profits, by company type, and excess congestion assignments for each planning period. The 2012/2013 and 2013/2014 planning periods, with a negative excess, were revenue inadequate and required FTR Holders to pay the difference. Starting with the 2014/2015 planning period FTRs were revenue adequate so excess congestion revenue was distributed prorata to FTR Holders. FTR Holders earned profits regardless of revenue adequacy.

The issue with the PJM FTR Market has never been the existence of risk or the related offer prices. The primary issues with the PJM ARR/FTR construct have been, and remain, the allocation of congestion rights and risks among the market participants, particularly the allocation of rights among ARR holders and between ARR holders and FTR Holders. For instance, PJM's conservative modeling of system capability in order to guarantee FTR funding has, in combination with an allocation of resulting congestion surplus to FTR Holders, allocated unclaimed, unallocated rights to FTR Holders at the expense of ARR holders. This was and continues to be a wealth transfer from ARR holders to FTR Holders.

The PJM proposal corrects, in part, one source of wealth transfers from ARR holders to FTR Holders. FTRs provide the right to congestion collected from the network (not necessarily related to the FTR path), up to the FTR target allocation based on a model of system capability that has been acquired by the FTR Holders. Any surplus congestion in

excess of total target allocations by definition comes from network system capability that was not allocated or sold in the form of an FTR, and not acquired by FTR Holders. Any congestion collected from this unallocated system belongs to the residual rights holders, represented by ARR holders. Allocating this surplus to ARR holders instead of FTR Holders corrects the current inequitable and unduly discriminatory treatment of ARR holders, contrary to the Joint Protesters' assertions.

C. FTR Overfunding is Caused by an Underallocation of ARR Rights

The Joint Protesters attempt to refute PJM's assertion that "the only cause that would lead to FTRs being over-funded is that too few ARR were allocated."⁶ The Joint Protesters claim that FTR under- or overfunding can occur independently of ARR allocation levels.⁷ As evidence, the Joint Protesters point to a number of short term events that would cause a particular instance of day-ahead modeled system capability to be greater than or less than system capability as represented by total FTR target allocations.

The Joint Protesters' assertion is based on a misunderstanding and/or mischaracterization of the market model set up to generate, in aggregate, a systematic surplus of congestion relative to total target allocations over the course of a planning year. The Joint Protesters' assertion is not supported, and cannot be supported, by their list of examples.

The Joint Protesters' examples show only that differences can occur between the FTR market model and the day-ahead market on any given day which can cause a mismatch between the total day-ahead congestion dollars collected and the total FTR target allocations. The basic argument is that when the day-ahead market model collects less congestion than FTR target allocations, day-ahead system capability was less than assumed

⁶ *Id.*, at 4.

⁷ *Id.*, at 4.

by the FTR model and when the day-ahead market model collects more congestion than FTR target allocations, day-ahead system capability was greater than assumed by the FTR model.

While stating the obvious, the examples also assume too much. The examples are based on a mischaracterization of the magnitude of the modeling differences created by PJM's conservative modeling of the ARR/FTR market construct that are specifically designed to guarantee the full funding of FTRs, over the course of the year, regardless of the so called "critical factors" identified in the Joint Protesters examples. In order to guarantee full funding PJM must guarantee a surplus of congestion relative to total target allocations. As implied in the Joint Protesters' examples, guaranteeing a surplus of congestion relative to target allocations requires an ARR/FTR market model that is, on a systematic basis, significantly less capable than the expected capability of the day-ahead market models that will be used in the associated planning year. This means an ARR/FTR market model that will underallocate ARRs relative to expected system capability.

In this case, surplus congestion in excess of total target allocations, by definition, comes from network system capability that was not allocated to ARRs or sold in the form of an FTR, and not acquired by FTR Holders. Any congestion collected from this unallocated system belongs to the residual rights holders, the ARR holders. Allocating this surplus to ARR holders instead of FTR Holders corrects the current inequitable and unduly discriminatory treatment of ARR holders, contrary to the Joint Protesters' assertions.

D. Surplus Should Be Allocated to ARR Holders on a ARR Value Prorated Basis

The Joint Protesters assert that because the September 2016 Order did not shift real-time balancing congestion within the FTR/ARR framework from FTR Holders to ARR holders, but instead from FTR Holders to real-time load and exports, there is no basis to PJM's argument that ARR holders should be allocated congestion surplus in compensation

for the shift in risk caused by the reallocation of balancing congestion from FTRs to load and exports.⁸

The Joint Protesters assert a distinction where none exists. Load serving entities are ARR holders. ARR holders are load serving entities.

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.⁹ 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 answer as the Commission resolves the issues raised in this proceeding.

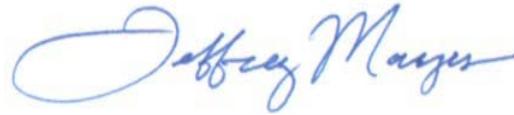
⁸ See Joint Protesters, at 6.

⁹ 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) (answer to protest accepted because it provided information that assisted the Commission in its decision-making process).

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Dated: May 7, 2018

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 May, 2018.



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