

Comments of the Financial Marketers Coalition On PJM Market Participant Risk Evaluation Enhancements

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The Financial Marketers Coalition (“Coalition”) appreciates the opportunity to present comments on PJM’s draft tariff language regarding Market Participant Risk Evaluation Enhancements. Overall, the Coalition supports PJM’s efforts. We are concerned, however, that with many of the proposals, the specific tariff and manual language is critical and must be carefully considered. While we appreciate the opportunity to provide these comments, our review of the Tariff and Operating Agreement language shows that much greater attention must be paid to these provisions. We ask PJM to allow for a second round of comment and discussion when this first round of comments is taken into account.

Significantly, the purpose of these revisions should be to decrease the risk of a significant default by a market participant. We are concerned that many of the proposed changes do not directly advance that goal, while also being potentially burdensome. We also highlight the importance of sufficient clarity in the new requirements to allow for robust compliance. While PJM wanted broad discretion and flexibility to address unforeseen situations, market participants need sufficient detail and clarity to ensure robust – and clear – compliance.

A. Audited Financial Statements

The Coalition supports the provision of audited financial statements. We suggest, however, that there be a ramp-up period for the next three (3) years so that companies which either have not yet started preparing audited financial statements, or which may have prepared them in the past but stopped for a period of time, would have time to resume such preparation and build up to the required three fiscal years most recently ended. While the provisions of Section II.B(2)(c) allow for the provision of equivalent financial information, this section does not fully address the concern for this interim period. As such, the Coalition proposes the addition of the following:

(d) During a three year transitional period from [January 1, 2020] to [December 31, 2022], Applicant may provide a combination of audited financial statements and/or equivalent financial information.

Similar concerns apply to Section II.A.(2)(c); however, a new Applicant is in a different situation than a long-standing PJM Market Participant which has a demonstrated track record with PJM.

Further, the draft language requiring audited financial statements is broad so as to potentially require audited financial statements from Affiliates which are not Market Participants. The language should be clear that Applicants (and Market Participants) need only provide audited financial statements for the PJM member (or applicant), not for every entity in the corporate family. Similarly, this provision should be limited to US entities only; Applicants and Market Participants should not be required to provide financial statements or disclosures for non-US entities unless those entities are providing some form of guaranty.

B. Definition of Affiliate

In Section 1 of both the Operating Agreement and the Tariff, PJM proposes to modify the definition of “affiliate” from “two or more entities” to also include “two or more Principals, corporations, partnerships, firms, joint ventures, associations, joint stock companies, trusts, unincorporated organizations or entities.” PJM’s proposed changes do not substantively change the definition of the term, but add an enumerated list of potential classes of affiliates that is frankly unnecessary. Instead, PJM should either maintain the status quo or adopt FERC’s definition of affiliate, which provides for persons, classes of persons, and companies. If PJM wishes to include an enumerated list of examples that potentially qualify as affiliates, such language should be included in a manual, rather than the tariff.

If PJM wishes to keep this language, the term “unincorporated organizations or entities” cannot be included. It is overbroad and illogical from a corporate law perspective. If an entity is unincorporated, it does not exist from a legal standpoint; as such, its disclosure as an affiliate is nonsensical.

The Coalition also recommends that PJM provide market participants with the option of demonstrating that an affiliate interest exceeding 10% is in fact a passive interest. FERC precedent provides market participants with this type of disclosure in market based rate applications.¹ It is particularly helpful in situations involving large institutional investors. For example, if an entity with controlling interests in a power plant also has an affiliate interest of 12% in another company, but exercises no control over the everyday management activities of that company, its interest should not be considered an affiliate relationship for purposes of disclosure and membership in PJM.

“Affiliate” shall mean any two or more Principals, corporations, partnerships, firms, joint ventures, associations, joint stock companies, trusts, ~~unincorporated organizations or entities~~, one of which directly or indirectly controls the other or that are both under common control. “Control” shall mean the possession, directly or indirectly, of the power to direct the management or policies of a person or an entity. Ownership of publicly-traded equity securities of another entity shall not result in control or affiliation for purposes of the Tariff or Operating Agreement if the securities are held as an investment, the holder owns (in its name or via intermediaries) less than 10 percent of the outstanding securities of the entity, the holder does not have representation on the entity’s board of directors (or

¹ See *Starwood Energy Group Global, L.L.C.*, 153 FERC ¶ 61,332 (2015); *AES Creative Resources, L.P.*, 129 FERC ¶ 61,239 (2009).

equivalent managing entity) or vice versa, and the holder does not in fact exercise influence over day-to-day management decisions. Unless the contrary is demonstrated to the satisfaction of the Members Committee, control shall be presumed to arise from the ownership of or the power to vote, directly or indirectly, ten percent or more of the voting securities of such entity. Entities may also demonstrate that ownership of or the power to vote, directly or indirectly, ten percent or more of the securities of an entity does not convey control because such ownership interest is passive.

C. Investigation Disclosure

In Section II.A.5, PJM proposes to require that each Applicant, Guarantor and/or Guaranteed Affiliate must provide information regarding investigations undertaken within the past five (5) years by certain governmental and regulatory agencies, including FERC and the CFTC. While the Coalition supports this disclosure requirement, the requirement must be clarified and tailored so as to obtain substantive information and not require an entity to report each interaction with an agency.

Specifically in the case of FERC, an investigation is only opened when the agency's staff makes a determination that their preliminary examinations of data and conversations with an entity have led the agency staff to believe that a formal process should occur.² Many of FERC's inquiries, self-reports and other conversations with entities are closed without opening a formal investigation. Specifically, FERC reported that in 2019, it processed "23 electric surveillance inquiries and ultimately five referrals to [the Division of Investigations ("DOI")] for investigation" ³ Those 18 entities which engaged in a surveillance inquiry but were not referred to DOI should not be required to report those inquiries, as no wrong-doing was found.

Further, while the Coalition does not oppose reporting opened, formal investigations, we note that the opening of an investigation is not a finding of wrong-doing. FERC reported:

DOI closed seven investigations in FY2019 either because staff found no violation or because there was not enough evidence to conclude that a violation had occurred. In addition, DOI closed five investigations where it found violations but concluded that further proceedings were not warranted.⁴

Therefore, the opening of an investigation, by itself, should not lead to a particular outcome, but should be part of the conversation between PJM and a Market Participant. Further, the concept of a "threatened" investigation is unnecessary and unclear, as regulatory agencies do not threaten to undertake an investigation. Further, the concept of a "proceeding" is also over-broad. For

² See Before The Investigation, *available at* <https://www.ferc.gov/enforcement/investigations/before-invest.asp>

³ See FERC 2019 Report on Enforcement at 8, *available at* <https://ferc.gov/legal/staff-reports/2019/11-21-19-enforcement.pdf> ("2019 FERC Enforcement Report").

⁴ *Id.* at 9 n.7.

example, a section 206 proceeding at FERC should not be subject to disclosure under this section.

The Coalition proposes the following edits to Section II.A.5:

Each Applicant, Guarantor and Guaranteed Affiliate is also required to disclose and provide information as to any known pending or, to the knowledge of any such Applicant, Guarantor and Guaranteed Affiliate and their directors, officers or general counsel, any ~~threatened~~ litigation, arbitrations, ~~Investigations, proceedings~~ concerning or involving the Applicant, Guarantor, Guaranteed Affiliate, its predecessors, subsidiaries, Affiliates and/or top five (5) Principals concerning any violations of any federal or state regulations or laws regarding energy commodities or the U.S. Securities and Exchange Commission (“SEC”), U.S. Commodity Futures Trading Commission (“CFTC”), FERC or Office of the Comptroller of the Currency (“OCC”) requirements by the SEC, CFTC, FERC, any exchange monitored by the National Futures Association, any entity responsible for regulating activity in energy markets, or any other governing, regulatory, or standards body which ~~could~~ would likely have a Material adverse impact on its financial condition and would likely materially affect the risk of non-payment by the Applicant, Guarantor or Guaranteed Affiliate, unless prohibited by law. Each Applicant, Guarantor and Guaranteed Affiliate, and shall take reasonable measures to obtain permission to disclose such information related to a non-public Investigation, as well as any commitments, contingencies, liabilities, criminal or civil penalties ~~or enforcement actions~~, that are Material or would be Material if adversely determined, as well as any prior bankruptcy declarations or petitions by or against the Applicant, Guarantor or Guaranteed Affiliate their respective predecessors, subsidiaries or Affiliates, or any Material defalcations or fraud by or involving the Applicant, Guarantor and Guaranteed Affiliate, their respective predecessors, subsidiaries or Affiliates, if any, commenced, pending or concluded within the five (5) years prior to the submission of the information. These disclosures shall be made by Applicant, each Guarantor and Guaranteed Affiliate, upon application, and within five (5) Business Day of any initiation or change with respect to any of the above matters. The Applicant, each Guarantor and Guaranteed Affiliate, shall resubmit and update such information at least annually thereafter, or as requested by PJM.

Definitions. Investigation. A formal inquiry initiated by a state or federal regulatory agency, per that agency’s procedures, regarding energy markets or energy commodities.

D. Definition of Principal

The Coalition concurs with DC Energy's comments regarding the need to clarify the scope of reportable defaults for Principals.⁵

Further, the Coalition is concerned that the broad scope of the definition of the term Principal is problematic when combined with the broad provisions for readmission of a Market Participant after a default. The definition of the term Principal, particularly subsets (v) and (vi), will essentially capture lower-level personnel in every financial trading shop. As a result, an individual who worked as a compliance officer or risk officer at a company will be deemed a Principal and could potentially be unemployable by another Market Participant. Further, just about every trader in a company will similarly be captured by draft subsection (vi) by virtue of "influence over an organization's trading activity" by engaging in trading. These provisions must be narrowed to fairly reflect decision-making authority.

Principal:

"Principal" shall mean an individual with the following roles and responsibilities:

(i) sole proprietor of a sole proprietorship; (ii) general partner of a partnership; (iii) manager, managing member of a member vested with the management authority for a limited liability company or limited liability partnership; (iv) any person or entity that (1) is the direct owner of 10% or more of any class of an organization's equity securities or (2) has directly contributed 10% or more of an organization's capital; and (v) a director, president, chief executive officer, vice president, ~~secretary, treasurer,~~ operating officer, ~~risk officer, general counsel,~~ ~~compliance officer, financial officer, general manager, comptroller~~ or senior officer (or equivalent positions) of a corporation or other organization, or individuals to whom they have delegated authority to perform executive duties functions; ~~and (vi) any person or entity that has the power to exercise supervisory authority or influence over an organization's trading activities in PJM.~~

Further, section 15.1.6(c)(b) is overbroad and unclear in its specification of "through another entity or the same entity using a different name." While the Operating Agreement provides for dispute resolution, PJM does not make clear how it will determine whether a new entrant is the "same entity using a different name." Will having one of the above Principals in common be sufficient? Is there any recourse for an entity to show they are not the same as a prior defaulting member? We propose edits to the Operating Agreement language to clarify.

Section 15.1.6(c)(b): A Member terminated in accordance with these provisions, and ~~all~~ of its Principals, shall be precluded from seeking future membership in PJM under this Agreement in the name of the Member when it was terminated from PJM membership and/or through another entity or the same entity using a different name.

Section 15.1.6(d). A Member may appeal a determination made pursuant to the

⁵ See Comments of DC Energy, LLC Regarding PJM's Market Participant Risk Evaluation Enhancements at 9 (Jan. 6, 2020) ("DC Energy Comments").

foregoing procedures utilizing PJM's dispute resolution procedure as set forth in Operating Agreement, Schedule 5, (provided, however, that a Member's decision to utilize these procedures shall not operate to stay the ability of PJM to exercise any and all of its rights under this Agreement and the PJM Tariff) and may be reinstated provided that the Member can demonstrate the following:

- a) that it has otherwise consistently complied with its obligations under this Agreement and the PJM Tariff; ~~and~~
- b) the failure to comply was not material; ~~and~~
- c) the failure to comply was due in large part to conditions that were not in the common course of business; and/or
- d) the Applicant is not the same company as the defaulting Member.

E. Unreasonable Credit Risk

In Section II.A.8, PJM proposes that it shall determine whether an entity presents unreasonable credit risk, and may take certain actions as a result of such finding. The section provides that PJM may use public or non-public sources of information. The Coalition understands that PJM wishes to have broad authority to address situations which may present risk. However, protections need to be built in for Market Participants against unilateral and unreasonable actions by PJM. At a minimum, the Coalition proposes the following language:

Specifically, PJM will notify the Applicant upon which information PJM is relying in making the determination that the Applicant poses an unreasonable credit risk.

F. Material Adverse Change

In Section II.A.3 of the Tariff-Attachment Q, PJM proposes to add an additional reporting requirement for any event or circumstance indicating that the market participant presents an unreasonable risk to PJM based on material provided under PJM's credit policy. The Coalition finds this language to be overly broad and in need of refinement. Reporting requirements for material adverse changes should be limited to those events or circumstances that would put PJM on notice that the market participant is at risk of defaulting on its obligations. Anything less than that threshold places an unreasonable reporting burden on the market participant without any additional benefits or default security to PJM.

As the language stands now, market participants would be required to report a nearly unlimited universe of facts and circumstances. For instance, PJM's proposed language would require a company to report any annual or quarterly decline in earnings, even when that company is not at risk of defaulting on its obligations. Requiring this level of reporting is burdensome both for the market participant, and for PJM, who will have to review irrelevant and redundant information from hundreds of market participants. Accordingly, the language should either be clarified to reflect reporting only for those events or circumstances placing the market participant at risk for default, or be deleted entirely. Next, litigation is already subject to disclosure and does not need to be listed as a Material Adverse Change. The list of reporting requirements that qualify as Material Adverse Changes under PJM's existing language is already sufficient to alert PJM to

any events or circumstances indicating that a market participant is at risk of defaulting on its obligations.

Section II.B.3.

- (a) a downgrade of any debt rating by any Rating Agency;
- (b) being placed on a credit watch with negative implications by any Rating Agency;
- (c) a bankruptcy filing;
- (d) insolvency;
- (e) ~~a report of a quarterly or annual loss or a decline in earnings of ten percent or more compared to the prior period;~~
- (f) restatement of prior financial statements unless required due to regulatory changes;
- (g) the resignation or removal of key officer(s) or director(s) unless there is a new key officer or director appointed or expected to be appointed, a transition plan in place pending the appointment of a new key officer or director, or a planned restructuring of such roles;
- (h) ~~the filing of a lawsuit or initiation of an arbitration, investigation or other proceeding that could Material adversely impact any current or future financial results or financial condition or increase the likelihood of non-payment;~~
- (i) Material financial default in another organized wholesale electric market, futures exchange or clearing house that has not been cured;
- (j) revocation of a license or other authority by any Federal or State regulatory agency; where such license or authority is necessary or important to the Participants continued business for example, FERC market-based rate authority, or State license to serve retail load;
- (k) a significant change in credit default swap spreads, market capitalization, or other market-based risk measurement criteria, such as a recent increase in Moody's KMV Expected Default Frequency (EDFtm) that is noticeably greater than the increase in its peers' EDFtm rates, or a collateral default swap (CDS) premium normally associated with an entity rated lower than investment grade;
- (l) Material financial default in a bilateral arrangement with another Market Participant that has not been cured;
- (m) a Material Adverse Change in the outlook of any debt rating;
- (n) any changes in financial condition which, individually, or in the aggregate, are Material;
- (o) any adverse changes, events or occurrences which, individually or in the aggregate, could affect the ability of the entity to pay its debts as they become due or could have a Material adverse effect on any current or future financial results or financial condition;
- (p) disclosure of conflict of interest issues;
- (q) a significant decrease in market capitalization; and
- (r) an event or circumstance indicating that the Participant may present an unreasonable credit risk to the PJM Markets, FTR markets and any other markets operated by PJM, or Members, which may be identified based on the information it provides to PJM pursuant to this Policy.

G. Posting Requirements Provision

The Coalition concurs with DC Energy's comments regarding the need to include all relevant provisions in its Tariff and/or Operating Agreement language, and delete references to the supplemental posting provisions.⁶ The supplemental posting provision creates a significant risk that market participants might miss some change by PJM, as the provision allows for only 15 days of review and comment.

H. Provision of Additional or Restricted Collateral

In Section III.D.2 of the Tariff-Attachment Q, PJM proposes that it shall have the ability to request additional and/or restricted collateral in the event that a market participant does not demonstrate compliance with PJM's minimum capitalization requirements. PJM's proposed language states that the amount of collateral requested "would be commensurate with the amount of the current risk plus any future risk to the PJM Markets [...], and may coincide with Position Limits." The Coalition supports PJM's ability to exercise discretion in requiring non-compliant market participants to supply additional collateral. However, the Coalition cautions PJM that requiring additional and/or restricted collateral must be limited to the extent necessary to prevent a potential default, and should take into consideration both the size of the market participant and the scope of its activity.

Additional collateral, particularly restricted collateral, should be scaled to the market participant's activity, taking into account that longer positions create additional risk. PJM should not require the same amount of additional collateral for a market participant participating in monthly auctions as it would require of a market participant participating in long term auctions. PJM should also take into account the size of the market participant. Imposing a \$10 million asset threshold may be acceptable for larger companies, but would eliminate the majority of smaller financial players. If PJM imposes overly restrictive collateral requirements it could effectively eradicate a majority of the liquidity and competition in its FTR market.

⁶ See DC Energy Comments at 10.