



# Market Participant Minimum Capitalization

Ryan Jones  
Senior Credit Manager

Eric Scherling  
Assistant General Counsel

Risk Management Committee  
September 24, 2024



# Adequate Capitalization

**A business that is adequately capitalized  
will have financial resources to:**

**Support its  
operations**

**Invest in  
growth**

**Weather unexpected  
challenges**

**Adequate capitalization equips business to meet its obligations because it has necessary financial cushion to absorb unexpected costs or downturns in revenue.**

## **Companies that operate on thin margins with high levels of debt and/or little equity are high risk.**

Small disruptions can jeopardize ability to meet obligations.

Poorly capitalized companies struggle to access credit markets.

Adequately capitalized companies are less likely to become insolvent or bankrupt, as capital reserves can be used to meet obligations during periods of financial stress.

## Adequate capitalization demonstrates:

**Prioritization** of financial stability over short-term gains

**Caution** about taking on excessive risk

**Recognition** that adverse future events can occur

**Concern** for ensuring that future obligations will be satisfied



# Connection to Fraudulent Transfer Law

## Constructively fraudulent transfer occurs:

**When debtor transfers property or assets;  
without receiving reasonably equivalent value in return; and**

### **Debtor:**

- was insolvent at time of transfer,
- becomes insolvent as a result of transfer, or
- is engaged in a business for which remaining assets are unreasonably small in relation to anticipated debts.



## Future claimants:

**Are those whose claims  
have not yet materialized**

but are likely to arise based on debtor's  
ongoing activities or legal obligations.

**Have a vested interest in ensuring  
that debtor does not transfer assets**  
in way that diminishes ability to pay  
future liabilities

***Fraudulent transfer law therefore protects future  
claimants in addition to present claimants***

**Fraudulent transfer statutes apply in all 50 states as well as in bankruptcy cases.**

Modeled after Uniform Fraudulent Transfer Act or Uniform Voidable Transactions Act.

Future creditors may challenge transactions that occurred before claims arose, if transfer rendered debtor insolvent or undermined the debtor's ability to satisfy future liabilities.

Courts can reverse or void the transaction, allowing assets to be used to satisfy creditor claims, including those of future claimants.

*Debtors cannot evade financial responsibilities by engaging in transactions that harm current and future creditors, including those that render company insolvent or leave it with unreasonably small capital.*

*Adequate capitalization requirements proactively protect creditors like PJM from the same harm that fraudulent transfer law can only remedy after the fact and at substantial burden and expense.*



# Market Participant Minimum Capitalization Requirements

## Why review minimum capitalization requirement:

- PJM's minimum capitalization requirements for eligibility were established as a result of FERC Order 741 in 2011 and have remained unchanged since implementation. Economy/Markets are significantly different today than 13 years ago.
- These requirements are intended to provide controls such that those participating in PJM markets have the financial ability and risk management capabilities for their planned market positions to protect against potential defaults.
- This problem statement provides an opportunity to review those requirements.

## Adequately capitalized companies:

- Have resources to operate business effectively
- Can absorb economic shocks or downturns in business operations
- Less likely to become insolvent
- Reflection of business acumen of management



# Market Participants Not Meeting \$1 Million Tangible Net Worth (TNW) Threshold

Line of Business (LOB)	Market Participants		Market Participants Not Meeting \$1 Million Tangible Net Worth Threshold		
	Number	Number that Meet	Number	% of Number	% of Gross Activity* (Dollar) by LOB
Generation Owner/Transmission Owner	358	299	59	16%	0.86%
Load Serving Entity	101	67	34	34%	5.65%
Power Marketer	126	107	19	15%	11.67%
Other	199	158	41	21%	3.54%
<b>Total</b>	<b>784</b>	<b>631</b>	<b>153</b>	<b>20%</b>	<b>2.97%</b>

\*Gross Activity is determined by summing the absolute dollar value of the charges and credits for each of the billing line items for the most recent 12 months.

When applying only the \$1MM tangible net worth threshold (regardless of tangible assets), 20% or 153 market participants do not meet the threshold. These market participants represent 3% of the total gross activity.

## Stress Scenario:

- 1 Comparison of Market Participants Highest Bill vs TNW
- 2 Increased real-time (RT) prices by 20% for all market participants participating in virtual market
- 3 Market participants with fluctuations in monthly bill over 36-month period and bill exceeding TNW



# Stress Scenario #1 – Comparison of Market Participants

## Highest Bill vs TNW

### Highest Bill Repeat Assumptions:

- August 2022 bill deemed to be highest bill
- Applied August 2022 increase relative to average bill in prices and load to all load serving entities
- If TNW is not sufficient to cover increase in bill, failure would occur

### RESULTS

### Of 101 Load Serving Entity:

**29**  
would fail

**26** do not meet min. capitalization  
requirement of \$1MM TNW

**3** meet min. capitalization requirement,  
however have TNW between \$1MM–\$5MM



## Virtual Market Participants Assumptions:

- Increase real-time (RT) prices by 20%
- Applied RT price increase to all 155 virtual market participants
- TNW is insufficient to cover 20% RT price increase a failure occurs

## RESULTS

### Of 155 Virtual Market Participants:

**34** would fail by measure of 20% RT price increase\*

**12** do not meet min. capitalization requirement of \$1M TNW

**22** meet min capitalization requirement of \$1M (14 have TNW between \$1– \$5M)

*\*Example: Normal obligation is \$5MM and TNW is \$900k. 20% RT price obligation is \$6MM and TNW is \$900k. TNW is insufficient to cover increase in obligation.*

## Monthly Revenue Volatility Assumptions:

- Monthly revenue volatility was measured by revenue movement over the last 36 months.
- If tangible net worth is less than monthly revenue movement at the 95th percentile, a failure occurs.

## RESULTS

**Of 784 Market Participants,**  
**128** have a TNW less than monthly revenue volatility\*

- Of 128:**
- **117** do not meet min. capitalization TNW requirement of \$1M
  - **11** meet min. capitalization requirements of >\$1M TNW  
( 7 have TNW between \$1-\$5M & 4 have TNW >\$5M)

1	2	3
<p>Based upon current minimum capitalization thresholds:</p> <p>Should stress market conditions occur, ~24% of market participants' balance sheets would be challenged to absorb impacts.</p>	<p>Over the past several years, PJM market participants have faced unforeseen events such as:</p> <ul style="list-style-type: none"> <li>• Winter Storm Elliott</li> <li>• Higher temperatures summer/winter impacting RT prices and load requirements</li> <li>• Impact of cleared capacity prices</li> </ul>	<p>Market participants with strong balance sheets are able to weather market-driven events (proactive) verses thinly capitalized market participants' reliance on UCR collateral calls (reactive).</p>



# Minimum Capitalization Matrix Review



# Proposed Minimum Capitalization Thresholds \$5 Million TNW or \$10 Million Tangible Assets

## Market Participants:

	Total #	Total That Do Meet Min Cap	Total That Do Not Meet Min Cap	% of Total #	% of Total Activity
Generation Owner/Transmission Owner	358	308	50	14%	0.65%
Load Serving Entity	101	72	29	29%	1.50%
Curtailment Service Provider	28	15	13	46%	2.30%
Financial Trader	125	73	52	42%	8.17%
Power Marketer	126	107	19	15%	2.57%
Other	46	38	8	17%	1.23%
<b>Total</b>	<b>784</b>	<b>613</b>	<b>171</b>	<b>22%</b>	<b>1.56%</b>

- Moving minimum capitalization requirement to \$5M TNW or \$10MM TA would impact 171 market participants, or 22% of total market participants.
- This is an increase of 65 market participants, or 8% of total market participants, that do not meet existing requirement of \$1M TNW or \$10M TA.

Facilitator:

Thomas Zadlo, [Thomas.Zadlo@pjm.com](mailto:Thomas.Zadlo@pjm.com)

Secretary:

Julia Spatafore,  
[Julia.Spatafore@pjm.com](mailto:Julia.Spatafore@pjm.com)

SME:

Ryan Jones, [Ryan.Jones@pjm.com](mailto:Ryan.Jones@pjm.com)

Eric Scherling, [Eric.Scherling@pjm.com](mailto:Eric.Scherling@pjm.com)

**Minimum Capitalization**



**Member Hotline**

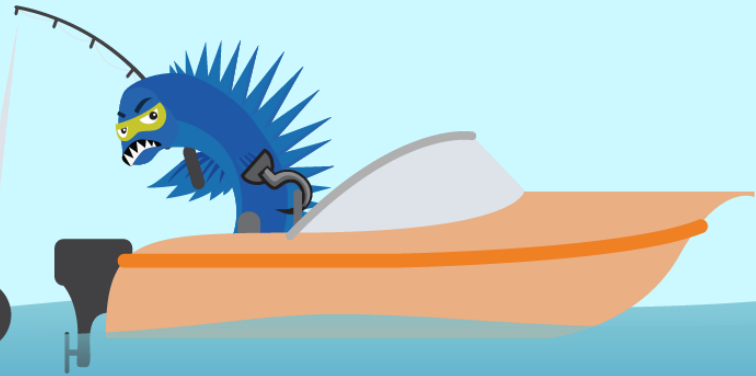
(610) 666 – 8980

(866) 400 – 8980

[custsvc@pjm.com](mailto:custsvc@pjm.com)

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