

128 FERC ¶ 61,093  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;  
Sudeen G. Kelly, Marc Spitzer,  
and Philip D. Moeller.

Midwest Independent Transmission  
System Operator, Inc.

Docket No. ER09-1220-000

ORDER ACCEPTING PROPOSED TARIFF REVISIONS FOR FILING

(Issued July 28, 2009)

1. On May 29, 2009, the Midwest Independent Transmission System Operator, Inc. (Midwest ISO) filed proposed revisions to the Attachment L Credit Policy within its Open Access Transmission, Energy and Operating Reserve Markets Tariff (Tariff).<sup>1</sup> The proposed revisions would revise the Attachment L Credit Policy to require a Market Participant to grant a security interest to Midwest ISO in the amounts due to the Market Participant from Midwest ISO if the Market Participant wants Midwest ISO to continue netting across all service categories when calculating the Market Participant's Total Potential Exposure (TPE). As discussed below, we accept the proposed revisions to the Attachment L Credit Policy for filing, to become effective on July 28, 2009, as requested.

**I. Background**

2. Currently, when calculating a Market Participant's TPE, Midwest ISO nets within and across service categories any amounts owed to the Market Participant against the amounts owing from the Market Participant. Midwest ISO states that this netting across service categories has the effect of reducing the amount of unsecured credit used by or financial security required from a Market Participant, thereby minimizing barriers to entry. However, Midwest ISO states that under current law, the netting and credit practices in the current Tariff expose Midwest ISO to credit risk.

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<sup>1</sup> FERC Electric Tariff, Fourth Revised Volume No. 1.

3. Midwest ISO states that federal bankruptcy law only permits a creditor to setoff amounts due to a debtor against amounts due to a creditor if the claims are “mutual.”<sup>2</sup> Mutual claims must be: (i) between the same parties, (ii) owed in the same capacity, and (iii) owed in the same right. Midwest ISO states that there is risk that a bankruptcy judge may conclude that the net amounts are not owed in the “same capacity” and under the “same right.” Such a ruling would prevent Midwest ISO from exercising its setoff rights under the Tariff. In such an instance, Midwest ISO states that it may be forced to turn over amounts owed to a Market Participant notwithstanding what the Market Participant owes Midwest ISO. Moreover, if another creditor has a perfected security interest in the Market Participant’s accounts receivable, this security interest could take precedence over any right of setoff or recoupment that Midwest ISO has, depending on how the receivable is defined and when it arises.<sup>3</sup>

4. Midwest ISO also states that a court could find that Midwest ISO cannot setoff amounts owed to it against amounts owed the Market Participant because the debts are not “mutual.” Alternatively, another creditor of the Market Participant could claim a superior security interest in the right to payment which might require Midwest ISO to release such amounts to the Market Participant even if on a net basis Midwest ISO is owed amounts from the Market Participant.<sup>4</sup>

## **II. Proposed Tariff Revisions**

5. According to Midwest ISO, the proposed revisions will permit netting both within and across service categories to continue for Market Participants if they grant Midwest ISO a first priority security interest in the accounts receivable owed to Market Participants from Midwest ISO. Market Participants that elect not to grant this security

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<sup>2</sup> We note that the Supreme Court has explained that “[t]he right of setoff (also called ‘offset’) allows entities that owe other money to apply their mutual debts against each other, thereby avoiding ‘the absurdity of making A pay B when B owes A.’” *Citizens Bank of Maryland v. Strumph*, 516 U.S. 16, 18 (1995), citing *Studley v. Boylston National Bank*, 229 U.S. 523, 528 (1913).

<sup>3</sup> *Id.* at 5. According to Midwest ISO, the ability of a regional transmission operator to setoff all amounts in a bankruptcy context is unsettled. It states that in the event of a bankruptcy, it would assert its right to cross-product netting under applicable law. However, given the current state of bankruptcy and creditor’s rights laws on this matter, Midwest ISO states that it has been advised by counsel that there is a risk that it may not prevail. *Id.* at 5, n.2.

<sup>4</sup> *Id.* at 5-6.

interest will no longer have their charges and credits netted across service categories when Midwest ISO calculates their TPE.

6. The proposed revisions would allow Market Participants that choose to grant the first priority security interest (Category A Customers) to continue to net credits against obligations as they currently do under the Tariff. Market Participants electing not to grant Midwest ISO a first priority security interest (Category B Customers) will have their net credit (within each service category) amount for each service category excluded from the TPE calculation. The proposed revisions also provide that qualifying municipalities and joint action agencies will be eligible to be Category A Customers without having to grant Midwest ISO first priority security interest. Midwest ISO requests an effective date of July 28, 2009.

7. Midwest ISO notes that it previously proposed a security interest provision when it filed its Open Access Transmission and Energy Markets Tariff (TEMT) in Docket No. ER04-691-000. In its August 6, 2004 Order,<sup>5</sup> the Commission conditionally accepted Midwest ISO's TEMT, but rejected the proposed requirement of a first priority security interest in accounts receivable as a precondition to netting for Market Participants and directed Midwest ISO to remove the language from its tariff. The Commission found that such provisions imposed an unfair burden on certain Market Participants (municipalities and joint action agencies) that would not be able to grant the security interest and as a consequence, would have their credit severely limited.<sup>6</sup> Midwest ISO states that the concern expressed by the Commission in the TEMT II Order is addressed in the instant proposal. Specifically, that concern is addressed by the provision that allows municipalities and joint action agencies to qualify to be Category A Customers without having to grant Midwest ISO a first priority security interest by providing a management representation letter, an opinion letter and rating agency ratings on revenue bonds.

8. Finally, upon request of Midwest ISO's Credit Practices Working Group, Midwest ISO performed an analysis of the effects of the proposed revisions that it says shows that

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<sup>5</sup> *Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,163 (TEMT II Order), *order on reh'g*, 109 FERC ¶ 61,157 (2004), *order on reh'g*, 111 FERC ¶ 61,043, *reh'g denied*, 112 FERC ¶ 61,086 (2005), *aff'd sub nom. Wisconsin Public Power, Inc. v. FERC*, 493 F.3d 239 (D.C. Cir. 2007).

<sup>6</sup> *Id.* P 450 (“While the Commission empathizes with the Midwest ISO's desire to preserve its rights to collect monies due, as bankruptcy law allows, this neither negates the need for credit policies that participants can legally comply with nor justifies a requirement that is not present in the credit policies of other [Independent System Operators (ISO) and Regional Transmission Organizations (RTO)].”).

even if every Market Participant chose not to grant a first priority security interest, and therefore would not be eligible to net across service categories, only nine Market Participants would be required to provide additional financial security and that the increased required security would be limited to \$18 million.<sup>7</sup>

### **III. Notice of Filing and Responsive Pleadings**

9. Notice of Midwest ISO's filing was published in the *Federal Register*, 74 Fed. Reg. 27,308-09 (2009), with motions to intervene and protests due on or before June 19, 2009. Timely motions to intervene, raising no substantive issues, were filed by: Ameren Services Company; American Municipal Power-Ohio, Inc.; Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc.; Duke Energy Corporation; Exelon Corporation; JP Morgan Ventures Energy Corporation; PJM Interconnection L.L.C.; RRI Energy, Inc.; and Wisconsin Electric Power Company.

10. A timely motion to intervene and protest was filed by Solios Power, LLC and JPTC, LLC (jointly, Financial Marketers). Financial Marketers argue that Midwest ISO's proposal misses the larger exposure that Market Participants face: the prospect of a Market Participant with uncollateralized positions filing for bankruptcy and the way that Market Participant's financial obligations to Midwest ISO would be treated under bankruptcy laws. Financial Marketers argue that while Midwest ISO is proposing tariff changes that would require Market Participants to provide a first priority security interest in their accounts receivable, it has failed to propose any changes to its policy of allowing certain Market Participants to trade on unsecured credit, notwithstanding the fact that such a policy provides the market with no protection from adverse outcomes under bankruptcy law and that this would be unduly discriminatory and preferential.

11. Citing the Commission's Policy Statement on Credit-Related Issues for Electric Open Access Transmission Tariff Transmission Providers, Independent System Operators and Regional Transmission Organizations,<sup>8</sup> Financial Marketers state that independent system operators' credit policies must reflect a balancing of interests in minimizing default risk and avoiding the imposition of significant costs on Market Participants that would represent a serious barrier to entry. Financial Marketers further argue that Midwest ISO's proposed revisions would violate the Commission's policy by allowing Market Participants not granted unsecured credit to provide increased financial security (either through a first priority security interest or an increase in their TPE) while

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<sup>7</sup> Midwest ISO Transmittal Letter at 7 and Tab A (Testimony of Michael P. Holstein) at 12.

<sup>8</sup> *Policy Statement on Electric Creditworthiness*, 109 FERC ¶ 61,186 (2004).

simultaneously exempting Market Participants that have been granted unsecured credit from making similar security provisions.

12. To rectify the shortfalls of Midwest ISO's proposal, Financial Marketers propose that acceptance of Midwest ISO's proposed tariff revisions be conditioned upon Midwest ISO revising its existing Credit Policy to eliminate unsecured credit. In support, Financial Marketers point to the recommendation of PJM's Market Reform Study that "All positions should be 'fully collateralized', to cover potential exposures to a high degree of statistical confidence. Unsecured credit should not be extended to any participant."<sup>9</sup>

13. In the alternative, Financial Marketers request that, if the Commission does not require Midwest ISO to eliminate unsecured credit, it at least require Midwest ISO to further revise its Credit Policy such that the costs of any default by a Market Participant trading on unsecured credit are socialized entirely among the Market Participants using unsecured credit.

14. On July 6, 2009, Midwest ISO filed an answer. Midwest ISO disputes Financial Marketers' assertion that the proposed revisions are unduly discriminatory and preferential. Specifically, Midwest ISO states that its proposed revisions would apply equally to all Market Participants, regardless of whether the Market Participant qualifies for unsecured credit, and that they would not discriminate against any particular class of Market Participant.

15. Midwest ISO also argues that Financial Marketers' request that the Commission direct Midwest ISO to eliminate the availability of unsecured credit is not appropriate in this proceeding because it falls outside the scope of Midwest ISO's proposed changes. Additionally, Midwest ISO argues that the elimination of unsecured credit is inconsistent with Commission precedent.<sup>10</sup>

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<sup>9</sup> *PJM Credit and Clearing Analysis Project, Finding and Recommendations*, at 4, available at <http://www.pjm.com/~media/committees-groups/committees/mc/20080626-item-03d-crm-sc-market-reform-credit-recommendations.ashx>. See also *PJM Credit and Clearing Analysis Project, Market Credit Comparison*, available at <http://www.pjm.com/~media/committees-groups/committees/crm-sc/postings/market-reform-market-credit-comparison.ashx>.

<sup>10</sup> Midwest ISO cites, e.g., *California Independent System Operator Corp.*, 126 FERC ¶ 61,285, at P 37 (2009) (*California ISO*); TEMT II Order, 108 FERC ¶ 61,163 at P 431, 437-439 (conditionally accepting unsecured credit provisions in Attachment L – Credit Policy); and *Midwest Independent Transmission System Operator, Inc.*, 109 FERC ¶ 61,285 at P 353 (2004) (order on compliance filings ordered by the

(continued...)

#### **IV. Discussion**

##### **A. Procedural Matters**

16. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2008), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

17. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 213 (a)(2) (2008), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept Midwest ISO's answer because it provides information that assisted us in our decision-making process.

##### **B. Substantive Matters**

18. We find that Midwest ISO's proposed revisions to its Attachment L Credit Policy are a just and reasonable means of addressing the credit risk that could arise under applicable bankruptcy laws and Midwest ISO's existing netting and credit practices under its Tariff.<sup>11</sup> Additionally, we are satisfied that Midwest ISO's proposed revisions allow a Market Participant to elect whether to be a Category A Customer or a Category B Customer without imposing an unfair burden on certain Market Participants (i.e., municipalities and joint action agencies) that are unable to grant such security interests. Thus, the proposal addresses our concerns in the TEMT II Order.

19. The Commission has previously accepted for filing Midwest ISO's Tariff provisions that provide for the use of unsecured credit,<sup>12</sup> and Midwest ISO does not propose to change those provisions in the instant filing. Accordingly, we reject Financial Marketers' request to eliminate Midwest ISO's use of unsecured credit, and their alternative request that we direct Midwest ISO to socialize default costs entirely among the Market Participants using unsecured credit, as a collateral attack on the Commission's

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TEMT II Order in which the Commission accepted unsecured credit provisions in Attachment L – Credit Policy) (TEMT II Compliance Order).

<sup>11</sup> In making our determination, we take no position interpreting bankruptcy and creditor's rights laws or concerning whether Midwest ISO could prevail in bankruptcy court if it asserted rights under the instant Tariff revisions.

<sup>12</sup> See TEMT II Order 108 FERC ¶ 61,163 and TEMT II Compliance Order 109 FERC ¶ 61,285.

previous orders approving the use of unsecured credit by Midwest ISO.<sup>13</sup> Financial Marketers' requests would be more appropriately raised in a complaint under section 206 of the Federal Power Act.<sup>14</sup>

The Commission orders:

Midwest ISO's proposed revisions to the Attachment L Credit Policy are hereby accepted for filing, to become effective on July 28, 2009, as requested.

By the Commission.

( S E A L )

Nathaniel J. Davis, Sr.,  
Deputy Secretary.

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<sup>13</sup> See *California ISO*, 126 FERC ¶ 61,285 at P 37 (rejecting request to eliminate the use of unsecured credit in the California ISO markets as a collateral attack on the Commission's previous orders approving the use of unsecured credit in California ISO markets and noting that the Commission "has previously rejected the notion of eliminating unsecured credit in ISO and RTO markets"). In *California ISO*, the Commission cited the *Policy Statement on Electric Creditworthiness*, 109 FERC ¶ 61,186, at P 19 (2004), where the Commission stated, in part, that "[w]hile requiring all market participants in ISOs/RTOs to be fully collateralized would eliminate the mutualized credit risk, the Commission believes that such a goal would impose significant costs on market participants and, in turn, would represent a serious barrier to entry into the markets. Short of that, the Commission believes that there are less burdensome ways to reduce credit exposure and minimize the mutualized default risk in ISO/RTO markets and encourages them to adopt such measures."

<sup>14</sup> 16 U.S.C. § 824e (2006).