Credit Reform Technical Conference

Title to Transactions:

Issues and Risks

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Title to Transactions Imposes Substantial New Risks

- Per Tariff, the RTO is "revenue neutral"
  - Midwest ISO bills those that net owe funds
  - Midwest ISO distributes funds received to those that are net due funds
  - Midwest ISO "short pays" in the event of less than full payment in order to remain "revenue neutral"
- "Short pay" feature seems inconsistent with RTO being a true seller and buyer

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Title to Transactions Imposes Substantial New Risks

- If "short pay" feature is retained, title to transaction creates two risks
- A court could treat transaction as a "true" purchase or sale
  - Impose obligation on Midwest ISO to pay shortfall
  - End result could lead to Midwest ISO being insolvent and filing for bankruptcy protection
- A court could treat transaction as one by an agent of some sort and permit the "no netting" argument that Mirant briefly made

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Title to Transactions Imposes Substantial New Risks

- If the “short pay” feature is not retained, the “no netting” risk is mitigated but the risk of insolvency is substantially increased
- The Midwest ISO would be obligated to pay any shortfall
- But, as currently structured, Midwest ISO would have no means to pay the shortfall
- End result could lead to Midwest ISO being insolvent and filing for bankruptcy protection

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Title to Transactions Imposes Substantial New Risks

- Per Order 2000, the RTO must be financially independent
- Midwest ISO borrowed money from qualified investors who relied upon “revenue neutrality” and “uplift” provisions of Tariff in assessing the risks associated with the loan of money
- Borrowers could argue title to transactions is a Material Adverse Event and demand immediate repayment in full
- Ruling in favor of Borrowers could lead to Midwest ISO being insolvent and filing for bankruptcy protection

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Title to Transactions Requires New Risk Mitigation Measures

- A central counterparty arrangement requires substantial risk mitigation to protect solvency of the central counterparty
- This is likely to require market participants to post substantially more collateral to mitigate the risk of insolvency of the RTO or ISO

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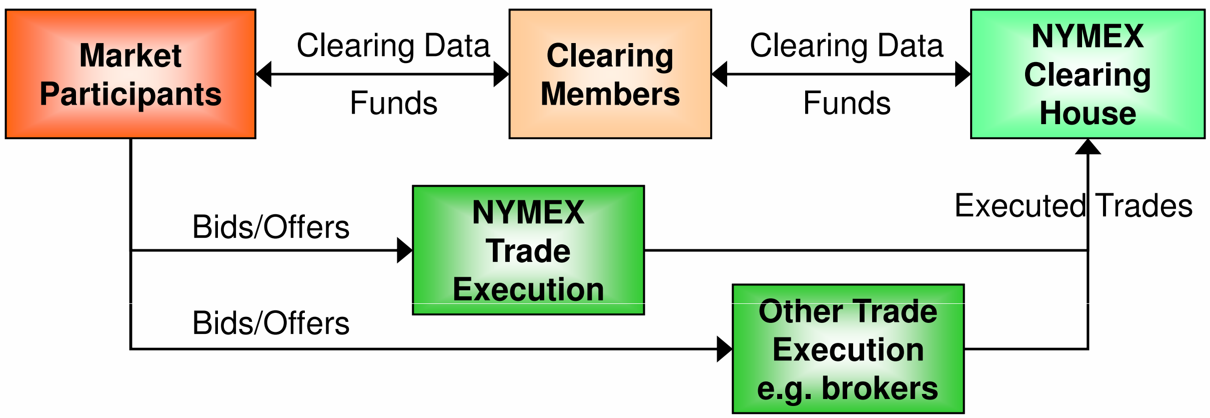
How Does NYMEX Clearing Work?

The NYMEX clearing process makes use of financial intermediaries known as Futures Commission Merchants (FCMs), or Clearing Members.



- Participants are responsible to their FCM – with whom they must post any required monies.
- The FCM, in turn, is responsible to NYMEX.
- Participants with sufficiently strong credit can choose to become their own FCM.

“Safety Net” consisting of multiple protections is necessary to provide confidence to participants that the clearing house will pay in full and to guard against insolvency.

FCMs play a key role in NYMEX’s system of trade guarantees

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NYMEX ClearPort® Clearing Risk Mitigation

Safety Net – in the event of a clearing member's failure to meet its obligations, i.e., maintain margin payments, the loss to the clearinghouse is restored through the "safety net" system

- That clearing member's assets
- Exchange surplus as determined by the board of directors
- Payments from the NYMEX Guaranty Fund $200 MM
- Default insurance $115 MM
- A pro-rated assessment of other clearing members based on trading participation

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Source: NYMEX ClearPort® Clearing
5 Years of Market Innovation,
March 19, 2007

Conclusions

- Title to transactions imposes substantial new risks
- New risks have potential for catastrophic outcome for RTO
- Residual level of risk from netting in Midwest ISO Tariff is minimal
- RTOs that wish to take title can do so by filing proposed Tariff changes at FERC
- Title to power should be on a case-by-case basis and not imposed unilaterally

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