

**PREPARED DIRECT TESTIMONY OF MICHAEL P. HOLSTEIN  
ON BEHALF OF THE MIDWEST INDEPENDENT TRANSMISSION  
SYSTEM OPERATOR, INC.  
DOCKET NO. ER04-\_\_\_\_-000 BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

Midwest Independent Transmission )  
System Operator, Inc. )

Docket No. ER04-\_\_\_\_-000

PREPARED DIRECT TESTIMONY OF  
MICHAEL P. HOLSTEIN

1

2

I. INTRODUCTION

3 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

4 A. My name is Michael P. Holstein. My business address is 701 City Center Drive, Carmel,  
5 Indiana 46032.

6 Q. BY WHOM AND IN WHAT CAPACITY ARE YOU CURRENTLY EMPLOYED?

7 A. I am the Vice President and Chief Financial Officer of the Midwest Independent  
8 Transmission System Operator, Inc. (“Midwest ISO”). I am responsible for the finance,  
9 accounting, internal audit, and credit functions of the Midwest ISO.

10 Q. PLEASE SUMMARIZE YOUR EDUCATIONAL AND PROFESSIONAL  
11 BACKGROUND.

12 A. Since May, 2001, I have been Vice President and Chief Financial Officer of the Midwest  
13 ISO. Prior to joining the Midwest ISO, I was Vice President of Strategic Business  
14 Initiatives for IPALCO Enterprises, Inc., a holding company that owns Indianapolis  
15 Power & Light Company (“IPL”). IPL is an electric utility serving over 400,000 retail  
16 customers in central Indiana. I have also worked for Deloitte & Touche LLP in Atlanta,

M. P. Holstein

1 EDS/Energy Management Associates, Inc. in Atlanta, Houston Lighting & Power in  
2 Houston, and Public Service Company of New Mexico in Albuquerque.

3 I am a graduate of the University of New Mexico with a Bachelor of Science  
4 degree in Civil Engineering and a Master of Business Administration degree with a  
5 finance concentration.

6 **Q. HAVE YOU PREVIOUSLY TESTIFIED IN PROCEEDINGS INVOLVING THE**  
7 **REGULATION OF PUBLIC UTILITIES?**

8 A. Yes. I have testified in numerous proceedings before the Federal Energy Regulatory  
9 Commission (“FERC” or “Commission”) involving the Midwest ISO. I have also  
10 testified before the Arizona Corporation Commission on behalf of Arizona Electric  
11 Power Cooperative, the Wisconsin Public Service Commission on behalf of the Joint QF-  
12 Citizens Utility Board Group, and the Michigan Public Service Commission on behalf of  
13 Midland Cogeneration Venture Limited Partnership. In addition, I recently testified  
14 before the Kentucky Public Service Commission on behalf of the Midwest ISO.

15 **Q. PLEASE DESCRIBE YOUR RESPONSIBILITIES WITH THE MIDWEST ISO**  
16 **AS THEY RELATE TO THIS FILING.**

17 A. I prepared, or caused to be prepared, the Midwest ISO’s Credit Policy, which is  
18 Attachment L to the proposed Tariff. I also prepared, or caused to be prepared, Section 7  
19 of Module A of the Tariff related to matters involving billing, collections, and actions  
20 upon declaration of default.

21 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

22 A. The purpose of my testimony is to explain the principles of the Credit Policy contained in  
23 the Tariff filing made by Midwest ISO on March 31, 2004.

**M. P. Holstein**

1 **II. BACKGROUND**

2 **Q. DOES THE MIDWEST ISO CURRENTLY HAVE A CREDIT POLICY?**

3 A. Yes. The current policy is a Business Practice of the Midwest ISO and is available online  
4 to all registered Midwest ISO Extranet users. The latest version of the current credit  
5 policy is Version 2.8b, last updated January 4, 2004.

6 **Q. PLEASE BRIEFLY DESCRIBE THE POLICY.**

7 A. The Midwest ISO currently evaluates the creditworthiness of Applicants and  
8 Transmission Customers per the provisions of the policy and specifies the amount, if any,  
9 of unsecured credit to be extended to Applicants and/or Transmission Customers. The  
10 Midwest ISO requires financial assurances such as corporate guarantees, letters of credit,  
11 or cash collateral be provided to cover any potential exposure to non-payment of  
12 Transmission Customers above the level of unsecured credit extended.

13 **Q. DID YOU CONSIDER THE CREDIT POLICIES OF ANY OTHER ISOs AS YOU**  
14 **PREPARED THE NEW CREDIT POLICY?**

15 A. Yes. We considered the credit policies of the following ISOs/RTOs -- Electric Reliability  
16 Council of Texas, ISO New England ("ISO NE"), New York Independent System  
17 Operator, Inc. ("NYISO"), and PJM Interconnection, Inc. ("PJM") -- as we prepared our  
18 Credit Policy for the Energy Markets. We also considered recent Commission orders  
19 related to the credit policies of NYISO and PJM in developing the Credit Policy included  
20 in this filing. Attached as Exhibit No. \_\_\_\_ (MPH-3) to this testimony is a table  
21 comparing the Midwest ISO's proposed Credit Policy with the credit policies of PJM and  
22 NYISO.

**M. P. Holstein**

1 **Q. DID YOU CONSIDER THE CREDIT POLICIES OF MARKETS IN OTHER**  
2 **INDUSTRIES?**

3 A. Yes. We considered the business practices and credit policy of the New York Mercantile  
4 Exchange (“NYMEX”).

5 **Q. WHAT ARE THE BASIC ELEMENTS OF NYMEX’S CREDIT POLICY?**

6 A. NYMEX effectively requires all activities to be fully collateralized at all times. To  
7 minimize the amount of collateral required, amounts for an operating day’s activities are  
8 settled, due and payable within one business day. As such, NYMEX does not extend  
9 unsecured credit to any market participant.

10 **Q. HOW DOES THE PROPOSED CREDIT POLICY INCLUDED IN THIS FILING**  
11 **COMPARE TO PJM’S FERC-ACCEPTED CREDIT POLICY?**

12 A. The two credit policies are very similar, in part because the Midwest ISO deliberately  
13 chose the FERC-accepted PJM credit policy as the basis for its proposed Credit Policy.  
14 This was done for two reasons. First, PJM’s credit policy has been reviewed and  
15 accepted by the Commission. Second, given the goal of a joint and common market  
16 between the Midwest ISO and PJM, minimizing differences between the two credit  
17 policies was deemed a desirable goal.

18 **III. GUIDING PRINCIPLES**

19 **Q. ARE THERE ANY GUIDING PRINCIPLES THAT UNDERLIE THE CREDIT**  
20 **POLICY?**

21 A. Yes.

1 **Q. PLEASE DESCRIBE THEM.**

2 A. The guiding principles that underlie the Credit Policy are to insulate Participants from  
3 undue financial exposure, and to minimize the required Financial Security. These  
4 principles are inherently at odds and the Credit Policy represents our attempt and the  
5 attempt of our stakeholders to achieve a reasonable and prudent balance of these two  
6 principles.

7 **IV. EVALUATION OF CREDIT**

8 **Q. PLEASE DESCRIBE THE PROCESS BY WHICH THE MIDWEST ISO**  
9 **PROPOSES TO INITIALLY EVALUATE THE CREDIT OF A PARTICIPANT.**

10 A. A Transmission Customer and/or Market Participant (collectively “Participant”) will be  
11 required to submit financial statements, trade references, and information on litigation,  
12 investigations, proceedings, commitments, contingencies, and liabilities, as well as  
13 information related to its planned activities that will create a potential exposure to non-  
14 payment. The Midwest ISO will generate a Credit Score for each Participant based on  
15 the Midwest ISO’s review and analysis of the information obtained from the credit  
16 evaluation process. Key factors in this scoring process include, but are not limited to,  
17 Rating Agency reports, financial statements and Significant Trade References.

18 **Q. PLEASE DESCRIBE THE PROCESS BY WHICH THE MIDWEST ISO**  
19 **PROPOSES TO EVALUATE PARTICIPANTS ON AN ONGOING BASIS.**

20 A. The Midwest ISO will evaluate Rating Agency reports, financial statements, information  
21 on material changes in financial condition, information on litigation, investigations,  
22 proceedings, commitments, and liabilities, and other information relevant to

1 creditworthiness on at least an annual basis. As part of the evaluation, the Midwest ISO  
2 will review the Credit Score and Unsecured Credit Limit assigned to the Participant.

3 Participants will have ongoing obligations to provide information relative to the Midwest  
4 ISO's credit evaluation.

5 **Q. IS THE INFORMATION REQUIRED FROM APPLICANTS AND**  
6 **PARTICIPANTS STANDARDIZED AND WELL DEFINED?**

7 A. Yes. The information required from Applicants and Participants is specified in Section  
8 IV of the Credit Policy. The information required is remarkably similar to that required  
9 under PJM's FERC-accepted credit policy.<sup>1</sup>

10 **V. TOTAL CREDIT LIMIT**

11 **Q. HOW DOES THE MIDWEST ISO PROPOSE TO DETERMINE THE**  
12 **UNSECURED CREDIT LIMIT FOR PARTICIPANTS?**

13 A. The Midwest ISO will assign an Unsecured Credit Limit as a percentage of the  
14 Participant's Tangible Net Worth, Working Capital or Operating Cash Flow. The  
15 percentage will vary based on the Participant's credit score. A key factor in determining  
16 whether Tangible Net Worth, Working Capital or Operating Cash Flow is used to  
17 establish the Unsecured Credit Limit will be the participant's core business. A  
18 participant's Unsecured Credit Limit may not exceed \$50 million. If an Affiliate of the  
19 participant provides a Corporate Guaranty, the Credit Score and financial measures of the  
20 Affiliate will be used to assign an Unsecured Credit Limit for the Participant.

21 **Q. HOW DOES THE MIDWEST ISO PROPOSE TO DETERMINE THE TOTAL**

---

<sup>1</sup> *PJM Interconnection, Inc.*, 105 FERC ¶ 61,106 (2003). ("PJM's FERC-accepted credit policy").

1           **CREDIT LIMIT FOR A PARTICIPANT?**

2    A.    The Total Credit Limit for a Participant will equal the amount of any Financial Securities  
3           that secure the Participant’s obligations plus the participant’s Unsecured Credit Limit.

4    **Q.    PLEASE EXPLAIN THE REASON THAT MOTIVATED THE MIDWEST ISO**  
5           **TO PROPOSE THE USE OF THE TABLE THAT APPEARS AS TABLE 1 TO**  
6           **THE CREDIT POLICY.**

7    A.    The Midwest ISO developed its credit scoring model and the values in Table 1 of the  
8           Credit Policy during 2001 with the help of credit specialists from Arthur Anderson LLP  
9           and Deloitte & Touche LLP. The credit scoring model, which assigns a numeric score to  
10          individual components evaluated in each of three categories – Rating Agency scores,  
11          financial ratios and intangibles – was based on similar credit scoring models in use within  
12          the electric utility and power marketing industry at that time. The values in Table 1 for  
13          business sectors scored primarily on the basis of their Tangible Net Worth started with a  
14          maximum of six percent (6%) for the best scores and declined towards zero percent (0%)  
15          as the credit score increased in value. The maximum of six percent was selected based  
16          on Arthur Anderson’s knowledge of best practices across all industries. The concept is to  
17          limit the exposure to non-payment to a maximum percentage of the counter-party’s  
18          tangible net worth. In effect, you determine the maximum you are willing to lose if the  
19          counter-party defaults.

20                 However, the application of this methodology to the public power sector yielded,  
21                 on average, a much smaller amount of Unsecured Credit to extend to companies with  
22                 comparable size, assets and business risks than to equity ownership companies for the

1 simple reason that many of these public power entities do not have, by design, significant  
2 Tangible Net Worth or equity.

3 **Q. WHY IS IT COMMON FOR PUBLIC POWER ENTITIES TO NOT HAVE**  
4 **SIGNIFICANT TANGIBLE NET WORTH OR EQUITY?**

5 A. Public power entities are for the most part non-profit entities that generally rely on debt  
6 as their primary source of funding and, as such, have less equity than their private sector  
7 counterparts. As such, the Midwest ISO elected to use Working Capital as the primary  
8 metric for determining how much Unsecured Credit to extend to public power entities  
9 and selected fifteen percent (15%) as the maximum amount for the best scores and  
10 declined towards zero percent (0%) as the credit score increased in value. The amount of  
11 Unsecured Credit extended on this basis was of comparable magnitude to that extended  
12 to investor-owned utilities of comparable size, assets and business risks.

13 **Q. WHY IS THE MAXIMUM PERCENT IN TABLE 1 FOR INDEPENDENT**  
14 **POWER PRODUCERS AND TRADING AND MARKETING ENTITIES LESS**  
15 **THAN FOR INVESTOR-OWNED UTILITIES?**

16 A. The Midwest ISO considers the business models of these entities to have higher risk than  
17 the business models of most investor-owned utilities. The predictability of the revenue  
18 stream for independent power producers is, in general, subject to more risk and volatility.  
19 The book value of their assets is therefore a less reliable predictor of value to be retained  
20 in a bankruptcy proceeding. For trading and marketing entities the volatility of their  
21 earnings and cash flow is generally much greater, and the nature of their assets much  
22 more liquid and therefore more easily devalued. The Midwest ISO, in consultation with  
23 the credit specialists of Arthur Anderson and Deloitte & Touche, elected to reduce the

1 percentage of Tangible Net Worth in Table 1 for these entities due to their higher risk  
2 business models.

3 **Q. HOW DOES THE CRITERIA FOR ESTABLISHING UNSECURED CREDIT**  
4 **LIMITS PROPOSED BY MIDWEST ISO COMPARE WITH THE CRITERIA IN**  
5 **PJM'S FERC-ACCEPTED CREDIT POLICY?**

6 A. The criteria for establishing unsecured credit limits in PJM's FERC-accepted credit  
7 policy involves using a percentage of tangible net worth as specified in Table 1 of their  
8 credit policy. The two credit policies use virtually the same criteria.

9 **Q. DOES THE MIDWEST ISO PROPOSE A MAXIMUM AMOUNT OF**  
10 **UNSECURED CREDIT FOR ANY PARTICIPANT?**

11 A. Yes. The Midwest ISO proposes that the maximum amount of Unsecured Credit for any  
12 single Participant or affiliate be \$50 Million. The basis for this proposal is discussed later  
13 in my testimony.

14 **Q. HOW DOES THIS COMPARE TO THE POLICIES OF OTHER ISOS?**

15 A. The NYISO Credit Policy sets a maximum unsecured credit limit of five percent (5%) of  
16 the market concentration cap or \$125 million, whichever is less. The ISO NE Credit  
17 Policy sets a maximum unsecured credit limit of twenty percent (20%) of the market  
18 concentration cap or \$125 million, whichever is less. The maximum unsecured credit is  
19 \$150 million under PJM's Credit Policy, with lesser amounts available for entities with  
20 lower credit scores. However, the maximum unsecured credit limits of PJM and the  
21 Midwest ISO should not be directly compared. PJM bases its total credit limit on 85% of

1 its unsecured credit allowance, whereas the Midwest ISO bases its total credit limit on  
2 100% of the unsecured credit limit.

3 **Q. WHY DO YOU PROPOSE THIS MAXIMUM AMOUNT?**

4 A. The \$50 million cap was established through the stakeholder process described later in  
5 my testimony.

6 **VI. MANAGING FINANCIAL EXPOSURE**

7 **Q. HOW DOES THE MIDWEST ISO PROPOSE TO USE THE TOTAL CREDIT**  
8 **LIMIT TO MANAGE TOTAL FINANCIAL EXPOSURE OF PARTICIPANTS?**

9 A. The Midwest ISO proposes to compare the Total Credit Limit for Participants to the Total  
10 Potential Exposure of those Participants in the Energy Markets and for Transmission  
11 Service. The Total Potential Exposure will be determined by evaluating the exposure of  
12 the Participant for the various transactions in the Energy Markets and for Transmission  
13 Service.

14 **Q. IN GENERAL, DESCRIBE THE PROCESS BY WHICH THE MIDWEST ISO**  
15 **PROPOSES TO DETERMINE THE VARIOUS ELEMENTS OF TOTAL**  
16 **POTENTIAL EXPOSURE?**

17 A. The Midwest ISO proposes to establish, with the assistance of its stakeholders,  
18 procedures by which it would estimate the potential exposure of a Participant for:

- 19 • FTR Auctions  
20 • FTR Portfolio  
21 • Real-Time Energy Market and Day-Ahead Energy Market Transactions

- 1           • Virtual Transactions
- 2           • Congestion and Losses
- 3           • Transmission Service

4 **Q. DOES THE MIDWEST ISO PROPOSE TO “NET” OR OFFSET AMOUNTS DUE**  
5 **THE PARTICIPANT AGAINST AMOUNTS DUE FROM PARTICIPANTS FOR**  
6 **THIS PURPOSE?**

7 A. Yes, if the Midwest ISO is able to obtain a security interest in the amounts due the  
8 Participant from the Midwest ISO. We refer to these Participants as Category A  
9 customers. All charges and all credits both within and across each service category  
10 would be netted for credit purposes.

11           For Category B customers, those Participants who do not give the Midwest ISO a  
12 security interest in the amounts due to the Participant from the Midwest ISO, the  
13 Midwest ISO proposes to net amounts due to the Participant within each of the following  
14 categories:

- 15           • FTR Portfolio
- 16           • Physical Energy
- 17           • Day-Ahead and Real-Time Transactions
- 18           • Virtual Transactions
- 19           • FTR Auctions

20           However, a positive balance in one of the above categories would not be offset  
21 against an amount that the Participant would owe in another category. We adopted this

**M. P. Holstein**

1 position because of concerns that we and our stakeholders have concerning the  
2 application of bankruptcy and creditors rights law in the event of a Participant's  
3 insolvency.

4 **Q. WHAT WERE THE ITEMS CONSIDERED BY THE MIDWEST ISO WHEN**  
5 **DEVELOPING THE NETTING PROVISIONS OF THIS POLICY?**

6 A. The Midwest ISO considered the impact of a bankruptcy by the Participant, the potential  
7 rights of a holder of a security interest in accounts receivable, and other creditors' rights  
8 matters.

9 The Midwest ISO also considered that, ultimately, Market Participants bear the  
10 relevant risks. If netting is not incorporated into the calculation of potential exposure, the  
11 Participants will have to provide greater amounts of financial assurance. If netting is  
12 incorporated into the calculation but is not permitted in a bankruptcy proceeding  
13 involving a Participant, the uncollectible amounts will be uplifted to the other  
14 Participants in the market.

15 **Q. WOULD YOU BRIEFLY DESCRIBE THOSE CONSIDERATIONS?**

16 A. The United States bankruptcy law permits a creditor to set off amounts due the debtor  
17 against amounts due to the creditor if the claims are "mutual." For claims to be "mutual"  
18 they must be:

- 19 • between the same parties;
- 20 • owed in the same capacity; and
- 21 • in the same right.

1 In addition to set off, the bankruptcy law permits a creditor to utilize a similar  
2 concept of recoupment when obligations arise out of a single transaction. The application  
3 of both set off and recoupment to the amounts due in the Energy Markets is unclear for a  
4 number of reasons related to the capacity in which the Midwest ISO collects and remits  
5 the various funds.

6 If set off or recoupment is not permitted, then the creditor will be required to pay  
7 the amount due the debtor in accordance with the terms of the transaction and participate  
8 with the other creditors in collecting from the debtor. Thus, there is a meaningful risk  
9 that a collateral requirement based on the net fees owed would not be sufficient if the  
10 Midwest ISO relied on set off or recoupment.

11 If another creditor has a perfected security interest in the Participant's account  
12 receivable, this security interest could take precedence over any right of set off or  
13 recoupment that the Midwest ISO has, depending on how the receivable is defined and  
14 when it is held to arise.

15 **Q. DID YOU SEEK LEGAL ADVICE ON THIS ISSUE?**

16 A. Yes.

17 **Q. WHAT WERE YOU ADVISED?**

18 A. The law on when set off and recoupment are permitted is not settled and there is a  
19 possibility that no netting will be allowed. If netting is not permitted, a collateral  
20 requirement based on net fees will not provide sufficient collateral.

21 The law is also unsettled on when and how netting will be allowed where another  
22 creditor holds a security interest in accounts receivable. If a court determines that a

**M. P. Holstein**

1 secured creditor is permitted to assert its claim to the amount which the Midwest ISO  
2 owes the insolvent Participant without giving effect to the amount due from the  
3 Participant, then a collateral requirement based on the net fees owed would not be  
4 sufficient to protect the Midwest ISO and its Participants against the insolvency of  
5 Participants.

6 We were advised that the safest course of action was to not incorporate netting  
7 into potential exposure calculations. However, counsel acknowledged that stakeholders  
8 had expressed that a policy of no netting would be unacceptable, that Participants  
9 ultimately bear the risks if netting is not permitted, and that the Commission had  
10 expressed a preference for netting.

11 Counsel expressed that the requirements for either setoff or recoupment are likely  
12 met in the case of physical Energy fees for purchases and sales of physical Energy,  
13 Virtual Energy fees in the case of purchases and sales of Virtual Energy, in the case of  
14 congestion costs and losses and in the case of FTR fees for obligations in connection with  
15 FTRs held, all of which may be positive or negative. Counsel further expressed that it is  
16 more likely, but not certain, that netting would be respected as against a secured creditor  
17 in the case of these fees. Counsel was not confident that either set off or recoupment  
18 would permit the Midwest ISO to net physical Energy fees, Virtual Energy fees,  
19 congestion costs and losses or FTR fees against each other or against the other fees. It is  
20 also less likely that netting of these fees against each other or against the other fees would  
21 be permitted where a secured credit is involved.

1 **Q. HAS THE MIDWEST ISO CONSIDERED OPTIONS THAT WOULD PERMIT**  
2 **PARTICIPANTS TO NET ACROSS BUCKETS?**

3 A. Yes.

4 **Q. WHAT ARE THOSE?**

5 A. The primary option is for the Participant to grant a security interest to the Midwest ISO in  
6 the amounts due to the Participant from the Midwest ISO. The Midwest ISO could then  
7 exercise its rights in the collateral in the event of a default by the Participant, even if  
8 recoupment or setoff would not otherwise be permitted. The practical exposure for the  
9 Midwest ISO if the Midwest ISO has a first priority security interest in the amounts due  
10 to the Participant is significantly similar to the Midwest ISO's exposure if it has  
11 enforceable rights of setoff and recoupment with respect to amounts payable to and by a  
12 Participant.

13 **Q. PLEASE DESCRIBE THE APPLICATION OF THE PROPOSED POLICY TO**  
14 **PARTICIPANTS.**

15 A. When a Participant completes its Credit Agreement, the Participant will have the option  
16 to grant a first priority security interest in the amounts due to the Participant from the  
17 Midwest ISO. As described earlier, the calculation of a Participant's potential exposure  
18 will vary based on whether the Participant elects to provide the security interest. The  
19 Midwest ISO will take appropriate actions to perfect security interests granted by the  
20 Participants, including conducting UCC searches and filing financial statements.

1 **Q. DOES THE MIDWEST ISO ANTICIPATE PROBLEMS WITH THE**  
2 **IMPLEMENTATION OF THE POLICY?**

3 A. The Midwest ISO anticipates that the grant of the proposed security interest will not  
4 significantly burden Participants. Some Participants may have to obtain the permission  
5 of lenders or the release of the proposed collateral from blanket security interests granted  
6 to lenders. However, we do not anticipate that lenders will view the requested waivers  
7 and releases as adversely impacting their credit protections in a significant manner. In  
8 general, lenders accommodate requests of this nature from their borrowers.

9 **Q. HOW DOES THE PROPOSED TARIFF ADDRESS NETTING ISSUES?**

10 A. The proposed Tariff addresses netting issues primarily through Section 7.6 and Section  
11 7.17 of the proposed Tariff. Section 7.6, regarding invoices for Market Activities,  
12 provides that a Participant will have no right to gross charges or credits for a billing  
13 period. This section explicitly provides for the issuance of net invoices.

14 Section 7.17 provides the Midwest ISO with rights to recoup and/or setoff  
15 amounts to be paid by the Midwest ISO to the Participant against amounts to be paid to  
16 the Midwest ISO by the Participant. Section 7.17 also explicitly provides for payment  
17 netting which would allow for the Midwest ISO to satisfy amounts to be paid to the  
18 Participant to the extent of amounts to be paid by the Participant through netting.

19 **VII. METHOD OF DETERMINING FINANCIAL EXPOSURE**

20 **Q. WILL THE METHOD OF DETERMINING FINANCIAL EXPOSURE FOR THE**  
21 **VARIOUS ELEMENTS BE A PART OF THE MIDWEST ISO TARIFF?**

22 A. No.

1 **Q. WHERE CAN PARTICIPANTS OBTAIN INFORMATION ABOUT HOW THE**  
2 **MIDWEST ISO PROPOSES TO DETERMINE THE FINANCIAL EXPOSURE**  
3 **FROM THE VARIOUS ELEMENTS OF THE ENERGY MARKETS?**

4 A. The calculations proposed for use to determine financial exposure from various elements  
5 of the Energy Markets will be included in the Business Practices Manuals. The Business  
6 Practices Manuals will be posted on the Midwest ISO's website.

7 **Q. WHY DOES THE MIDWEST ISO PROPOSE TO PUBLISH THE FINANCIAL**  
8 **EXPOSURE CALCULATION IN A BUSINESS PRACTICES MANUAL?**

9 A. The Credit Practices Task Force continues to consider formulas and/or methodologies to  
10 determine the financial exposures from the various elements of the Energy Markets. The  
11 Midwest ISO and its stakeholders desire to maintain discretion and flexibility with  
12 respect to the formulas and methodology. The Midwest ISO anticipates that the  
13 calculations and methodology will evolve as the Midwest ISO and the Participants gain  
14 experience with the Energy Markets.

15 **Q. HOW WILL THE BASIC METHOD FOR DETERMINING FINANCIAL**  
16 **EXPOSURE DIFFER WITH RESPECT TO FTR AUCTIONS AND VIRTUAL**  
17 **TRANSACTIONS?**

18 A. With respect to exposure in the FTR Auctions, the Participant will provide an estimate of  
19 its exposure and will be required to allocate a portion of its Total Credit Limit to FTR  
20 Auctions to completely cover that exposure. The Participant's FTR Bids and FTR Offers  
21 in the FTR Auction will be monitored, and the Midwest ISO will reject FTR Bids that are  
22 expected to result in the Participant's FTR Auction exposure exceeding its allocation.

1 With respect to Virtual Transactions, the Participant will request a megawatt hour limit  
2 for its Virtual Transactions. The Midwest ISO will monitor Virtual Bids and Virtual  
3 Supply Offers to purchase Virtual Energy and reject Virtual Bids or Virtual Supply  
4 Offers by a Participant that would result in a violation of its megawatt hour limit.

5 **Q. WHAT BILLING CYCLE DOES THE MIDWEST ISO PROPOSE TO USE FOR**  
6 **THE ENERGY MARKETS?**

7 A. The Midwest ISO proposes to bill Participants on a weekly basis.

8 **Q. HOW OFTEN DOES THE MIDWEST ISO PROPOSE TO CALCULATE OR**  
9 **SETTLE ENERGY MARKET TRANSACTIONS?**

10 A. Initially, preliminary settlements will be calculated on the Business Day following the  
11 Operating Day on which the transaction occurred. The amounts obtained from these  
12 preliminary settlements will be used to update the participant's financial exposures.

### 13 **VIII. DEFAULT AND REMEDIES**

14 **Q. DOES THE PROPOSED TARIFF DIFFER FROM THE PJM TARIFF AS TO**  
15 **DEFAULTS AND REMEDIES?**

16 A. Yes.

17 **Q. WOULD YOU DESCRIBE THE MORE IMPORTANT DIFFERENCES AND**  
18 **THE RATIONALE FOR THOSE DIFFERENCES?**

19 A. PJM did not place its core energy market default and remedy provisions in the body of  
20 the PJM Tariff. Instead, PJM located these provisions in its Credit Policy and Operating  
21 Agreement. Participants in the PJM energy markets are required to sign the PJM

1 Operating Agreement. The Midwest ISO wanted to present the default and remedy  
2 provisions applicable to its Energy Markets in a clearer and more transparent manner.  
3 Therefore, the Midwest ISO added default and remedy provisions to Section 7 of its  
4 proposed Tariff.

5 The vast majority of the Midwest ISO default and remedy provisions have a  
6 counterpart in the PJM Tariff, Operating Agreement, Credit Policy and/or Credit  
7 Agreement. Both the Midwest ISO Tariff and the PJM documents address payment  
8 defaults and breaches of other energy market and tariff related obligations. The PJM  
9 documents and the Midwest ISO Tariff allow for the suspension of participation in  
10 various Market Activities upon the occurrence of certain defaults and for exercise against  
11 the Participant's security. Both the PJM Operating Agreement and the Midwest ISO  
12 Tariff provide that the listed remedies are not exclusive, require Participants to pay the  
13 costs of enforcement, including attorneys' fees, and provide that a failure or delay to  
14 exercise any right or remedy does not act as a waiver.

15 Some of the PJM default and remedy sections may act as a partial cross default.  
16 However, the Midwest ISO wanted to clearly provide a cross default so that a default  
17 under any portion of the Tariff, Credit Policy, Market Participant Agreement or other  
18 agreements entered into in connection with the Tariff would be a default under all of  
19 them. The Tariff allows for a default of the Participant with respect to its transmission-  
20 related obligations to be considered a default of its Energy Market-related obligations,  
21 and vice versa. The Midwest ISO wanted to be able to act in the event of a default to  
22 prevent the other Participants and Transmission Owners from bearing the risks associated

1 with allowing a Participant who is not in good standing with the Midwest ISO to continue  
2 incurring obligations in connection with Transmission Service or Market Activities.

3 The Midwest ISO Tariff includes bankruptcy-related actions as defaults. The  
4 PJM tariff does not include an explicit bankruptcy-related default. The PJM Tariff and  
5 PJM Operating Agreement include a general default for failure to comply with  
6 “creditworthiness requirements” that may well be a trigger in the event of a bankruptcy-  
7 related action.

8 The Midwest ISO has also included a provision that allows the Midwest ISO to  
9 close out FTRs in the event of a default. Entities must be Market Participants to hold  
10 FTRs and should not be permitted to retain FTRs in the event that their status as Market  
11 Participants terminates. The closeout provision allows the Midwest ISO to financially  
12 settle with FTR Holders upon termination for a default.

13 The Midwest ISO’s FTRs may be regarded as swaps, and the Midwest ISO has  
14 included the bankruptcy-related default and the closeout provision to enhance the  
15 likelihood that the Midwest ISO could take advantage of certain benefits afforded to  
16 swaps under the federal bankruptcy code.

17 **IX. UNCOLLECTIBLE AMOUNTS**

18 **Q. DOES THE PROPOSED TARIFF ADDRESS WHO BEARS THE FINANCIAL**  
19 **BURDEN FOR UNCOLLECTIBLE AMOUNTS OWED BY PARTICIPANTS?**

20 **A. Yes.**

1 **Q. DESCRIBE HOW THE MIDWEST ISO PROPOSES TO ADDRESS THE RISK**  
2 **OF UNCOLLECTIBLE AMOUNTS?**

3 A. The proposed Tariff provides for uncollectible amounts to be allocated to each Participant  
4 that had been invoiced by the Midwest ISO for Market Activities during the same billing  
5 period as the unpaid invoices of the Participant with uncollectible amounts. The absolute  
6 value of all charges and credits invoiced for Market Activities to Participants for the  
7 invoicing cycle associated with the uncollectible amount will be calculated for each  
8 Participant. A Participant's percentage share of the uncollectible amount will be based  
9 on the ratio of the absolute value of charges and credits of the participant for the  
10 invoicing cycle to the total of all such charges and credits for all Market Participants  
11 other than Market Participants with the uncollectible obligations.

12 **Q. WHEN WILL A PAST DUE AMOUNT BE CONSIDERED AN**  
13 **UNCOLLECTIBLE OBLIGATION AND UPLIFTED TO THE OTHER**  
14 **PARTICIPANTS?**

15 A. The Midwest ISO proposes to declare unpaid past due amounts to be uncollectible  
16 obligations after the Midwest ISO pursues all commercially reasonable efforts to collect  
17 the past due amounts.

18 **X. DISPUTED AMOUNTS**

19 **Q. HOW DOES THE MIDWEST ISO PROPOSE TO HANDLE DISPUTED**  
20 **AMOUNTS?**

21 A. The proposed Tariff requires Participants to pay all invoiced amounts regardless of  
22 whether the Participant disputes the amount owed. Payment of disputed amounts will not

1 waive the Participant's right to dispute invoiced amounts. The Midwest ISO intends to  
2 make appropriate adjustments to Participants' invoices to reflect the outcome of the  
3 dispute within a reasonable time after the dispute has been resolved.

4 **XI. HISTORY OF LATE PAYMENT**

5 **Q. DOES THE MIDWEST ISO PROPOSE TO IMPOSE ANY SPECIAL**  
6 **REQUIREMENTS ON PARTICIPANTS WHO HAVE A HISTORY OF LATE**  
7 **PAYMENT?**

8 A. Yes.

9 **Q. WOULD YOU PLEASE DESCRIBE THESE SPECIAL OBLIGATIONS?**

10 A. If a Participant fails to pay two invoices during a 12 month period by the invoice due  
11 date, the Midwest ISO proposes to require that the Participant post Financial Security in a  
12 form acceptable to the Midwest ISO. The amount of the Financial Security to be required  
13 will be based on the total invoiced charges to the Participant for the month with the  
14 highest total invoiced charges over the most recent twelve (12) month period. Past due  
15 amounts carried forward from prior invoices will not be included when determining the  
16 amount of Financial Security to be required. The Midwest ISO proposes to release the  
17 required Financial Security if the Participant makes all payments on time for six  
18 consecutive months.

19 After the return of the initial Financial Security, the Participant will be required to again  
20 post similar Financial Security if it again fails to pay on time. Once the Participant has  
21 been required to repost Financial Security due to failure to make timely payment, the

1 Financial Security will be returned only if the Participant makes all payments on time  
2 over a 12 month consecutive period.

3 **Q. HOW WILL THE MIDWEST ISO USE FINANCIAL SECURITY POSTED DUE**  
4 **TO A HISTORY OF LATE PAYMENT?**

5 A. The Midwest ISO will draw upon the Financial Security posted due to a history of late  
6 payment to cover any invoice not paid on the first Business Day after the payment due  
7 date. The Participant will be required to replenish the Financial Security.

8 **Q. WILL THE FINANCIAL SECURITY REQUIRED DUE TO A HISTORY OF**  
9 **LATE PAYMENT REPLACE ANY OTHER FINANCIAL SECURITY POSTED**  
10 **BY THE PARTICIPANT?**

11 A. No.

12 **XII. MAJOR POLICY ISSUES FOR COMMISSION CONSIDERATION**

13 **Q. IN YOUR OPINION, WHAT ARE THE MAJOR POLICY ISSUES FOR**  
14 **COMMISSION CONSIDERATION REFLECTED IN THE PROPOSED**  
15 **MIDWEST ISO CREDIT POLICY AND/OR SECTION 7 OF MODULE A OF**  
16 **THE TARIFF?**

17 A. There are four major policy issues for Commission consideration in the proposed  
18 Midwest ISO Credit Policy (“Day 2 Credit Policy”) and Section 7 of Module A of the  
19 Tariff. These policy issues are:

20 (1) Weekly invoicing for all Market Activity,

21 (2) Uplift of Uncollectible Amounts to Market Participants,

1 (3) Maximum of \$50 million in Unsecured Credit extended to any one legal entity,  
2 and

3 (4) Limitations on netting credits against charges absent a security interest in  
4 Midwest ISO receivables due to U.S. Bankruptcy Code provisions.<sup>2</sup>

5 **Q. ARE THERE ANY OTHER IMPORTANT POLICY CONSIDERATIONS**  
6 **RELATIVE TO THE PROPOSED MIDWEST ISO CREDIT POLICY?**

7 A. Yes. The current Midwest ISO Credit Policy (“Day 1 Credit Policy”) contains a  
8 provision that states that a Participant who has one or more unsecured, senior long-term  
9 debt ratings or Issuer Ratings below investment grade by any Rating Agency is not  
10 eligible for an Unsecured Credit Allowance. Further, in the event a Participant with an  
11 Unsecured Credit Allowance has an unsecured, senior debt rating or Issuer Rating  
12 downgraded to below investment grade by any single Rating Agency they shall have their  
13 Unsecured Credit Allowance promptly revoked by the Midwest ISO. A stakeholder  
14 group, the Credit Practices Task Force, has requested that Midwest ISO remove this  
15 provision. The request was made in the form of a formal vote by electronic ballot with  
16 the result of the vote being 19 Members in favor of eliminating this provision and 10  
17 Members opposed to eliminating this provision.

18 **Q. WHAT IS THE STATED REASON FOR REQUESTING THE ELIMINATION OF**  
19 **THIS “ELIGIBILITY FOR UNSECURED CREDIT” PROVISION?**

20 A. The argument for eliminating this “eligibility for unsecured credit” provision is that  
21 Midwest ISO does score and, if warranted based on such score, extend Unsecured Credit

---

<sup>2</sup> 11 U.S.C. §§ 101-1330 (2000).

1 to entities that do not have unsecured, senior long-term debt ratings or Issuer Ratings  
2 (“Unrated Entities”). As such, Midwest ISO should also score and, if warranted based on  
3 such score, extend Unsecured Credit to entities with below investment grade unsecured,  
4 senior long-term debt ratings or Issuer Ratings. Proponents of changing the Day 2 Credit  
5 Policy argue that to do otherwise is to unduly discriminate against entities that go to the  
6 trouble and expense of obtaining a debt or Issuer Rating and in favor of Unrated Entities.

7 **Q. WHAT IS MIDWEST ISO’S POSITION ON THIS POLICY DEBATE?**

8 A. Midwest ISO filed its proposed Day 2 Credit Policy with the “eligibility for unsecured  
9 credit” provision removed. Midwest ISO’s reasons for doing so are as follows:

10 (1) The stakeholder vote recommending a policy change was almost 2:1 in

11 favor of a change,

12 (2) PJM’s credit policy does not have such a provision, and

13 (3) Modifications to the Rating Agency score component of the Midwest

14 ISO’s credit scoring model can and will be made to reflect the

15 elimination of this provision given that this component of the model was

16 designed with the provision in place.

17 **Q. WILL STAKEHOLDERS BE INVOLVED IN MAKING CHANGES TO THE**  
18 **MIDWEST ISO’S CREDIT SCORING MODEL IN ORDER TO**  
19 **ACCOMMODATE THIS CHANGE TO ITS CURRENT POLICY?**

20 A. Yes. The Credit Practices Task Force will be the principal forum for obtaining  
21 stakeholder input on modifying its credit scoring model and Credit Policy as needed both  
22 in the near term to accommodate this change and in the long term as circumstances

**M. P. Holstein**

1 warrant in this evolving industry. At the end of the day, the Midwest ISO's Credit Policy  
2 operates to protect the financial interest of all Market Participants more so than its own  
3 financial interests. As such, the Midwest ISO is supportive of on-going stakeholder input  
4 on its Credit Policy.

5 **XIII. STAKEHOLDER INPUT TO FOUR MAJOR POLICY ISSUES**

6 **Q. PLEASE DESCRIBE THE PROCESS AND STAKEHOLDER INPUT RECEIVED**  
7 **BY THE MIDWEST ISO RELATED TO THE FOUR MAJOR POLICY ISSUES**  
8 **LISTED IN YOUR TESTIMONY.**

9 A. The four major policy issues previously listed in my testimony are all inter-related. Two  
10 separate task force level stakeholder groups were involved in developing policy  
11 recommendations on these four issues – the Credit Practices Task Force (“CPTF”) and  
12 the Market Settlements Task Force (“MSTF”). The CPTF began evaluating credit policy  
13 issues related to: (1) weekly versus monthly invoicing, (2) netting of credits against  
14 charges for Market Services and (3) uplift of default and shortfall payments on February  
15 11, 2003. The discussion at the March 13, 2003, CPTF meeting included a comparison  
16 of the uplift of default methodologies of the various ISOs/RTOs. As noted at that  
17 meeting, all ISOs/RTOs other than the California ISO uplift default amounts to their  
18 market participants. Only the California ISO short pays market participants who are  
19 owed funds by the market as its means of addressing default on payments owed. The  
20 discussion at this meeting of the CPTF also addressed the business practices of the New  
21 York Mercantile Exchange.

1 **Q. DOES NYMEX EXTEND UNSECURED CREDIT TO ITS MARKET**  
2 **PARTICIPANTS?**

3 A. No. In effect, every market participant is required to maintain cash collateral sufficient to  
4 cover all open positions and all transactions at all times. To minimize the amount of cash  
5 collateral involved NYMEX settles all transactions and adjust all positions for changes in  
6 market prices daily. Funds are then withdrawn from or paid to market participant bank  
7 accounts each business day based on that day's trading activity and market price changes.

8 **Q. PLEASE CONTINUE TO DESCRIBE THE PROCESS AND STAKEHOLDER**  
9 **INPUT RECEIVED BY THE MIDWEST ISO RELATED TO THE FOUR MAJOR**  
10 **POLICY ISSUES LISTED IN YOUR TESTIMONY.**

11 A. During the first quarter of 2003, the MSTF was also discussing the issue of weekly versus  
12 monthly invoicing and related matters. As such, the next CPTF meeting was held on  
13 March 25, 2003, immediately following the MSTF meeting held that same day to  
14 encourage MSTF members to participate in the CPTF meeting. The issue of whether to  
15 cap the amount of Unsecured Credit extended to any single legal entity was introduced at  
16 this meeting of the CPTF.

17 On April 22, 2003, the CPTF reviewed a side-by-side comparison of the different  
18 ISO/RTO credit policies prepared by a representative of Mirant. This review revealed  
19 that ISO NE and NYISO cap the maximum amount of unsecured credit extended to any  
20 single legal entity at \$125 million or stated percentage of the amount due from all Market  
21 Participants. NYISO's use of a line of credit as a working capital fund to guarantee  
22 prompt payment to all Market Participants was discussed at this meeting. The Midwest  
23 ISO next presented a comparison of the potential exposure to non-payment for a weekly

**M. P. Holstein**

1 versus a monthly invoice cycle as a function of: (a) size of Market Participant (e.g., Load  
2 in MWh), (b) amount of market activity (percent of Load), and (c) market price. In  
3 general, the dollar exposure to non-payment increased by a factor of 2.5 for the monthly  
4 invoicing period, all other factors being equal.

5 **Q. WAS THE MSTF CONTINUING TO DISCUSS WEEKLY VERSUS MONTHLY**  
6 **BILLING AND OTHER CREDIT-RELATED ISSUES DURING THE SECOND**  
7 **QUARTER OF 2003?**

8 A. Yes. In fact, a joint MSTF-CPTF task force was established to evaluate and make a  
9 recommendation to the now defunct Policy Subcommittee on the following four issues:  
10 (1) weekly versus monthly invoicing, (2) whether or not to uplift default amounts and if  
11 yes, by what methodology, (3) number of Business Days before declaring a default  
12 existed for non-payment, and (4) number of days following invoice date that payment  
13 would be due. The recommendations of the joint MSTF-CPTF task force on these four  
14 issues were: (1) weekly invoicing, (2) uplift default using absolute value of net invoice,  
15 (3) one Business Day to cure non-payment, and (4) payment due seven days after invoice  
16 date. These recommendations were presented to the CPTF at its July 8, 2003 meeting.  
17 The CPTF members were then asked to vote via e-mail on these four issues with the  
18 votes due the next day in order for the results to be presented to the Policy Subcommittee  
19 at its July meeting.

1 **Q. DID THE NOW DEFUNCT POLICY SUBCOMMITTEE TAKE ACTION ON**  
2 **THE RECOMMENDATIONS OF THE JOINT MSTF-CPTF TASK FORCE**  
3 **RECOMMENDATIONS AT ITS JULY 2003 MEETING?**

4 A. Yes. The Policy Subcommittee received reports from the MSTF, CPTF and the joint  
5 MSTF-CPTF task force representatives on the votes of their respective committees. The  
6 Policy Subcommittee then took its own vote on these four issues with the results being:  
7 (1) monthly invoicing [17 for monthly, 15 opposed to monthly, 16 abstained]; (2) no  
8 uplift of default amounts [15 for no uplift, 14 against no uplift, and 16 abstained]; (3)  
9 three Business Days to cure non-payment before declaring a default [14 for, 12 against  
10 with all votes against preferring less than three days]; and (4) payment due seven days  
11 after invoice date [24 for and 4 opposed].

12 **Q. WHAT DID MIDWEST ISO DO WITH THE STAKEHOLDER INPUT ON**  
13 **THESE FOUR ISSUES?**

14 A. On the issues of weekly versus monthly billing and whether or not to uplift default  
15 amounts the Midwest ISO the Policy Subcommittee vote was essentially one third for,  
16 one third against and one third abstained. The Midwest ISO prepared a position paper for  
17 discussion with the Markets Committee of the Board of Directors. A copy of the position  
18 paper is provided as Exhibit No. \_\_\_\_ (MPH-2). For the reasons stated in the position  
19 paper the Midwest ISO elected to adopt the policy of weekly invoicing and uplift of  
20 default amounts.

1 **Q. DID THE MIDWEST ISO COMMUNICATE THESE POLICY DECISIONS TO**  
2 **ITS STAKEHOLDERS?**

3 A. Yes. The decision to invoice weekly and uplift default amounts was communicated in  
4 writing to all stakeholders on the Advisory Committee e-mail distribution list.

5 **Q. WAS THE ADVISORY COMMITTEE CONSULTED ON THE**  
6 **METHODOLOGY FOR UPLIFTING DEFAULT AMOUNTS?**

7 A. Yes. The Midwest ISO provided Advisory Committee members with two options for  
8 uplifting default amounts: (1) Load Ratio Share, and (2) gross dollar volume of market  
9 activity. The Advisory Committee voted on this issue at its September 17, 2003,  
10 meeting. The outcome was ten (10) votes for the gross dollar volume of market activity  
11 methodology, five (5) votes for the Load Ratio Share methodology and seven (7)  
12 abstentions. The uplift of default amount methodology in the proposed Day 2 Credit  
13 Policy is the gross dollar volume of market activity preferred by the Advisory Committee  
14 by a vote of 2:1.

15 **Q. WHAT DID MIDWEST ISO DO WITH THE STAKEHOLDER INPUT ON THE**  
16 **OTHER TWO ISSUES?**

17 A. The Tariff as filed reflects the vote to have payment due seven (7) days after invoice  
18 date. The Credit Policy, based on additional feedback from a March 3, 2004, meeting of  
19 the CPTF, provides for a two (2) day cure period prior to declaring a default.

20 **Q. YOUR TESTIMONY TO THIS POINT DISCUSSES THE STAKEHOLDER**  
21 **INPUT ON TWO OF THE FOUR MAJOR POLICY ISSUES PREVIOUSLY**  
22 **IDENTIFIED IN YOUR TESTIMONY. PLEASE DESCRIBE THE**

1           **STAKEHOLDER INPUT ON THE OTHER TWO ISSUES -- \$50 MILLION CAP**  
2           **ON UNSECURED CREDIT AND LIMITATIONS ON NETTING OF CREDITS**  
3           **AND CHARGES.**

4    A.    Beginning with the August 14, 2003, meeting of the CPTF the Midwest ISO initiated a  
5           stakeholder process to address these two major policy issues. This was done through the  
6           use of a “straw man” credit policy patterned after the NYISO’s credit policy. The  
7           minutes of the August 14, 2003 CPTF meeting reflect the following four discussion items  
8           related to the “straw man” policy: (1) no netting of FTR revenue against Energy Market  
9           charges for collateral requirement purposes due to U.S. Bankruptcy Code issues; (2)  
10          requiring fully collateralized positions for all Virtual Market transactions; (3) requiring  
11          fully collateralized positions for FTR Auctions; and (4) adoption of a market  
12          concentration cap of 5% as the maximum Unsecured Credit Limit for any one Market  
13          Participant.

14                 Further information on the U.S. Bankruptcy Code and the implications for netting  
15                 credits and charges associated with Market Activities was presented at the September 9,  
16                 2003, CPTF meeting by outside counsel retained by Midwest ISO to research this issue.  
17                 A vote of the CPTF by e-mail was taken on whether or not to require fully collateralized  
18                 positions for Virtual Transaction and FTR Auction activity as well as establishing a  
19                 market concentration cap/maximum Unsecured Credit Limit. The results of that vote,  
20                 essentially half for and half against the requirement to maintain fully collateralized  
21                 positions for Virtual Transactions and FTR Auctions, were presented to the Advisory  
22                 Committee at its October 15, 2003, meeting. The Advisory Committee itself then voted  
23                 on these three issues at its November 19, 2003, meeting.

1 **Q. WHAT WAS THE OUTCOME OF THE ADVISORY COMMITTEE VOTE ON**  
2 **ESTABLISHING A MAXIMUM UNSECURED CREDIT LIMIT?**

3 A. The Advisory Committee voted to permit Unsecured Credit for Virtual Transactions and  
4 FTR Auction activity, but to cap Unsecured Credit at \$50 million for any single legal  
5 entity. The vote was 14 “Yes”, 3 “No” and 2 “Abstain”. The “No” voters preferred a cap  
6 of \$100 million. The proposed Day 2 Credit Policy filed as part of the Midwest ISO  
7 Tariff reflects the outcome of this vote.

8 **Q. DID MIDWEST ISO HOLD ADDITIONAL STAKEHOLDER MEETINGS ON**  
9 **CREDIT ISSUES PRIOR TO FILING THE PROPOSED DAY 2 CREDIT**  
10 **POLICY AND DID THEY ADDRESS THE NETTING ISSUES?**

11 A. Yes. The results of the Advisory Committee vote were shared with the CPTF members at  
12 its December 16, 2003, meeting. Additional information was presented to the CPTF at  
13 that meeting on the issues related to netting credits and charges in light of U.S.  
14 Bankruptcy Code provisions. The Chair of the CPTF provided a written summary of  
15 these issues to the CPTF members that explained the risks associated with netting all  
16 credits and charges associated with Market Activities and in support of the  
17 recommendation of legal counsel not to net across categories of market services for credit  
18 purposes. This written summary is attached as Exhibit No. \_\_\_\_\_ (MPH-2). Outside  
19 counsel retained by Midwest ISO then presented an issues paper on cross default/cross  
20 collateralization to the CPTF at the December 16, 2003, meeting. The position paper  
21 presented the case for declaring a default under all agreements in the event of a default  
22 under any agreement, a position that is incorporated into the Midwest ISO Tariff and Day  
23 2 Credit Policy.

1           The CPTF next met on January 13, 2004, to review the initial draft of the Day 2  
2           Credit Policy. At that meeting Midwest ISO explained that the draft Credit Policy under  
3           review was largely based on the FERC-accepted PJM Credit Policy and demonstrated  
4           this fact by comparing the table of contents for the PJM Credit Policy to the draft Day 2  
5           Credit Policy. At that meeting the Midwest ISO also reviewed proposed  
6           changes/additions to Section 7 of what is now Module A of the Tariff. The changes  
7           reviewed included the provisions in Section 7 to implement the policy on uplift of default  
8           amounts and a requirement to provide Financial Security for customers with a history of  
9           late payments to the Midwest ISO. This latter requirement is in the current Day 1 Credit  
10          Policy.

11   **Q.    DID THE DRAFT CREDIT POLICY UNDER REVIEW BY THE CPTF IN**  
12   **JANUARY 2004 CONTAIN PROVISIONS RELATED TO NOT NETTING**  
13   **ACROSS CATEGORIES OF MARKET SERVICE?**

14   A.    Yes. Section II.G of the draft credit policy under review by the CPTF in January 2004  
15          contained the following draft language:

16                   For credit purposes, a Participant's Total Potential Exposure shall  
17                   be the sum of the **Net Service Charge** for each of the following  
18                   charge/credit types that have a net charge amount:

- 19                                   1) Transmission Charges/Credits;
- 20                                   2) FTR Charges/Credits;
- 21                                   3) Physical Energy Charges/Credits;
- 22                                   4) Day-Ahead and Virtual Market Charges/Credits; and
- 23                                   5) Congestion and Loss Charges/Credits.

24                                   

25                                   

26                   If the Net Service Charge amount for one of the above  
27                   charge/credit types is negative, meaning a credit is owed the  
28                   Participant, the amount of the credit shall be excluded from the  
29                   determination of the Total Potential Exposure. In determining the  
30                   amount of the Net Service Charge within one of the above

1 charge/credit types all credits due a Participant for a service within  
2 the category shall be included on the calculation.  
3

4 **Q. DID THE CPTF CONTINUE TO MEET AFTER JANUARY 13, 2004 MEETING?**

5 A. Yes. The CPTF met again on January 28, 2004, to discuss the draft Day 2 Credit Policy  
6 and to review information provided by Midwest ISO related to its credit scoring model.  
7 On February 3, 2004, and February 10, 2004, the CPTF met to review information related  
8 to the credit scoring model and responses provided by Midwest ISO to written comments  
9 on the draft Day 2 Credit Policy. At the February 10<sup>th</sup> meeting, a decision was made to  
10 conduct a day-long CPTF meeting on March 3, 2004, in order to finalize the Day 2 Credit  
11 Policy prior to filing it with FERC.

12 **Q. WAS A FORMAL VOTE EVER TAKEN ON THE ISSUE OF NOT NETTING**  
13 **CREDITS AND CHARGES ACROSS CATEGORIES OF MARKET SERVICE?**

14 A. No. With the exception of a small number of CPTF participants who expressed  
15 opposition either verbally or in writing, the CPTF as whole understood and accepted the  
16 reasons for the proposed policy of not netting across service categories. Further, the  
17 Midwest ISO subsequently modified the policy to differentiate between two categories of  
18 Market Participants – those that grant a security interest in Midwest ISO receivables to  
19 the Midwest ISO and those that don't. The ability to net all credits and charges for  
20 Market Services both within categories and across categories for credit purposes is made  
21 possible by the granting of a security interest that must be recognized under U.S.  
22 Bankruptcy Code. As such, only Market Participants that do not grant a security interest  
23 in Midwest ISO receivables will be affected by the proposed “no netting across market  
24 service categories” policy as filed.

**M. P. Holstein**

1 **Q. WHAT ARE THE RISKS TO ALL MARKET PARTICIPANTS IF THE**  
2 **COMMISSION DOES NOT ACCEPT THE PROPOSED “NO NETTING**  
3 **ACROSS MARKET SERVICE CATEGORIES” LANGUAGE FOR CATEGORY**  
4 **TWO PARTICIPANTS?**

5 A. Simply stated, the risk is that Midwest ISO may be required by a bankruptcy judge to  
6 make full payment on all Market Service credits owed to an entity that files for  
7 bankruptcy protection before any consideration is given to how much of the funds owed  
8 the Midwest ISO will be recovered in the bankruptcy proceeding. If this were to happen,  
9 then Midwest ISO would ultimately uplift to all other Market Participants as an  
10 uncollectible amount the credit amount owed to the entity in bankruptcy netted against  
11 Financial Security held by the Midwest ISO, if any. In other words, the Midwest ISO  
12 may hold insufficient Financial Security to make the required payment and be forced to  
13 uplift this amount to all other Market Participants per the uplift of default methodology in  
14 Section 7 of the Tariff. Absent an uplift of default provision, the Midwest ISO would  
15 short-pay all Market Participants owed funds by the entity in bankruptcy an amount  
16 sufficient to make the payment required under bankruptcy. Either way, the Market  
17 Participants would bear the economic cost associated with this risk occurring.

18 **Q. PLEASE SUMMARIZE WHAT ARE, IN YOUR OPINION, THE REASONS FOR**  
19 **ACCEPTING AS FILED THE FOUR MAJOR POLICY ISSUES DISCUSSED IN**  
20 **YOUR TESTIMONY.**

21 A. First, weekly invoicing reduces potential exposure to non-payment by twenty-one (21)  
22 days relative to monthly invoicing, thereby significantly reducing potential collateral  
23 requirements. Second, uplift of default amounts provides sellers certainty of payment,

**M. P. Holstein**

1 thereby increasing confidence in the market and encouraging participation which in turn  
2 increases liquidity, a key component of a successful market. Third, setting a limit of \$50  
3 million in Unsecured Credit helps minimize the impact of a default should it occur,  
4 thereby protecting all other Market Participants from a potentially much larger amount of  
5 uplift due to default. Fourth, not netting credits and charges across all types of Market  
6 Services for Category Two participants protects all other Market Participants from the  
7 risk of a potentially large uplift due to the impact of the provisions upon amounts that the  
8 Midwest ISO may owe a Market Participant that files bankruptcy under the U.S.  
9 Bankruptcy Code.

10 **Q. ARE THERE OTHER ASPECTS OF THE CREDIT POLICY AND ASSOCIATED**  
11 **FINANCIAL SECURITY AGREEMENTS YOU WISH TO HIGHLIGHT?**

12 A. Yes. I would like to highlight the following additional aspects of the proposed Day 2  
13 Credit Policy:

- 14 (1) Time required to modify the Virtual MWh Limit and associated Virtual  
15 Transactions Credit Limit;
- 16 (2) Number of days in the Virtual Transactions Estimated Exposure Window; and
- 17 (3) Requirement to replace a letter of credit 120 days prior to its expiration date.

18 **Q. HOW MUCH TIME IS REQUIRED TO MODIFY A PARTICIPANT'S VIRTUAL**  
19 **MWH LIMIT AND ASSOCIATED VIRTUAL TRANSACTIONS CREDIT LIMIT**  
20 **REQUIREMENT?**

21 A. As noted in Section III.A(3) of the Credit Policy, a request to increase or decrease a  
22 Participant's Virtual MWh Limit becomes effective two (2) Days after the date the new

1 Virtual MWh Limit is approved by Midwest ISO. If the request is to increase the limit,  
2 then the associated increase in the Virtual MWh Credit Requirement also becomes  
3 effective two (2) Days after the date the new Virtual MWh Limit is approved by Midwest  
4 ISO. However, if the request is to decrease the limit, then the associated decrease in the  
5 Virtual MWh Credit Requirement does not become effective until nine (9) Calendar Days  
6 after the date the new Virtual MWh Limit is approved by Midwest ISO.

7 **Q. PLEASE EXPLAIN WHY IT TAKES TWO DAYS FOR AN INCREASE TO THE**  
8 **VIRTUAL TRANSACTIONS CREDIT REQUIREMENT TO BECOME**  
9 **EFFECTIVE BUT TAKES NINE DAYS FOR A DECREASE TO BECOME**  
10 **EFFECTIVE, GIVEN A REQUEST TO DECREASE A PARTICIPANT'S**  
11 **VIRTUAL MWH LIMIT MAY ALSO BE ACCOMPANIED BY A REQUEST TO**  
12 **RETURN COLLATERAL HELD BY MIDWEST ISO?**

13 A. An increase in a Participant's Virtual MWh Limit and Virtual Transactions Credit  
14 Requirement becomes effective two (2) calendar days after the new Virtual MWh Limit  
15 is approved by Midwest ISO, assuming that the request is received by the 4:00 PM  
16 deadline, due to the time it takes to complete the following actions and process the  
17 associated information:

- 18 1. Midwest ISO receives request to increase a Participant's Virtual MWh Limit by  
19 4:00 PM deadline of Day 1.
- 20 2. Midwest ISO approves the increase of the Virtual MWh Limit on Day 1 and  
21 enters the change into the Credit Management System by 8:00 PM on Day 1.

- 1           3.       The Credit Management System sends the changes via batch file to the Day-  
2                   Ahead/Real-Time (“DART”) System during the overnight (which brings us into  
3                   the following Operating Day that begins at midnight).
- 4           4.       The DART System receives the change on Day 2. The change becomes effective  
5                   at the point where the clock turns midnight, which is the start of next operating  
6                   day, or Day 3.
- 7           5.       As such, the increase goes into effect two (2) calendar days after Midwest ISO  
8                   approves the new Virtual MWh Limit.

9                   By contrast, a decrease in a Participant’s Virtual Transactions Credit Requirement  
10                  becomes effective nine (9) calendar days after the reduced Virtual MWh Limit is  
11                  approved by Midwest ISO, assuming that the request is received by the 4:00 PM  
12                  deadline, due to the time it takes to complete the following actions and process the  
13                  associated information:

- 14           1.       MIDWEST ISO receives request to decrease a Participant’s Virtual MWh Limit  
15                   by 4:00 PM deadline on Day 1.
- 16           2.       MIDWEST ISO approves the decrease of the Virtual MWh Limit on Day 1 and  
17                   enters the change into the Credit Management System by 8:00 PM on Day 1.
- 18           3.       The Credit Management System sends the change via batch file to the Day-  
19                   Ahead/Real-Time (DART) System during the overnight (which brings us into the  
20                   following Operating Day that begins at midnight).
- 21           4.       The DART System receives the change on Day 2.

1           5.     Day 2 becomes the last day the Participant can submit Bids under the previously  
2                     approved, higher Virtual MWh Limit.

3           6.     At midnight on Day 2, which is the start of Day 3, the Virtual MWh Limit  
4                     decrease becomes effective in the DART system. However, on Day 2, the  
5                     Participant could still submit Bids and Offers at the previously approved, higher  
6                     limit for up to six (6) operating days beyond the current Operating Day, creating  
7                     an exposure to non-payment window of seven (7) Operating Days. Therefore,  
8                     Day 9 is the last Operating Day where Bids and Offers can be submitted at the  
9                     previously approved, higher Virtual MWh Limit.

10          7.     As such, the requested decrease in the Virtual Transactions Credit Requirement  
11                     does not become effective until nine (9) calendar days after the date the requested  
12                     decrease in the limit is approved by the Midwest ISO.

13                     In short, the ability to submit Bids and Offers for the current Operating Day plus  
14                     the next six Operating Days creates an exposure to non-payment window of seven days.  
15                     This seven day exposure window, plus the two days to process the change within the  
16                     Midwest ISO's information systems for a total of nine days of exposure, must be covered  
17                     by maintaining the Virtual Transactions Credit Requirement in the amount needed to  
18                     support the previously approved, higher Virtual MWh Limit.

1 **Q. PLEASE EXPLAIN WHY THERE ARE SIX (6) DAYS IN THE VIRTUAL**  
2 **TRANSACTIONS EXPOSURE WINDOW COMPONENT OF THE VIRTUAL**  
3 **TRANSACTIONS CREDIT REQUIREMENT.**

4 A. As explained in the response to the question above, a Participant may submit Bids and/or  
5 Offers for the current Operating Day plus the next six Operating Days. The Midwest ISO  
6 will not know how many of these Bids and/or Offers are accepted until the close of each  
7 bidding window. As such, for credit purposes, the Midwest ISO must assume that all of  
8 the Bids and/or Offers will be accepted, thereby creating exposure to non-payment for six  
9 (6) days into the future that must be covered by the amount of the Virtual Transactions  
10 Credit Requirement as defined in Section III.A(1) of the Credit Policy.

11 **Q. PLEASE EXPLAIN WHY A PARTICIPANT IS REQUIRED TO REPLACE AN**  
12 **EXISTING LETTER OF CREDIT 120 DAYS IN ADVANCE OF THE**  
13 **EXPIRATION DATE.**

14 A. The reason the letter of credit must be replaced 120 days in advance of its expiration date  
15 is the amount of time the Midwest ISO is exposed to non-payment for Transmission  
16 Service under Module A of the Tariff. As noted in the affidavit of Midwest ISO witness  
17 Michael Mackles in the Midwest ISO's filing in Docket No. ER02-2541-000<sup>3</sup>, the  
18 number of days the Midwest ISO was exposed to non-payment for Transmission Service  
19 was one hundred fifty (150) days at the time of that filing (*see Id.* Exhibit No.\_\_(MISO-  
20 4) in that docket for timeline to support the exposure window of 150 days). The Midwest  
21 ISO proposed a number of changes to reduce the exposure window, some of which the

---

<sup>3</sup> *Midwest Independent Transmission System Operator, Inc.*, "Proposed Revisions to the Midwest ISO's Open Access Transmission Tariff, FERC Electric Tariff, Second Revised Volume No. 1," Affidavit of Michael Mackles, Docket No. ER02-2541-000, (September 5, 2002).

1 Commission accepted and some of which the Commission did not. The current exposure  
2 to non-payment window for Transmission Service is one hundred twenty days (120 days)  
3 made up of the following time periods:

- 4 1. Invoice issued on 5<sup>th</sup> Business Day of the month following the month service was  
5 taken (accumulated approximately 35 days of exposure to non-payment at this  
6 point based on 30 days of service taken but not paid for plus 5 days to issue  
7 invoice);
- 8 2. Invoice due fifteen (15) days later (accumulated approximately 50 days of  
9 exposure to non-payment at this point);
- 10 3. Cure period for non-payment is ten (10) days from receipt of written notification  
11 (accumulated approximately 60 days of exposure to non-payment at this point);  
12 and
- 13 4. File with Commission to terminate service with Commission action up to sixty  
14 (60) days after the filing to terminate service is made (accumulated approximately  
15 120 days of exposure to non-payment by the end of the 60 day period for the  
16 Commission to act on the request to terminate service).

17 A Participant's letter of credit must be renewed 120 days in advance of the  
18 expiration date in order to maintain adequate protection against non-payment for the 120  
19 day period the Midwest ISO is exposed to non-payment for transmission service.

1 **Q. ARE THERE ANY ASPECTS OF SECTION 7 OF MODULE A OF THE TARIFF**  
2 **YOU WISH TO DISCUSS?**

3 A. Yes. I would like to discuss Section 7.10 – Financial Security Required Due to History  
4 of Late Payment.

5 **Q. PLEASE DESCRIBE THE REASONS FOR THE FINANCIAL SECURITY**  
6 **REQUIREMENT AS DEFINED IN SECTION 7.10 AND THE STAKEHOLDER**  
7 **PROCESS FOLLOWED PRIOR TO ITS IMPLEMENTATION AS PART OF**  
8 **THE CURRENT MIDWEST ISO CREDIT POLICY.**

9 A. The transmission-owning members of the Midwest ISO include a number of  
10 transmission-only companies, including American Transmission Company, GridAmerica  
11 LLC, International Transmission Company and Michigan Electric Transmission  
12 Company. The Load served by these transmission-only companies is more than fifty  
13 percent (50%) of the total Load served by transmission assets under the functional control  
14 of the Midwest ISO. Virtually all of the revenue these transmission-only companies  
15 generate is from the sale of transmission service and the vast majority of that revenue is  
16 from large network integration service customers. As such, late payment from a  
17 transmission-only company's single largest revenue source can have severe, adverse  
18 financial consequences for the company.

1 **Q. WHY IS INTEREST ASSESSED FOR LATE PAYMENTS AT THE RATE**  
2 **SPECIFIED IN 18 C.F.R. § 35.19A(A)(2)(III)(2003) NOT AN ADEQUATE**  
3 **RESPONSE?**

4 A. The cost associated with a late payment fee to a large customer is quite small when  
5 measured relative to the customer's overall operating expenses. Further, the cost is offset  
6 by interest earned on the funds that remain in the late paying customer's bank account.  
7 On the other hand, the cost to the transmission-only company can be quite severe. As  
8 such, the outcome is disproportionate.

9 **Q. ARE THE PROVISIONS OF SECTION 7.10 PART OF THE MIDWEST ISO'S**  
10 **CURRENT CREDIT POLICY?**

11 A. Yes. The provisions of Section 7.10 of the proposed Day 2 Credit Policy were added to  
12 Version 2.8 of the Midwest ISO's Credit Policy effective June 23, 2003.

13 **Q. WHAT STAKEHOLDER PROCESS WAS FOLLOWED PRIOR TO**  
14 **INCORPORATING THE FINANCIAL SECURITY REQUIREMENT FOR**  
15 **HISTORY OF LATE PAYMENT INTO THE CURRENT MISO CREDIT**  
16 **POLICY?**

17 A. The Credit Practices Task Force met on June 10, 2003. One of the agenda items for that  
18 meeting was a proposal to require Financial Security from any customer with a history of  
19 late payment. The proposal was discussed and voted on by the CPTF. The vote to  
20 require financial security for a history of late payment was unanimous. Based on the vote  
21 the Midwest ISO amended its Credit Policy to include the same provisions as in Section  
22 7.10 of the proposed Day 2 Credit Policy.

1 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

2 A. Yes.



## **Credit Policy and Related Business Practice Issues**

**August 2003**

### **Key Decisions to be Made**

1. Default – uplift unpaid amount to Market Participants, Yes or No?
2. Invoice period – Monthly? Weekly? Daily?

### **Background – Commercial Matters**

The Market Rules filed with the Commission state that the Midwest ISO will only distribute funds to market participants to the extent it receives funds due from market participants. Absent a change to the Market Rules, the Midwest ISO will “short pay” all market participants due funds in a given invoice period by a pro rata amount of any funds not received during the invoice period.

All ISOs and RTOs other than California ISO have a policy of “uplifting” partial payments and non-payments in order to ensure that market participants who are owed funds are paid in full on a timely basis.

From a market design point a view, sellers in a market need certainty of payment in order to participate in the market. The introduction of uncertainty of payment may cause sellers to: (1) price the risk of short payment into their bid prices, (2) limit their participation in a market, or (3) outright avoid the market and transact entirely on a bilateral basis in order to the risk of non-payment by the market. This could lead to fewer participants and less liquidity in the market, thereby reducing one of the primary benefits of an energy market – robust competition with liquid markets and transparent prices.

### **Stakeholder Involvement**

The Midwest ISO has conducted extensive stakeholder meetings related to the topics above. Stakeholder involvement has been obtained in the following forums:

- Policy Subcommittee
- Credit Practices Task Force (reports to Policy Subcommittee)
- Market Settlements Task Force (reports to Congestion Management Work Group, which reports to Policy Subcommittee)
- Joint Credit Practices Task Force/Market Settlements Task Force

**M. P. Holstein**



Midwest Independent Transmission System Operator | 701 City Center | Carmel, IN 46032

---

While the votes to proceed with uplifting defaults and weekly invoicing were in the majority at the Task Force and Working Group levels, the Policy Subcommittee voted not to uplift defaults and not to invoice weekly (intended to reduce collateral requirements and minimize the magnitude of a default). The Policy Subcommittee votes have been characterized as “1/3 For, 1/3 Against and 1/3 Abstain” on these two issues. The abstentions were notably from the State Regulatory members of the Policy Subcommittee. Representatives from these members did not participate at the Task Force or Working Group level on these two issues.

### **Management Recommendation**

From the perspective of what is best for the market, the Midwest ISO management team recommends the following:

1. Uplift default amounts to all Market Participants
2. Invoice on a weekly basis

As noted above, sellers need certainty of payment in order to have confidence in a market.

Weekly invoicing is needed to minimize the collateral required from all Market Participants and to minimize the impact of potential default<sup>4</sup>.

Opposition to weekly invoicing is based primarily on three arguments. One, opponents argue that their accounting departments will need to change their business procedures and potentially information systems in order to pay market invoices weekly. Two, opponents argue their cash flow will be negatively impacted if they pay suppliers weekly but their customers pay them monthly. Three, smaller entities argue that their board of directors and city councils must approve payments for all invoices and these governing bodies only meet once per month.

---

<sup>4</sup> The Midwest ISO, like NYISO, proposes to require all virtual bids to be fully collateralized at all times regardless of creditworthiness. Virtual bids are financial transactions with no physical delivery. As such, absent a limit to the number or volume of bids imposed by requiring collateral, there is potentially unlimited exposure to non-payment.

Based on conversations with Steve Dutton at Barnes & Thornburg and Mike Holstein and Anastasia Heinzelman of the MISO, regarding the risk/rewards related to the ability to set off in bankruptcy, I have compiled a summary of these conclusions below:

Line items of credit exposure calculation:

Transacted Under the Service Agreement:

1. FTR transactions: these are very likely to be considered swaps and or forward contracts which allow for setoff and thus this value is the net of all FTR transactions
2. Physical Energy: these are very likely to be considered forwards. This value would be the net of the injections and withdrawals of physical energy.
3. Day Ahead (Virtual Market) Offers: these CANNOT be forwards since they are entered into less than 2 days in advance
4. Day Ahead (Virtual Market) Bids: these CANNOT be forwards since they are entered into less than 2 days in advance

Transacted Under the Transmission Agreement

1. Transmission, congestion and losses

The GROSS value of the 5 items above would constitute a MP's credit risk and compared to the overall credit limit established by the MISO

Cross Collateralization:

Currently MISO contemplates "allocating" collateral (regardless of form) to provide limits for MP's participating in the activities under the Service Agreement (i.e. Day Ahead, FTR). MISO's will be able to utilize all collateral posted by a MP under the Service Agreement, regardless of which activity it has been earmarked for in the event of a MP default. Based on our call today, the MISO will allocate collateral against these activities based on the formula utilized in the uplift methodology.

Cross Default:

The CPTF agreed that a default by a MP under the Service Agreement should trigger a default under the Transmission Agreement (vice versa)(pending review of the default provisions for materiality).

Additionally, language will be included in the credit policy allowing collateral posted under either agreement be used to satisfy the total outstanding obligations allocated in the same manner as the uplift methodology.

**M. P. Holstein**

**TABLE MAPPING MIDWEST ISO TARIFF PROVISIONS  
RECOMMENDED BY BARNES & THORNBURG TO  
CORRESPONDING PJM PROVISIONS**

The table that follows may be easier to understand with some background on the different approaches taken by the Midwest ISO and PJM when establishing the terms and conditions for their respective energy markets. The Midwest ISO incorporated the terms and conditions into its Open Access Transmission Tariff as a separate module of that tariff. Market Participants sign a one page agreement under which they basically agree to abide by the tariff.

PJM created a document containing the basic terms and conditions for its energy market and incorporated that document into its Operating Agreement, as Schedule 1. The Operating Agreement is an extensive document that outlines the governance procedures for PJM, as well as the obligation of its members. PJM requires all energy market participants to become members and execute its Operating Agreement. The energy market terms and conditions document is also attached to PJM's Open Access Transmission Tariff, by way of an attachment on transmission congestion charges and credits.

NYISO created a Market Administration and Control Area Services Tariff (the "NYISO Services Tariff") to govern its market activities. The NYISO Open Access Transmission Tariff ("NYISO OATT") appears to govern transmission, including congestion, and financial transmission rights, while the NYISO Services Tariff appears to govern the real time and day-ahead energy markets. Participants under the NYISO Services Tariff enter into an agreement incorporating the terms of the services tariff. It appears most market participants are also required to be transmission customers under NYISO's OATT pursuant to Section 7.2A and Section 4.1.6 of the NYISO Services Tariff.

The Midwest ISO, PJM and NYISO include their respective credit policies as attachments to their respective tariffs. Each also requires participants to enter into credit agreements.

Barnes & Thornburg has created a central default and remedy provision for the Midwest ISO Tariff. The corresponding PJM default and remedy-related provisions have not been consolidated and are scattered throughout PJM's Operating Agreement, Tariff, Credit Policy and Credit Agreement. The corresponding NYISO provisions are largely consolidated in one section of its NYISO Services Tariff.

<b>MIDWEST ISO TARIFF PROVISION</b>	<b>CORRESPONDING PJM PROVISION</b>	<b>CORRESPONDING NYISO PROVISION</b>
<b>Definition of Default</b>		
Section 7.13(a); Failure to Pay for Transmission	<p>Section 7.3 of the PJM Tariff provides that a failure to make a payment to the Transmission Provider (for any reason other than a billing dispute) will result in a default if not corrected within three business days after notice from the Transmission Provider.</p> <p>Also under Section 7.3, the Transmission Provider may act to terminate service if there is a billing dispute and the Transmission Customer fails to continue making undisputed payments and paying disputed amounts into an escrow account.</p> <p>Failure to make a payment for transmission is also a default under the PJM Operating Agreement where the Transmission Customer is also a Member of the LLC. See Section 15.1.3(a) of the PJM Operating Agreement.</p>	<p>Section 7.3A(i) of the NYISO OATT provides that a failure to make a payment to the NYISO will result in a default, regardless of whether the payment obligation is in dispute. The Transmission Customer has two business days to cure the payment default.</p> <p>Failure to make a payment for transmission also appears to be a default under the NYISO Services Tariff. See Section 7.5A(iii) of the NYISO Services Tariff.</p>
Section 7.13(b); Failure to Pay for Market Services	<p>Failure to make any payment will result in a default if not cured within three business days after notice. See Section 15.1.3(a) of the PJM Operating Agreement. Payment is due notwithstanding any dispute, but payment of a disputed amount is not deemed a waiver of any right with respect to the dispute.</p>	<p>Failure to make any payment will result in a default if not cured within two business days. See Section 7.5A(iii) of the NYISO Services Tariff. Payment is due notwithstanding any dispute.</p> <p>Failure to make payment for market services also appears to be a default under the NYISO OATT pursuant to Section 7.3A(i) which refers to failure to make any payment to the ISO.</p> <p>Note that congestion and FTR charges are owed under the OATT while energy charges are owed under the services tariff.</p>

<b>MIDWEST ISO TARIFF PROVISION</b>	<b>CORRESPONDING PJM PROVISION</b>	<b>CORRESPONDING NYISO PROVISION</b>
<p>Section 7.13(c); Failure to Perform any Obligations under Tariff, Credit Policy or other agreements.</p>	<p>Section 15.1.3(a) of the PJM Operating Agreement contains a broad default for failure to perform any payment obligation arising from the Operating Agreement or any tariff or service performed by the Office of the Interconnection (the employees/department of PJM responsible for administering the energy market).</p> <p>Section 15.1.3(a) also contains a broad default for failing to meet any obligation under the Operating Agreement and clarifies that these obligations include the obligation to comply with PJM’s credit policies.</p> <p>The PJM Tariff (in Section 7.3) and the PJM Operating Agreement (in Section 15.1) state that it is a default for the participant to fail to meet PJM’s “creditworthiness requirements.”</p> <p>The PJM Credit Policy provides that it is an event of default for a participant to fail to comply with any provision of the Credit Policy (other than the responsibility to notify PJM of a Material Change). The Midwest ISO provision allows for a default upon the failure to notify of a Material Change but only if the party is given notice of the failure and does not provide the required information within three days. The Midwest ISO must know enough to request the additional information before there can be any default. As a practical matter, we would not expect the failure to notify of a Material Change to result in a default.</p> <p>The PJM Credit Policy also suggests that a default under the PJM Credit Policy, the PJM Operating Agreement, the PJM Tariff and any other agreements between PJM and its members may operate as a default under all of the above. The suggestion comes from language related to remedies. It is not clear whether the language effectively defines what will constitute a default under the various documents.</p>	<p>Section 7.5A(xv) of the NYISO Services Tariff provides for a default for the failure to perform any material covenant in the NYISO Services Tariff or the Service Agreement entered into in connection with that tariff. There is no corresponding provision under the NYISO OATT.</p> <p>As referenced above, both NYISO tariffs contain a broad default for failure to make any payment to the NYISO. Both tariffs also contain a default for the participant’s failure to meet “creditworthiness requirements.”</p> <p>As the credit policies are part of the tariff, a breach of those policies should qualify as a breach of the tariff, even though the default provisions do not specifically reference the credit policy.</p>

<b>MIDWEST ISO TARIFF PROVISION</b>	<b>CORRESPONDING PJM PROVISION</b>	<b>CORRESPONDING NYISO PROVISION</b>
Section 7.13(d); Bankruptcy	<p>The PJM documents do not include a direct bankruptcy default.</p> <p>A bankruptcy default may fall within PJM’s vague default for failures to comply with its “creditworthiness requirements.”</p>	<p>Section 7.5A of the NYISO Services Tariff contains various defaults that correspond to the items contained in the Midwest ISO’s bankruptcy default, including a default for an assignment for the benefit of creditors, bankruptcy filings, insolvency <i>etc.</i> There is no corresponding provision in the NYISO OATT, though a bankruptcy related action may fall within the broad default for failure to comply with “creditworthiness requirements.”</p>

<b>MIDWEST ISO TARIFF PROVISION</b>	<b>CORRESPONDING PJM PROVISION</b>	<b>CORRESPONDING NYISO PROVISION</b>
<p>Section 7.13, last paragraph; Cross Default</p>	<p>Neither the PJM Tariff nor the PJM Operating Agreement directly provide for cross default. However, a cross default of a least a limited nature appears to result in practice.</p> <p>The provisions governing the energy markets are attached, in identical form, to both the PJM Tariff and the PJM Operating Agreement, so a default of the energy market provisions may trigger a default under both.</p> <p>Noncompliance with the PJM Credit Policy, by its terms, is an event of default under both the PJM Operating Agreement and the PJM Tariff. Both the PJM Operating Agreement and the PJM Tariff provide for default upon a failure to comply with “creditworthiness requirements.”</p> <p>The payment default language under the PJM Operating Agreement is very broad, suggesting that a payment default under the PJM Tariff will trigger a payment default under the PJM Operating Agreement.</p> <p>The PJM Credit Policy provides that in the event of a default under the PJM Credit Policy, the PJM Tariff, the PJM Operating Agreement and any other agreement between PJM and its members, PJM may take any action permitted or required under the agreement, including, termination of transmission service, termination of participation in PJM markets and the liquidation of all or any financial security.</p>	<p>The NYISO tariffs do not provide for a cross default.</p> <p>The broad default language on creditworthiness requirements and payment in both tariffs may allow for defaults of those types to result in default under both tariffs and the related service agreements.</p>

<b>MIDWEST ISO TARIFF PROVISION</b>	<b>CORRESPONDING PJM PROVISION</b>	<b>CORRESPONDING NYISO PROVISION</b>
<b>Remedy Provisions</b>		
Section 7.14 (a); Broad List of Available Remedies	<p>The PJM documents list possible remedies in several places.</p> <p>Termination of transmission service is referenced in Section 7.3 of the PJM Tariff and Section V of the PJM Credit Policy.</p> <p>Suspension and termination of energy market services and participation in any PJM operated market are mentioned in Section 15.1.1 of the PJM Operating Agreement and Section V of the PJM Credit Policy.</p> <p>The PJM Credit Policy mentions liquidation of financial assurances in Section V.</p> <p>As additional remedies, PJM may strip a defaulting member of its rights to participate in committees or vote on any committees or bodies established by the PJM Operating Agreement. See Section 15.1.3 of the PJM Operating Agreement.</p>	<p>The NYISO tariffs do not include an enumerated list of remedies. Both tariffs reference a right to suspend and/or terminate immediately service and/or service agreements. See NYISO Services Tariff Section 7.5C and NYISO OATT Section 7.3C.</p>
Section 7.14(b); Non-exclusive Remedies (and Language in Section 7.4(b))	<p>Section 15.1.3 of the PJM Operating Agreement indicates that the listed remedies are “in addition to such other remedies as may be available.”</p>	<p>Section 12.5 of the NYISO Services Tariff provides that the tariff will not be construed as limiting any rights and remedies available at law or in equity.</p>
Section 7.14 (c); No Waiver	<p>Section 15.5 of the PJM Operating Agreement provides that a failure to insist upon or enforce strict performance will not be construed as a waiver of the right to assert or rely upon provisions, rights or remedies, in that case or in any other case.</p>	<p>Section 14.7 of the NYISO Services Tariff contains the standard “no waiver” language.</p>
Section 7.14(d); Costs of Collection and Attorneys’ Fees	<p>Members are required to pay reasonable costs incurred in enforcing the member’s obligations. See Section 15.2 of the PJM Operating Agreement.</p> <p>The PJM Credit Agreement also requires payment of all collection and legal fees incurred.</p>	<p>The tariffs and credit policies did not address this issue.</p> <p>I did not review the credit agreements.</p>

<b>MIDWEST ISO TARIFF PROVISION</b>	<b>CORRESPONDING PJM PROVISION</b>	<b>CORRESPONDING NYISO PROVISION</b>
<b>Net Billing, Payment Netting and Setoff Provisions</b>		
<p>Section 7.4(a); Net Billing to Market Participants; Market Participants only have a Right to Net Amounts</p> <p>Section 7.17, last paragraph; Payment Netting</p>	<p>PJM has incorporated references to net amounts and payment netting throughout its energy market documents. For example, Transmission Congestion Charges is defined as a net amount of credits for congestion, debits for congestion less the net amount owed for sales and purchases in the energy market. See Attachment K(A).(1.)of the PJM Tariff.</p> <p>See also Section 3.2.1, Section 3.3, Section 3.4 and Section 5 of Schedule 1 to the PJM Operating Agreement (also part of Attachment K of the PJM Tariff).</p>	<p>Net billing language is incorporated throughout the billing and payment language of both NYISO tariffs. The NYISO Services Tariff explicitly allows for the netting of amounts owed with respect to both tariffs.</p> <p>Setoff and netting language is contained in several sections of the NYISO Services Tariff, including Sections 7.1, 7.2A, 7.2C and 7.5E.</p>
<p>Section 7.14(e); Setoff Upon Default</p> <p>Section 7.17; Setoff, Recoupment and Payment Netting</p>	<p>Section 15.1.3 of the PJM Operating Agreement provides for a right of setoff. With respect to any payment that PJM is required to make to a member in connection with or arising under or from the PJM Operating Agreement, any service or rate schedule, or any tariff, PJM has a right to setoff equal to any amount that the member is required to pay PJM in connection with or arising under or from the PJM Operating Agreement, any service or rate schedule, any tariff or any services performed by the Office of Interconnection.</p>	

MIDWEST ISO TARIFF PROVISION	CORRESPONDING PJM PROVISION	CORRESPONDING NYISO PROVISION
<b>FTR Related Provisions</b>		
<p>Section 1.77; FTRs as Swaps</p> <p>Section 7.16; Closeout of FTRs in an Event of Default</p> <p>Section 7.13(f); Bankruptcy Default (Necessary to allow closeout of FTRs in the event of Bankruptcy)</p>	<p>The PJM documents do not refer FTRs as swaps. However, PJM FTRs differ significantly from Midwest ISO FTRs. The differences may explain why PJM has not characterized its FTRs as swaps or added provisions to take advantage of the bankruptcy benefits of swaps.</p> <p>PJM FTRs do not entitle the holder to any payments. Instead, FTR owners are entitled only to credits that may be applied only to Transmission Congestion Charges. See Section 7.2.3 of Attachment K to the PJM Tariff (also Schedule 1 to the PJM Operating Agreement).</p>	<p>Section 7 of the NYISO Services Tariff specifically provides that the tariff, the corresponding service agreements and the transactions under those agreements are forward contracts. It is not clear the extent to which this covers the NYISO version of the FTR, the TCCs. The TCCs are referenced in the NYISO Services Agreement but settlement for the TCCs and the attachments containing most of the provisions regarding TCCs are incorporated into the OATT. The OATT does not address forward contract or swap issues.</p> <p>Also note that while a bankruptcy default is included in the NYISO Services Agreement, it was not included in the NYISO OATT.</p> <p>I found no language outlining how TCCs would be closed out in the event of any defaults.</p>