UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

Midwest Independent Transmission System Operator, Inc.	Docket Nos. ER05-794-000 ER05-809-000

ORDER CONDITIONALLY ACCEPTING TARIFF FILINGS

(Issued May 26, 2005)

1. In an order dated August 6, 2004, the Commission approved the Midwest Independent Transmission System Operator, Inc.'s (Midwest ISO) proposed Transmission and Energy Markets Tariff (TEMT), which has allowed the Midwest ISO to initiate Day 2 operations in its 15-state region.[1] The Midwest ISO's Day 2 operations include, among other things, day-ahead and real-time energy markets and a financial transmission rights (FTR) market for transmission capacity. The TEMT II Order required the Midwest ISO to make further modifications to the TEMT, including revisions to Attachment L (Credit Policy) and Module A, section 7 (Billing and Payments; Defaults and Remedies).[2] Today we will accept two filings that propose the modifications to Attachment L and Module A, section 7 of the TEMT. Our order benefits customers because it permits the Midwest ISO to implement revised tariff provisions that will decrease financial risk for all energy market participants.

[1] *Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,163 (TEMT II Order), *order on reh'g,* 109 FERC ¶ 61,157 (2004), *order on reh'g,* 111 FERC ¶ 61,043 (2005). The TEMT contemplates that all services provided pursuant to its terms and conditions will be provided by a Transmission Provider. In turn, the TEMT defines "Transmission Provider" as the Midwest ISO or any successor organization. *See* Module A, section 1.320, Original Sheet No. 133. For clarity, we will refer to the Midwest ISO wherever the TEMT refers to the Transmission Provider.

[2] *See* TEMT II Order at P 423-80.

I. **Background**

2. Attachment L establishes the requirements of the Midwest ISO credit policy and describes the methodology used to calculate the credit limit for market participants. Attachment L also outlines the methodology the Midwest ISO uses to monitor its market participants' financial activity relative to each market participant's credit limit. Monitored financial activity is categorized as: (1) invoiced but not paid; (2) measured but not invoiced; or (3) estimated. If a market participant exceeds its credit limit, then it is notified of the need to cure this Total Potential Exposure Violation.[3]

3. Section 7 of Module A details the Midwest ISO's billing, payment, and default policies. Among other things, section 7.1 sets forth an invoice payment schedule, section 7.11 establishes more stringent requirements for posting financial security due to a history of late payments, and section 7.13 sets forth default provisions.

II. **Docket No. ER05-809-000**

A. **The Midwest ISO's Proposal**

4. On April 12, 2005, the Midwest ISO filed a proposal to revise the calculation of the Transmission Service Potential Exposure Formula, which is located in Attachment L, and corresponding provisions in section 7 of the TEMT. The Midwest ISO proposes to revise: (1) the Transmission Service Potential Exposure formula, to reduce the exposure period from 120 to 50 days; (2) section 7.1, to reduce the invoice payment period from 15 to seven days; (3) section 7.11, to require the posting of financial security equal to 60 days of confirmed transmission service upon failure to pay for transmission service within the required payment and subsequent cure period; and (4) section 7.13, to provide that a tariff customer's failure to provide financial security under section 7.11 is an event of default under the TEMT, and to reduce the cure period on defaults from 10 to two business days.

5. The Midwest ISO notes that the proposed changes were discussed with stakeholders at meetings of the Credit Practices Working Group (CPWG) during March 2005. The Midwest ISO also states that the proposed revisions were submitted to

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[3] *See* Attachment L, Second Substitute Original Sheet No. 1231.

stakeholders for comment prior to filing.[4] After stakeholder comment, the CPWG voted 29 to 6 in favor of the revisions.[5] Therefore, 83 percent of the 35 votes cast were in favor of the collective changes.[6]

6. In addition, the Midwest ISO filed the affidavit of Michael P. Holstein, Chief Financial Officer of the Midwest ISO, to support the need for the proposed changes and clarify their potential effects on the market. As stated by Mr. Holstein, the filing addresses reducing the current number of days covered (window of exposure) by the current formula used to calculate Transmission Service Potential Exposure.[7] The current exposure formula's three time components are added to other estimated time frames to arrive at the 120-day exposure period. The Midwest ISO bases the 120-day exposure period on several assumptions.

7. The first assumption used in the calculation of the 120-day exposure window is that transmission service is billed in arrears, so that approximately 30 days of service has been taken before an invoice is issued. Second, invoice preparation and presentment takes five business days. Third, payment for invoiced transmission service is due 15 days after the receipt of the invoice, per section 7.1. Fourth, the cure period for non-payment of invoiced transmission service is 10 days, per section 7.13.b. Fifth, and finally, the Midwest ISO assumes that Commission action to terminate service for non-payment of an invoice can take up to sixty days.[8] The sum of these time periods is 120 days, in which a transmission customer may be accruing charges for transmission service before the Midwest ISO can terminate its service for non-payment.

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[4] *See* Transmittal Letter at 3, Docket No. ER05-809-000 (Apr. 12, 2005).

[5] *See Id.*

[6] *See Id*. at 4.

[7] *See* Affidavit of Michael P. Holstein, on Behalf of the Midwest Independent Transmission System Operator, Inc. at 3, Docket No. ER05-809-000 (Apr. 12, 2005) (Holstein affidavit, Docket No. ER05-809-000). Transmission Service Potential Exposure is currently calculated using the following formula: • TIE + • TME + • TEE, where TIE = Transmission Invoiced Exposure, TME = Transmission Measured Exposure and TEE = Transmission Estimated Exposure. *See* First Revised Sheet No. 1232E.

[8] *See* Holstein affidavit, Docket No. ER05-809-000, at 2.

8. To reduce the amount of financial security required to support a given level of transmission service activity, the Midwest ISO proposes to eliminate the Transmission Estimated Exposure (TEE)[9] from the Transmission Service Potential Exposure calculation. In addition, the Midwest ISO proposes to modify the Transmission Measured Exposure (TME) calculation to define it as all transmission service charges associated with confirmed transmission service reservations for: (1) the number of days of the current month which, when added to the number of days in the previous month, equals 50 calendar days if the Transmission Invoiced Exposure (TIE) has not been paid; or (2) the number of days in the current month, plus the required number of days in the subsequent month, equal to 50 calendar days if the TIE has been paid.

9. In his affidavit, Mr. Holstein outlines the benefits expected from making the proposed changes. The major benefit is to reduce the amount of unsecured credit and/or financial security required to support a given level of transmission service activity. However, Mr. Holstein states that this benefit to transmission customers is obtained by shifting the risk to transmission owners given that there is no uplift of unpaid transmission charges to ensure that transmission owners are always paid in full. Mr. Holstein states that the transmission owners that are most affected by the proposed changes are the independent transmission companies (ITCs) – American Transmission Company (ATCLLC), International Transmission Company (ITC), and Michigan Electric Transmission Company (METC). The other revisions proposed to TEMT section 7 offset some of the additional risk taken on by the ITCs by reducing the amount of time to pay invoices and accelerating the default cure period. An additional safeguard is provided by requiring tariff customers with a history of late payment to post additional financial security equal to 60 days of confirmed transmission service. All three ITCs support the proposed changes as long as the risk is mitigated by changing the terms, cure periods and financial security requirements as proposed in section 7, according to Mr. Holstein.[10]

B. <u>Notice, Interventions and Comments</u>

10. Notice of the April 12 Filing was published in the *Federal Register*, 70 Fed. Reg. 22,021 (2005) with interventions and protests due no later than April 29, 2005. American Municipal Power-Ohio filed an intervention. Consumers Energy Company (Consumers),

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[9] TEE is defined as: all transmission service charges associated with confirmed Transmission Service reservations for the remaining days of the current month plus the reservations for the future two months. *See* First Revised Sheet No. 1232F.

[10] *See* Holstein affidavit, Docket No. ER05-809-000, at 5.

the Detroit Edison Company (Detroit Edison), the Midwest Stand-Alone Transmission Companies (MSATs),[11] TDU Intervenors,[12] and Wisconsin Electric Power Company (WEPCO) filed interventions and comments. The Midwest ISO filed an answer.

11. TDU Intervenors support the Midwest ISO's proposal to modify the methodology for calculating Transmission Service Potential Exposure and make corresponding changes to section 7. According to the TDU Intervenors, the proposed changes should be accepted because they strike a better balance between facilitating transmission customer participation in the Midwest ISO markets, and protecting the financial security of transmission owners. By shortening the period used to calculate the transmission exposure, the proposed change reduces the amount of unsecured credit necessary to facilitate transmission customers' transmission service. The Midwest TDUs find that by reducing the payment time on invoices from 15 to seven days, and requiring the posting of financial security if payments are not made on time, the proposed changes also reduce the financial risk to transmission owners.

12. WEPCO also supports the proposed changes. WEPCO states that the current 120-day credit exposure window is particularly burdensome to market participants that are transmission-dependent and therefore must commit a large portion of their approved credit to transmission services. WEPCO also believes that the changes sought by the ITCs will result in a reasonable balance of the risks and obligations of both transmission owners and transmission customers.

13. Detroit Edison states that it is a transmission-dependent utility and the Midwest ISO's proposal properly aligns credit requirements with non-payment exposure risks reducing the credit requirement from 120 to 50 days. Detroit Edison states that the credit policy regarding transmission service currently overstates the credit exposure and imposes an undue burden on transmission-dependent utilities. According to Detroit Edison, this undue burden is caused because, unlike vertically-integrated transmission owners, transmission-dependent utilities cannot net transmission service charges against transmission revenues due to the divestiture of those assets. Detroit Edison submits that

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[11] MSATs are: American Transmission Company LLC, GridAmerica LLC, International Transmission Company, and METC.

[12] TDU Intervenors are: Indiana Municipal Power Agency, Lincoln Electric System, Madison Gas and Electric Company, Manitowoc Public Utilities, Marshfield Electric & Water Department, and Wisconsin Public Power Inc.

any money tied up to meet credit requirements is not available to be used in the energy market, negatively impacting long-term participation. Therefore, Detroit Edison urges the Commission to accept the Midwest ISO's proposal.

14. Consumers is a transmission-dependent utility that receives transmission service from METC. Consumers also urges the Commission to approve the Midwest ISO's proposal, but with a clarification. Consumers requests the Commission to direct the Midwest ISO to clarify section 7.1 to make it consistent with section 7.11.1. Section 7.11.1 requires a payment within seven business days, but section 7.1 simply requires payment within seven days of receipt. Therefore, Consumers requests that the Midwest ISO be required to modify section 7.1 to require payment within seven business days of receipt of the invoice.

15. The MSATs generally support the Midwest ISO's proposed revisions to its credit policy because they significantly reduce the exposure period used to calculate the amount of unsecured credit required for transmission service. However, the MSATs state that the benefits realized by transmission customers are obtained by shifting risk to transmission owners because unpaid transmission charges are not subject to uplift, whereas energy market defaults are subject to uplift. Because the MSATs' only revenue source is transmission, they state that they are the most exposed to risk. Nevertheless, the MSATs support these changes, provided that they are accompanied by the other refinements proposed to the invoice payment period, the use of dedicated financial security for customers that do not pay their bills on time, and a reduction in the cure period. Therefore, the MSATs view the proposed revisions as a balanced approach to manage risk and support the revisions provided they are accepted by the Commission as a package. The MSATs state that they may withdraw their support if the Commission orders further revisions.

16. On May 17, 2005, the Midwest ISO filed an answer to the comments received in this filing. The Midwest ISO noted the positive comments filed in support of the proposed changes. In addition, the Midwest ISO responded to Consumers' request that it be directed to revise section 7.1 to be consistent with section 7.11.1, which states that payments are due within seven business days. The Midwest ISO states that it intended to state seven calendar days in section 7.11.1, so section 7.1, as written, is correct and section 7.11.1 is incorrect. The Midwest ISO clarifies that, upon Commission direction, it will revise section 7.11.1 to state seven days, consistent with sections 7.1 and 7.6.

C. Discussion

1. Procedural Matters

17. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2004), the interventions serve to make the entities that filed them parties to this proceeding.

2. Substantive Matters

18. We accept the Midwest ISO's proposed revisions to its Transmission Service Potential Exposure calculation in Attachment L and the corresponding revisions to Module A, sections 7.1, 7.11, and 7.13, to be effective June 11, 2005, as requested.

19. The revisions to the credit and billing policies represent a balanced approach to distributing and mitigating financial risk. The Midwest ISO has concurrently reduced the amount of unsecured credit needed to facilitate transmission customers' transactions through the revisions to the Transmission Potential Exposure formula, and shortened the risk exposure period for transmission owners through its proposed revisions to section 7. This is evident in the comments accompanying this filing, which urge the Commission to accept the revisions as proposed.

20. Transmission owners benefit from this proposal because payments to the transmission provider (or, where applicable, the ITC) are now made in seven days, rather than fifteen – less then half the time of the current requirement. In addition, failure to make payments when due are now required to be remedied in one-fifth of the time currently required (two days, as opposed to 10 days). Also, the revisions mean that a tariff customer that does not pay a transmission service invoice when due is required to provide the transmission provider with additional financial security equal to 60 days of confirmed transmission service. This amount of additional financial security on hand with the transmission provider significantly reduces the future exposure to non-payment for the transmission owners. Additionally, under the proposal the transmission customer can have its financial security returned if it pays all invoices on time for the next six months. Finally, we find that these modifications bolster the assurance that payment will be made for services rendered and that brings additional security to the market.

21. Transmission customers benefit because the revisions reduce the amount of financial security or unsecured credit that must be dedicated to transmission service. The reductions are largely a result of the elimination of the TEE calculation. The TEE required the potential exposure to consider all current month transmission service charges, plus all reservations for the future two months. Under the revisions, the maximum amount of transmission potential exposure calculated is 50 calendar days.

These changes will bring market benefits as more credit will be available to conduct other market activities. Therefore, the revisions should increase the liquidity in the market as new market participants are encouraged to transact through lower barriers to entry and existing market participants will have the ability to transact more often with the same amount of financial security.

22. We direct the Midwest ISO to revise section 7.11.1 to state "seven (7) days," consistent with sections 7.1 and 7.6 of Module A and the Midwest ISO's answer. This revision will make section 7.11.1 consistent with the weekly billing schedules of the rest of Module A, section 7. We direct the Midwest ISO to make this revision though a compliance filing within 30 days of the date of this order.

III. Docket No. ER05-794-000

A. The Midwest ISO's Proposal

23. On April 7, 2005, the Midwest ISO filed a proposal to revise the FTR Portfolio Residual Value Formula in Attachment L to align the time period over which the FTR portfolio is computed with the time period over which the related estimated congestion cost value is computed. When a market participant exceeds its credit limit, it is notified of the need to cure its Total Potential Exposure Violation.[13] One of the types of estimated exposure that factors into the Total Potential Exposure Calculation is the FTR Portfolio Residual Value. FTR Portfolio Residual Value is calculated based on the anticipated value of each FTR in a market participant's FTR portfolio over the life of the FTR.

24. The Midwest ISO proposes to revise the FTR Portfolio Residual Value formula to align the time period over which the FTR portfolio is computed with the time period over which the related estimated congestion cost value is computed. The proposed revisions limit the FTR Portfolio Residual Value to the lesser of: (1) the value under the current formula; or (2) the value based on up to six days of estimated exposure. In addition, the Midwest ISO proposes to add the estimated monthly value of the FTR portfolio for any future month where the value is expected to be negative to the result of the calculation comparison. A negative net value for the FTR portfolio means that the market participant owes money to the market.

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[13] *See* Attachment L, Second Substitute Original Sheet No. 1231.

25. The Midwest ISO states that the proposed changes are needed because the current formula for FTR Portfolio Residual Value leaves the market too exposed to a payment default not covered by the collateral available to the transmission provider at the time of non-payment. To support the need for this filing, the Midwest ISO filed an affidavit from Mr. Holstein.[14] In addition, the Midwest ISO filed revised tariff sheets to reflect these changes.

26. The Midwest ISO provides the following example to illustrate the need for this filing. If a market participant holds an FTR for 100MW in every hour of the year and the revenue owed the market participant is $10/ MWh, the formula effectively credits $8,760,000 to the market participant as of January 1.[15] Throughout the year, the credit declines as time elapses. In contrast, the cost of congestion in the exposure formula never exceeds 34 days, resulting in a potential shortfall when comparing 365 days to 34 days. The Midwest ISO desires to more closely align these exposure windows.

27. The Midwest ISO states that the proposed changes were discussed with stakeholders at various meetings of the CPWG and the Credit Exposure Task Force during January, February, and March, 2005. On March 8, 2005, the CPWG reviewed the proposal and voted in favor of adopting the proposed revisions to Attachment L.

28. The Midwest ISO requests a waiver of the 60-day notice provision[16] to accommodate an effective date of April 8, 2005. The Midwest ISO states that it needs this effective date to begin correcting unnecessary exposure as soon as possible with the software that is available.[17] However, it also notes that it has not yet completed all the necessary software modifications to execute the revisions proposed in this filing. It states that, as a result, the Payable Exposure Months portion of the equation outlined on First

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[14] Affidavit of Michael P. Holstein, on Behalf of the Midwest Independent Transmission System Operator, Inc., Docket No. ER05-794-000 (Apr. 7, 2005) (Holstein affidavit, Docket No. ER05-794-000).

[15] This example assumes that the FTR always has a positive value, but in actual practice the FTR could have a negative value for portions of the year.

[16] *See* 16 U.S.C. § 824d (2000); 18 C.F.R. § 35.3(a) (2004).

[17] The Midwest ISO began operation of its energy markets on April 1, 2005, so financial exposures have been accruing in the interim while this filing is pending.

Revised Sheet No. 1232C will need to be implemented within sixty days of the filing. The Midwest ISO states that it will inform the Commission and the market participants when the software modifications are completed and ready to be implemented.

B. Notice, Interventions and Comments

29. Notice of the Midwest ISO's filing was published in the *Federal Register*, 70 Fed. Reg. 20,892 (2005), with interventions and protests due no later than April 28, 2005. Consumers and WEPCO filed interventions. The MSATs filed an intervention and limited comments, which state that the MSATs support the Midwest ISO's filing. They argue that the filing is intended to more accurately reflect an entity's market activities in the credit evaluation process, by adjusting the credit afforded to FTR holders.

C. Discussion

1. Procedural Matters

30. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2004), the interventions serve to make the entities that filed them parties to this proceeding.

2. Substantive Matters

31. We find that the Midwest ISO's proposed revisions to the calculation of the FTR Portfolio Residual Value formula, when fully implemented, will result in a credit policy with greater balance between the exposure timelines for the FTR portfolio value and the estimated congestion cost value. Balanced credit policies are the predicate to any acceptable credit policy. It is crucial to the long-term success of the market that the level of collateral required to conduct market activities correlate with the exposure to risk. Financial exposure without corresponding collateral to draw upon in the event that it is needed is a detriment to the overall viability of the market. By lowering the exposure window on the FTR Portfolio Residual Value the Midwest ISO is mitigating risk for all.

32. We are encouraged that the Midwest ISO continues to discuss alternatives to improve its credit policies with stakeholders.[18] The Commission has previously stated its preference for discussions at the stakeholder level to gauge support prior to filing revisions to RTO credit policies.[19] We also note that no party opposed the revisions, and

[18] *See* Holstein affidavit, Docket No. ER05-794-000, at 4.

[19] *See* TEMT II Order at P 432.

that the majority of stakeholders supported the filing of these revisions.[20] Although the Commission must weigh each rate filing on its merits, the lack of stakeholder opposition is considered because in matters related to credit, stakeholders are uniquely impacted.[21]

33. Therefore, we accept the revised tariff sheets for filing. Waiver of the 60-day notice requirement is appropriate for uncontested filings that do not change rates, and for filings that reduce rates and charges.[22] As the Midwest ISO's filing is both uncontested and will reduce the market's exposure to payment default, reducing the need for uplift to all market participants, we will grant the Midwest ISO's request for waiver of the 60-day notice requirement and grant an effective date of April 8, 2005.[23] This waiver will enable the Midwest ISO to immediately begin to correct unnecessary financial risk exposures, where software permits. We also grant the Midwest ISO's request that the Payable Exposure Months portion of the FTR Portfolio Potential Exposure calculation be implemented when the necessary software updates are ready. However, we will require the Midwest ISO to notify the Commission and the market participants seven days before the new software is implemented. This notification may be submitted as an informational filing to the Commission. This arrangement was outlined in the Midwest ISO's filing and no stakeholders protested it, so we find it reasonable to believe that it will not prejudice or unduly burden any market participant.

The Commission orders:

(A) The Midwest ISO's tariff filing in Docket No. ER05-809-000 is hereby accepted for filing, as modified, to become effective June 11, 2005.

(B) The Midwest ISO's tariff filing in Docket No. ER05-794-000 is hereby accepted for filing, to become effective April 8, 2005.

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[20] *See* Attachment III and Holstein affidavit, Docket No. ER05-794-000, at 4.

[21] *See Midwest Independent Transmission System Operator, Inc.*, 111 FERC ¶ 61,053 at P 177 & n.132 (2005).

[22] *See Central Hudson Gas & Electric Corp.*, 60 FERC ¶ 61,106 at 61,337-38, *reh'g denied*, 61 FERC ¶ 61,089 (1992).

[23] *See* Transmittal Letter at 4, Docket No. ER05-794-000 (Apr. 7, 2005).

(C) The Midwest ISO is hereby required to make the compliance filing and the informational filing described in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.